

## ***Handbook for Chapter 7 Trustees – Your Questions Answered***

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The new *Handbook for Chapter 7 Trustees (Handbook)* became effective on October 1, 2012. Since that time many of the questions and concerns raised by trustees regarding the *Handbook* have been addressed on a local level, or nationally at gatherings of the National Association for Bankruptcy Trustees (NABT). For this quarter's column, *NABTalk* Editor Lynn Schoenmann asked if we could address some of the *Handbook*-related questions frequently asked by chapter 7 trustees on the NABT listserv. We have modified some of the questions received so that we could focus our answers on specific *Handbook* provisions—and avoid asserting our business judgment in place of yours.

### **Sale Not in the Ordinary Course of Business**

Q. Fed. R. Bankr. P. (Rule) 6004(f)(1) requires that an itemized statement be filed with respect to sales “not in the ordinary course of business” by private sale or by public auction. Are there situations where a report of sale is not required?

A. *Handbook* Chapter 4.C.9.g states that sales of estate property must conform to the requirements of Rule 6004 and, upon completion of a sale, an itemized statement of the property sold, the names of the purchasers and the price received for each item must be transmitted to the United States Trustee and filed with the clerk of the bankruptcy court. In accordance with Rule 6004(f)(1), if the property is sold by an auctioneer, the auctioneer must file the statement. If the property is not sold by an auctioneer, the trustee must file the statement. However, Rule 6004(f)(1) provides an exception to the reporting requirement if creating such a report is “impracticable.” A trustee who believes that it would be impracticable to generate and file the required report of sale should consult with his or her local U.S. Trustee.

### **Scheduled vs. Unscheduled Assets on USTP Form 1**

Q. When is an asset considered “scheduled” and when is it considered “unscheduled” for purposes of reporting on Form 1, Individual Estate Property Record and Report?

A. This question is addressed in the Instructions for Form 1 found in the Supplementary Materials to the *Handbook*. An asset is “scheduled” if the debtor reported it on the original petition, schedules or statement of financial affairs. For Form 1 reporting purposes, the term “unscheduled assets” refers to all estate assets that are not on the debtor's original schedules and statements. In other words, an asset is reported as an unscheduled asset if it was added by the debtor on amended schedules and statements or if it was identified by the trustee, but not included in the original petition, schedules and statement of financial affairs. Unscheduled assets are identified on Form 1 by inserting “u” after the asset description. In addition, certain uniform transaction codes are designated specifically to track the liquidation of unscheduled assets.

Note that an amendment by the debtor to correct the description or value of a scheduled asset does not alter its classification as a scheduled asset.

## **Bank Reconciliations**

Q. Some of today's chapter 7 case management systems can provide a daily reconciliation of the cash balance provided electronically by the bank to the system cash balance—that is, the balance according to Form 2, Estate Cash Receipts and Disbursements Record. The system can alert trustees via a daily exception report if an account is out of balance. Trustees also receive monthly statements from their banks for each estate account. If the system is reconciling the accounts on a daily basis, do trustees need to reconcile the monthly bank statements to the Form 2 system balances? If so, how often?

A. The policies and procedures governing bank reconciliations are discussed in *Handbook* Chapter 5.E.5 and in the Supplementary Materials at Chapter 7 Trustee Bank Account Review and Reconciliation Procedures. Pursuant to these procedures, trustees must personally review bank statements and canceled checks within 10 days of receipt. The monthly review and reconciliation of the bank statements to the balances in the case management system serves several purposes. First, it allows the trustee to identify unusual items on the statement and to detect fraudulent activity and bank errors. Second, it allows the trustee to reconcile the bank statement month-end balance to the corresponding Form 2 month-end balance before the end of the following month to ensure that the balances match or that any differences are explained. Finally, the monthly bank statements provide independent corroboration that the balances within the case management system are correct.

The daily system reconciliation process and exception report is an excellent tool to alert trustees when an account is out of balance. It can be an early warning sign of an overdraft in the account, a mis-deposit or a Form 2 data entry error. Although not required by the *Handbook*, it would certainly be a best practice for a trustee to utilize this tool to monitor the integrity of the estate bank accounts between the monthly reconciliations of the Form 2 balances to the bank statements provided by the depository institution.

## **Deposits to Law Firm Trust Account**

Q. The trustee is about to receive substantial cash proceeds from a settlement. May the trustee or trustee's counsel hold the funds in an attorney trust account until the trustee is ready to make distributions thereby avoiding bank service fees?

A. In general, bankruptcy-related funds may not be commingled with funds from other estates or with the trustee's personal, business or law firm trust accounts. *Handbook* Chapter 5.D. The updated *Handbook* provides an exception to this general policy. Earnest monies and settlement proceeds received by the trustee pending court approval of a sale or settlement may be deposited to the trustee's or outside counsel's attorney trust account if done so pursuant to a written escrow agreement or court order. The trustee must disclose on Form 1 where the funds are held. ***When the sale or settlement is approved by the court, the funds must be transferred to the***

*estate account* (emphasis added). *Handbook* Chapter 5.D.3.b and c. The *Handbook* does not permit trustees to leave the funds in an attorney trust account until the trustee is ready to make distributions.

## **Operating a Business in Chapter 7**

Q. The debtor was a manufacturer of widgets. Before filing chapter 7 bankruptcy, the debtor maintained a relationship with an online retail vendor whereby the vendor maintained an inventory of the debtor's widgets in the vendor's warehouse and made them available online for sale to the public. On a monthly basis, the vendor remitted to the debtor the net proceeds of sales for that month with an accounting.

Pre-petition, the debtor stopped manufacturing widgets. On the petition date, the online vendor held a substantial inventory of widgets in its warehouse.

The trustee wants to enter into an agreement with the vendor extending the pre-existing agreement. The vendor would retain the inventory of widgets and continue to sell them online until the inventory is depleted. The net proceeds would continue to be remitted to the trustee under the pre-existing arrangement. The trustee would provide notice to all creditors and obtain court approval.

Would the trustee be "operating a business" and be required to consult with the U.S. Trustee and obtain an operating order before pursuing this course of action?

A. A trustee who is concerned that his or her actions might be construed as "operating a business" should consult with the U.S. Trustee before seeking court authority to engage in the actions. *Handbook* Chapter 4.I discusses the factors a trustee must consider in determining whether continued operation of the debtor's business is in the best interest of the estate. These include:

- Whether operating the business will result in an operating loss.
- The tax consequences of operating the business.
- The costs necessary to bring the business into compliance with local laws, to the extent local laws do not conflict with the Bankruptcy Code.
- Potential liabilities and claims against the estate and the trustee, which may arise from the operation of the business.
- The length of time the business will be operated.

In addition, the trustee may be required to obtain a separate bond as the trustee's blanket bond may not cover the trustee's operation of a business in a chapter 7 case.

## **Tax Payments Related to Wage Claims**

Q. In connection with the payment of wage claims as part of a final distribution in a chapter 7 estate, the trustee is advised by the accountant for the estate that payroll taxes are due and payable on account of the wage claim payments. Does the trustee need to apply separately for court

approval before paying the payroll taxes?

A. The trustee must withhold and pay all applicable taxes from any wage claims paid by the estate. 11 U.S.C. § 346(h); *Handbook* Chapter 4.C.5.c. The withheld taxes receive the same priority for payment as the claims from which they were withheld. The taxes must be properly and timely remitted to the Internal Revenue Service using the Treasury Department's Electronic Federal Payment System.

Payroll taxes withheld on account of wage claim payments are included in the Trustee's Final Report (TFR), which is reviewed by the U.S. Trustee and filed with court. If no objections are lodged to the notice of intent to distribute or to the report of distribution, the trustee may make the distribution according to the TFR. *Handbook* Chapters 4.J.1 and 2. No separate application for approval to pay payroll taxes is required.

### **Domestic Support Obligations**

Q. The debtor is obligated to pay monthly child support payments to the debtor's former spouse. As required by statute, the trustee mails notices to the former spouse and to the state child support enforcement agency when the petition is filed and when the debtor receives a discharge. Is it sufficient to make a note in the trustee's software that the notices have been sent, or should the trustee retain hard copies of the notices in the case files?

A. No, it is not sufficient to make a note in the trustee's software that the notices have been sent. As with all correspondence pertaining to the administration of the bankruptcy case, the trustee must retain these notices, either in paper or electronic format, for at least two years after the date on which the trustee was discharged and during which a proceeding on the trustee's bond may be commenced. *Handbook* Chapter 5.G.5.c.1. In addition, the notices must be safeguarded from theft, loss or accidental disclosure in the same manner as any other bankruptcy papers that contain personally identifiable information (PII). See *Handbook* Chapters 5.G.3.e and 5.G.5.a.2., as well as 5.G.5.e for the procedures to be followed if PII is lost.

### **Conclusion**

We are pleased to address trustees' questions regarding the new *Handbook* and we welcome future inquiries as new issues arise. We appreciate the opportunity to communicate with trustees about the *Handbook* as well as other important matters relating to chapter 7 case administration. Please continue to send your questions and comments to your local office of the U.S. Trustee.