

A Guide to Chapter 7 Trustee Elections

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It is not uncommon for non-bankruptcy attorneys and their unsecured creditor clients to conclude that when a customer files a Chapter 7 bankruptcy it is not worth the time and expense to seek bankruptcy counsel because the recovery is undoubtedly going to be small for most creditors. However, in many cases, the opportunity to choose the person appointed to oversee the case, the Chapter 7 Trustee, is overlooked by unsecured creditors without consideration of whether another professional may be better suited for the particular case in order to maximize creditor recovery. For example, does the case involve a specialized industry requiring expertise to properly liquidate the debtor's inventory? Is the case similar to a prior bankruptcy where that trustee may reduce the learning curve and more efficiently administer the estate? Does the client (and similarly situated creditors) have an unfavorable opinion of the trustee's work in the prior case? In such instances, creditors have the ability to request a trustee election and nominate a candidate, however this process is rarely invoked. The framework below is provided as an overview for clients and practitioners who may be unfamiliar with the process and therefore hesitant to move for an election.

Election Requirements

The election of a Chapter 7 Trustee occurs at the meeting of creditors (§ 341 meeting). A creditor moving for an election should contact the U.S. Trustee's office in advance of the meeting of creditors and notify them of the election. The U.S. Trustee will then attend the meeting of creditors and conduct the election.

11 U.S.C. § 702 is the framework for the election of a Chapter 7 Trustee. Under section (a) of this statute, only unsecured creditors which hold allowable, undisputed, fixed and liquidated claims are eligible to vote. 11 U.S.C. § 702(a)(1). Further, creditors whose interests are materially adverse to other unsecured creditors or who are insiders may not vote. 11 U.S.C. § 702(a)(2) and (3). A secured creditor may vote its deficiency claim, provided the claim is not contingent and unliquidated.

Pursuant to Fed. R. Bank. P. 2003(b)(3), a creditor in a chapter 7 "is entitled to vote at a meeting if, at or before the meeting, the creditor has filed a proof of claim or a writing setting forth facts evidencing a right to vote pursuant to § 702(a) of the Code unless an objection is made to the claim or the proof of claim is insufficient on its face." *In re Blanchard Mgmt. Corp.*, 10 B.R. 186, 188-189 (Bankr. S.D.N.Y. 1981).

In order for an election to be held, at least 20% of qualified creditors holding § 702(a) claims must move for an election and vote. 11 U.S.C. § 702(b) and (c). The candidate receiving the majority in claim amount of the votes of creditors is elected. *Id.*

The Election

In a case where a trustee election is anticipated, the U.S. Trustee's office presides over the meeting of creditors. The job of the U.S. Trustee is to conduct the election and prepare a report for the court. If there is a dispute regarding the election, the matter is decided by the bankruptcy judge, not the U.S. Trustee.

Generally speaking, the U.S. Trustee will begin the meeting of creditors by identifying him/herself and the interim trustee who will also be present. Some Trustees will then explain the purpose of the meeting of creditors (examining the debtor), however others will cut to the chase and ask if any party requests an election.

Presuming your client does not attend the meeting of creditors, bankruptcy counsel must be prepared to respond to the following questions directed toward qualifying your client's vote:

1. Does your firm regularly represent [x] creditor requesting the election?
 - If not, you will need an executed proxy and Power of Attorney per Fed. R. Bank. P. 2006.
2. Did your firm solicit the creditor in order to represent the creditor for purposes of this election?
3. Has the creditor filed a Proof of Claim in the case? (If not, be prepared to hand the Trustee a completed and signed Proof of Claim with all attachments.)
 - If so, is the claim secured, unsecured or bifurcated?
 - What is the nature of the claim?
 - Is the unsecured amount of the claim fixed?
 - Is the unsecured claim liquidated?
 - Is there an ability for set-off?
4. Is the creditor in any way related, associated, or affiliated to the debtor or would be deemed an insider pursuant to Section 101(31)?
5. Who does the creditor nominate (name, address and telephone number)?

If your client appears with bankruptcy counsel at the meeting of creditor, #1 and 2 are not applicable as the creditor would be directly asked #3-5.

The same questions are asked of the remaining voting creditors. If an eligible person is elected and the election is undisputed, the U.S. Trustee will then file a report with the court stating the election is undisputed per Rule 2003(d). However, if there is a dispute as to an issue(s), the trustee will file a report with the court describing the dispute(s) and creditors have ten (10) days to file a request for the bankruptcy judge to resolve the dispute. Fed. R. Bankr. P. 2003(d). As a general rule, "...the bankruptcy court may take practical measures to resolve election disputes....The parameters for

resolving the dispute are undefined. Accordingly, the court should adopt the approach that maximizes the estate's recovery and that comports with the Chapter 7 policy of creditor control." *In re Klein*, 119 B.R. 971, 984 (N.D. Ill. 1990) (citations omitted). If no request is filed, the interim trustee will become the permanent trustee.

Examples of Disputes

Although the process, applicable statutes and rules are relatively straight forward, numerous issues can arise which may derail the appointment of your client's choice of trustees. Some of the common disputes follow.

Quorum Requirement

In determining whether the 20% of claims requirement has been met in order to hold an election, there is often a dispute as to how to calculate the total claims in a case. Courts have adopted two opposing formulas. The first looks at the total of the proofs of claim on record as of the date of the meeting of creditors. *In re Lake States Commodities*, 173 B.R. 642, 646-47 (Bankr. N.D. Ill. 1994). The other view looks at the "universe of claims" which includes the proofs of claim on file as of the date of the meeting of creditors, plus the debtor's schedules. *In re Michelex, Ltd.*, 195 B.R. 993 (Bankr. W.D. Mich. 1996). This calculation can become complex and tedious, however the total claims starting point could be important depending on the amount of the claims of the creditors seeking the election.

Materially Adverse Interests

"Materially adverse interests" under Section 702(a) is not defined by the Bankruptcy Code, however legislative history provides that "The application of the standard requires a balancing of various factors, such as the nature of the adversity." *In re Klein*, 119 B.R. at 974 *citing* S.Rep. No. 95-989, 95th Cong., 2d Sess. 92, U.S. Code Cong. & Admin. News 1978, pp. 5963, 6053. "...[M]aterial adversity is measured by the effect on the creditor body as a whole, particularly by whether the challenged creditor's interest is such that it would tend to minimize distributions to other creditors from the estate...Further, claims between creditors do not reduce the size of the estate and, therefore, also do not reduce the amount available for distribution to other creditors." *Id.*

If the claim in dispute is large, the election may ride on its outcome. Therefore, bankruptcy counsel will not only consider your client's claim(s), but also may challenge another creditor's claim that is does not vote for your client's candidate.

Solicitation of Proxies

In the first discussion with a client about a trustee election, bankruptcy counsel will advise the client about the restrictions on solicitation of proxies. Federal Rule of Bankruptcy Procedure 2006 includes specific procedures and rules on the soliciting and voting of proxies. A well-meaning client may begin a solicitation campaign in violation

of the rules which jeopardizes the status of key proxies needed to carry the vote. Rule 2006(f) provides that on motion of a party in interest or the court on its own initiative may determine whether there has been a failure to comply with the rules and, if so, the court may reject the proxy or vacate any order entered as a result of counting the rejected proxy.

Conclusion

In sum, the election of a Chapter 7 Trustee can have a meaningful impact on the administration of the case and ultimate recovery for creditors. We are happy to answer any questions you or your client may have as you consider whether the time of an election and expense of legal advice to make sure the proper procedures are followed in the election process may be worth the investment in a particular Chapter 7 case.

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