

## **Best Practices for Handling Initial Matters in a Chapter 11 Case**

### **Office of the United States Trustee, Seattle Office**

When filing a new Chapter 11 case, there are some things to be mindful of to assist the debtor in meeting its obligations while in Chapter 11.

#### **1. The debtor in possession is a fiduciary**

Chapter 11 provides an opportunity for a debtor to reorganize its debts while continuing to operate. With the filing of a voluntary Chapter 11 petition, a debtor becomes a new entity called a debtor in possession. The debtor in possession, often with the participation of creditors, develops a plan of reorganization of its business and financial affairs and for payment of its debts. The debtor in possession may continue to operate pending approval of its plan of reorganization, unless the court orders the appointment of a trustee under Chapter 11. A debtor in possession has a fiduciary duty to its creditors, much the same as a Chapter 11 trustee, to preserve and maintain the bankruptcy estate and to operate its business efficiently to maximize ultimate payments on pre-petition debts while keeping post-petition debts current.

#### **2. Court Approval is Required for Certain Transactions**

The debtor should consult with its counsel when a question arises about whether court approval is required for a specific action; the United States Trustee's office cannot provide legal advice. The following matters generally require court approval:

- Using cash collateral (funds encumbered by a security interest);
- Making a payment on a pre-petition unsecured debt;
- Hiring a professional, such as an attorney, accountant, realtor, appraiser, auctioneer, business consultant, engineer, or other professional;
- Making a payment to a professional, such as an attorney, accountant, realtor, appraiser, auctioneer, business consultant, engineer, or other professional;
- Selling the debtor's business, or selling an asset outside of the ordinary course of business;
- Accepting a loan from a principal or general partner of the debtor;
- Obtaining a loan or financing from an outside source; and,
- Entering into a settlement agreement with another party.

#### **3. Employment and Compensation of Professionals**

The employment and compensation of any professional must be approved by the court. See 11 U.S.C. §327 and Fed. R. Bankr. P. 2014(a). This includes counsel as well as any other professionals, including accountants, realtors, advisors, IT special services, and management consultants.

#### **4. Initial Reporting Requirements**

The Bankruptcy Code establishes several Initial Reporting Requirements for a Chapter 11 debtor. See, e.g., 11 USC §§ 345, 521, 541, 1106(a), 1107, 1116; Fed. R. Bankr. P. 1007, 2015, 2015.3, 4002; and [Local Rule 2015-1](#). A full list of Initial Reporting Requirements can be found at: [https://www.justice.gov/ust/r18/docs/chapter11/wwa/initial\\_reporting\\_requirements.pdf](https://www.justice.gov/ust/r18/docs/chapter11/wwa/initial_reporting_requirements.pdf).

Documentation satisfying these requirements must be submitted to the United States Trustee at the Initial Debtor Interview (see paragraph 10 below) or 14 days after the debtor files for Chapter 11 relief, whichever is earlier. The debtor's Initial Reporting Requirements are not filed with the court, rather, they are intended to provide the United States Trustee with information about the debtor and to ensure the debtor meets its bankruptcy requirements.

## **5. Insurance**

The debtor is required to maintain adequate insurance to preserve the interests of its creditors by protecting estate assets. The insurance must include coverage customary in debtor's business and may include a combination of commercial, liquor, automobile, or product liability; property insurance; worker's compensation; malpractice insurance; or contractor or employee fidelity bonds. The debtor's failure to maintain appropriate insurance is cause for dismissal of the case or conversion to Chapter 7. 11 U.S.C. §1112(b)(4)(C).

The debtor must provide the United States Trustee with adequate proof of insurance. The debtor is responsible for including the address of the United States Trustee on the cancellation notice for each insurance policy. Further, before any insurance coverage expires or terminates, the debtor shall provide the United States Trustee with proof of renewal or replacement insurance.

## **6. Bank Accounts**

Section 345(b) of the Bankruptcy Code requires a Chapter 11 debtor to protect its creditors' interests by depositing bankruptcy funds in a financial institution that will collateralize or bond the debtor's funds in favor of the United States. The financial institution must be approved by the United States Trustee in the district where the bankruptcy case is filed. The Initial Reporting Requirements include a list of banks approved by the United States Trustee for cases filed in this district. Each Chapter 11 debtor in possession bank account should be opened at one of the institutions on this list.

The debtor's bank statements must report account activity on a full calendar month basis. The debtor is required to notify the United States Trustee within five business days of any change of bank accounts and must provide proof of compliance with section 345(b) for each new account.

## **7. Duty to Keep Records and File Reports**

The debtor's accounting records must establish a clear cut-off between financial transactions that occur before the Chapter 11 filing, and those that occur on and after the date of filing.

The debtor is required to file a detailed financial report with the bankruptcy court and serve copies on the United States Trustee for each calendar month (or portion of a month) after the petition is filed. The debtor's financial reports shall be prepared on the United States Trustee's Monthly Financial Report forms and are due by the 14th day of the succeeding month pursuant to local rule 2015-1(a). Failure to timely file required reports is cause for dismissal of the case or conversion to Chapter 7. 11 U.S.C. § 1112(b)(4)(F).

## **8. Taxes**

The debtor in possession must remain current on all post-petition federal, state and local taxes and file all tax returns on a timely basis. The debtor's failure to timely pay postpetition taxes or to file post-petition tax returns is cause for conversion or dismissal of the case. 11 U.S.C. §1112(b)(4)(I).

For individual Chapter 11 debtors, post filing bankruptcy earnings for services are property of the bankruptcy estate. 11 U.S.C. § 1115. An individual Chapter 11 debtor should review IRS Publication 908, Bankruptcy Tax Guide, for further details. This publication can be viewed and downloaded from the IRS website ([www.irs.gov](http://www.irs.gov)) using the Forms and Publications search function.

## **9. Periodic Reports Regarding Entities in Which the Debtor has a Substantial Controlling Interest**

The debtor must file periodic reports of the value and profitability of any entity in which the debtor has a substantial or controlling interest. Fed. R. Bankr. P. 2015.3. The debtor's first report must be filed no later than seven days before the first date set for the meeting of creditors. Subsequent reports must be filed no less frequently than every six months, until the effective date of a plan or the case is dismissed or converted. The periodic reports required by Fed. R. Bankr. P. 2015.3(a) must be prepared on Official Form B426.

## **10. Initial Debtor Interview**

Generally, within seven to ten days of filing a Chapter 11 case, the United States Trustee will conduct an initial debtor interview (IDI) with the debtor and the debtor's counsel. The IDI will be conducted as soon as practicable after the petition is filed and before the meeting of creditors. Depending on the debtor's location and the nature of its business, the IDI will occur at the debtor's place of business, the office of the United States Trustee or debtor's counsel, or by telephone. A person knowledgeable about the debtor's accounting operations should attend the IDI. During the IDI, the United States Trustee's representative will ask questions about the debtor's accounting records, bank accounts, insurance, and other administrative matters.

At the IDI, the United States Trustee's bankruptcy analyst will explain the monthly financial reporting requirements and debtor's other obligations and discuss scheduling matters. The debtor's failure to attend meetings reasonably requested by the United States Trustee can also be cause for conversion or dismissal of the case. 11 U.S.C. § 1112(b)(4)(H).

The United States Trustee for Region 18 has Chapter 11 materials and guidance available at: <https://www.justice.gov/ust-regions-r18/region-18-chapter-11-1>. Or you can contact the office at (206) 553-2000.