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Election of Chapter 7 Trustees under the Bankruptcy Code

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ELECTION OF CHAPTER 7 TRUSTEES UNDER THE
BANKRUPTCY CODE

DARRELL DUNHAM¹

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I. INTRODUCTION

In 1983, Gordon Blesi owned, by a single share, the majority of the stock in Blesi-Evans Company.² Melvin Evans owned the other stock. Prior to 1983, Blesi and Evans had been in business for a number of years. The two had a falling out, and in 1983, Evans recovered a judgment in state court against Blesi. The judgment was later amended in 1984 and provided that the company was jointly and severally liable with Blesi to Evans in the amount of \$381,136.00. Blesi, himself, was personally liable to Evans in the amount of \$250,000.00. The judgment further provided that the company was to remain in business for two years after which an evaluation was to take place. After the evaluation, Blesi was to have the right to purchase Evans's shares. In the event that Blesi did not purchase the shares, Evans had the right to buy-out Blesi at the value placed on the company by an "evaluator."³ In July, 1984, the state court ordered the sale of some of Blesi's shares which had been given in lieu of bond as security for the payment of Evans's attorneys fees. But before this sale could be accomplished, Blesi filed a petition in bankruptcy seeking relief under Chapter 7 of the Bankruptcy Code. Thus, the business did not continue for two years and the evaluation never did take place as required by the judgment. Practically, Evans's right to purchase Blesi's shares was terminated by the Chapter 7 filing.

If the Blesi bankruptcy had followed the usual course, there would have been a first meeting of creditors⁴ at which some cursory questions would have been asked. While the Blesi bankruptcy was clearly of intense concern to Evans, the bankruptcy trustee presiding at the first meeting of creditors was probably an "interim trustee"⁵

²See *In re Blesi*, 43 B.R. 45 (Bankr. D. Minn. 1984).

³*Id.* at 46.

⁴11 U.S.C. § 341 (1999). § 341 provides:

Meetings of creditors and equity security holders

- (a) Within a reasonable time after the order for relief in a case under this title, the United States trustee shall convene and preside at a meeting of creditors.
- (b) The United States trustee may convene a meeting of any equity security holders.
- (c) The court may not preside at, and may not attend, any meeting under this section including any final meeting of creditors.
- (d) Prior to the conclusion of the meeting of creditors or equity security holders, the trustee shall orally examine the debtor to ensure that the debtor in a case under chapter 7 of this title is aware of--
 - (1) the potential consequences of seeking a discharge in bankruptcy, including the effects on credit history;
 - (2) the debtor's ability to file a petition under a different chapter of this title;
 - (3) the effect of receiving a discharge of debts under this title; and
- (4) the effect of reaffirming a debt, including the debtor's knowledge of the provisions of section 524(d) of this title.

⁵Section 701 provides for the appointment of an interim trustee until the first meeting of creditors. That section provides:

appointed by the United States Trustee.⁶ The Blesi bankruptcy was likely one of hundreds. There is no reason to assume that this bankruptcy would have been given any special attention by the interim trustee appointed by the United States Trustee.

As a creditor, Evans did have some remedies. He had standing to object to Evans's discharge if Blesi had violated the provisions of section 727 of the Bankruptcy Code in some manner.⁷ He also could have sought an exception from discharge for his claim if section 523 applied.⁸ Also, he probably would have been granted the right to conduct a thorough examination of Blesi, his assets, and his business dealings under Rule 2004 of the Bankruptcy Rules.⁹ But it is generally the bankruptcy trustee who controls the administration of the case and therefore decides how thorough the search for assets and how aggressive the estate will litigate claims.

Interim trustee

(a)(1) Promptly after the order for relief under this chapter, the United States trustee shall appoint one disinterested person that is a member of the panel of private trustees established under section 586(a)(1) of title 28 or that is serving as trustee in the case immediately before the order for relief under this chapter to serve as interim trustee in the case.

(2) If none of the members of such panel is willing to serve as interim trustee in the case, then the United States trustee may serve as interim trustee in the case.

(b) The service of an interim trustee under this section terminates when a trustee elected or designated under section 702 of this title to serve as trustee in the case qualifies under section 322 of this title.

c) An interim trustee serving under this section is a trustee in a case under this title.

11 U.S.C. § 701 (1999). Section 586, cited in § 701, gives to the United States Trustee the authority to create the panel of private trustees. 28 U.S.C. § 586(a)(1) (1999).

⁶United States Trustees for the various judicial districts are appointed by the Attorney General of the United States. 28 U.S.C. § 581 (1999). Among the duties of the United States Trustee is to "establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11." 28 U.S.C. § 586(a)(1) (1999).

⁷11 U.S.C. § 727(a) (1999).

⁸11 U.S.C. § 523(a) (1999).

⁹Rule 2004 (a) and (b) provide:

(a) Examination on motion. On motion of any party in interest, the court may order the examination of any entity.

(b) Scope of examination. The examination of an entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In a family farmer's debt adjustment case under chapter 12, an individual's debt adjustment case under chapter 13, or a reorganization case under chapter 11 of the Code, other than for the reorganization of a railroad, the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan.

FED. R. BANK. PROC. 2004(a), (b) (1999).

Evans therefore did something which although not rare is unusual—at the 341 meeting he moved to elect his own bankruptcy trustee.¹⁰ Section 702 of the Bankruptcy Code provides under stated conditions that twenty percent of the debtor's creditors may request an election.¹¹ A majority of those voting elect the trustee. Since Evans's claim constituted over ninety percent of the outstanding debts, it appeared that he could control the election. Evans therefore called for an election and voted his ninety percent claim for Howard Malmon.¹²

Blesi was not pleased with the prospect of having a bankruptcy trustee other than the usual standing trustee—particularly one beholden to Evans. He therefore objected to the election, raising various issues.¹³ Evans, in turn, argued that Blesi did not even have standing to make an objection.¹⁴ The court eventually ruled that while Blesi had standing to object to Malmon's election, the statutory objections were without merit.¹⁵ Thus, Evans was successful in electing Malmon the Chapter 7 trustee.

In our credit-driven economy, bankruptcy is becoming almost a way of life for failed entrepreneurs and credit card chargeaholics. As standing trustees become even more inundated, it seems likely that more creditors will take a serious look at the option of electing their own trustee. Elected trustees typically will serve in only one or, at most, a few cases. By definition, the elected trustee enjoys the confidence of those who elected him. Thus, although it is improbable that trustee elections will become the norm, it is anticipated that creditors will increasingly call for elections of trustees in Chapter 7 cases. This article reviews prior statutes and the legislative history supporting 11 U.S.C. § 702, the present statute, which governs the election of trustees in Chapter 7 cases.¹⁶ The statute is analyzed and the procedures governing the election are discussed. The article concludes by offering the authors own thoughts about trustee elections.

This article offers an analysis of the election of chapter 7 trustees. Part II the prior statutory scheme and the legislative history supporting the present statute. Part III examines the present statute, discussing the statutory requirements for the election of a chapter 7 trustee. Part IV discusses election procedures. The bankruptcy rules mandate a prescribed set of procedures for elections, including procedures for disputing the results of an election. These rules and the cases applying them are discussed in Part IV. In Part V, appellate reviewed is examined. This section

¹⁰The United States Trustee's Office estimates that of the over 1,000,000 Chapter 7 bankruptcies filed in 1998 a trustee was elected in less than 500 cases. Telephone interview with Mr. Edward Flynn, Research Analyst, Executive Office of the United States Trustee, United States Department of Justice, 901 E. Street, Suite 9400, Washington, D.C. 20530.

¹¹See text accompanying note 39, *infra*, for the text of the statute.

¹²*In re Blesi*, 43 B.R. 45, 47 (Bankr. D. Minn. 1984).

¹³*Id.* at 46-47.

¹⁴*Id.* at 48. See discussion *infra* notes 235-247, regarding standing issue.

¹⁵*Id.* at 46-48.

¹⁶A trustee may be elected in Chapter 11 cases as well. 11 U.S.C. § 1104 (1994). See, e.g., *In re Aspen Marine Group, Inc.*, 189 B.R. 859 (Bankr. S.D. Fla. 1995). This article is limited to a discussion of trustee elections in Chapter 7 cases.

analyzes questions such as standing and appealable orders. Finally, in Part VI a proposal is offered to amend portions of the statute and supporting rules.

II. HISTORY

A. *Prior Statutes*

The creditors' right to elect the trustee extends back over a century. The Bankruptcy Act of 1898 provided that the creditors could "appoint one or three trustees." Section 44 of the 1898 act provided:

The creditors of a bankruptcy estate shall, at their first meeting after the adjudication or after a vacancy has occurred in the office of trustee, or after an estate has been reopened, or after a composition has been set aside or a discharge revoked, or if there is a vacancy in the office of trustee, appoint one trustee or three trustees of such estate. If the creditors do not appoint a trustee or trustees as herein provided, the court shall do so.¹⁷

The reader should note that the statute is worded to assume that elections will be the norm. It is only when the creditors fail to act that the court selected the trustee.¹⁸

The voting requirements for the creditors were set forth in section 56. That section provided:

a) Creditors shall pass upon matters submitted to them at their meetings by a majority vote in number and amount of claims of all creditors whose claims have been allowed and are present, except as herein otherwise provided.

b) Creditors holding claims which are secured or have priority shall not, in respect to such claims, be entitled to vote at creditors' meetings nor shall such claims be counted in computing either the number of creditors or the amount of their claims, unless the amounts of such claims exceed the values of such securities or priorities, and then only for such excess.¹⁹

Back in 1898, Congress established limitations on the right to vote.²⁰ Not only secured creditors but also priority creditors were disenfranchised.²¹ But the statute did provide that creditors holding only partially secured claims or claims which had less than full priority²² status were permitted to vote to the extent that their claim was truly unsecured.²³

¹⁷Act of July 1, 1898, ch. 541, § 44, 30 Stat. 557 (1898).

¹⁸*Id.*

¹⁹*Id.* § 56 at 560.

²⁰*Id.*

²¹*Id.*

²²The 1898 Act did not have an elaborate priority distribution scheme, leaving priority issues to non-bankruptcy law.

²³Act of July 1, 1898, ch. 541, § 56, 30 Stat. 560 (1898).

In 1938, the act was amended to prevent relatives of the bankrupt and shareholders, officers, and directors of bankrupt corporations from voting.²⁴ In 1940, the statute was again amended to prohibit elections when the debtor was a “face-amount certificate company” under the Investment Company Act of 1940.²⁵ Therefore, the provision governing elections prior to the present statute read as follows:

The creditors of a bankrupt, exclusive of the bankrupt’s relatives or, where the bankrupt is a corporation, exclusive of its stockholders or members, its officers, and the members of its board of directors or trustees or of similar controlling bodies, shall, at the first meeting of creditors after the adjudication, or after a vacancy has occurred in the office of trustee, or after an estate has been reopened appoint a trustee or three trustees of such estate. If the creditors do not appoint a trustee or if the trustee so appointed fails to qualify as herein provided, the court shall make the appointment. If the bankrupt is a face-amount certificate company, as defined in section 4 of the Investment Company Act of 1940 [15 USCS § 80a-4], the court alone shall make the appointment; but the court shall not make such appointment without first notifying the Securities and Exchange Commission and giving it an opportunity to be heard.²⁶

Prior to the present legislation, the bankruptcy courts had an established history of creditor elections.²⁷ The right to vote, however, was tempered by preventing secured creditors, relatives, and corporate insiders from voting.

B. Legislative History to Section 702

The reader should note that under prior statutes it was possible for a single creditor, holding only a small fraction of the existing claims, to appear at the first meeting, call for an election, and by her solitary vote, elect a trustee. The present statutory scheme was enacted in 1978 after a thorough study of our bankruptcy laws by the Commission on the Bankruptcy Laws of the United States.²⁸ The Commission was highly critical of the possibility of a single creditor being able to elect the trustee where the creditor owned only a small claim.²⁹ In the Commission’s view, creditors did not choose to exercise control of the bankruptcy in most cases.³⁰ Instead, the election procedure was subject to the control of a handful of creditors’

²⁴Act of June 22, 1938, ch. 575, § 1, 52 Stat. 860 (1938).

²⁵Act of August 22, 1940, ch. 686, Title I, § 29(b), 54 Stat. 836 (1940).

²⁶*Id.*

²⁷*See e.g.* Peerless Mfg Co., 416 F.2d 57 (7th Cir. 1969); Manhattan Shirt Co. v. Tomlinson, 327 F.2d 449 (9th Cir. 1964).

²⁸*See* Pub. L. No. 91-354, 84 Stat. 468 (1970) (creating the Commission). *See also* Commission on the Bankruptcy Laws of the United States, H.R. DOC. NO. 93-137, pt. 1 at 1-2 (1973) (where the Commission describes its purpose and objectives).

²⁹*Id.*

³⁰*Id.*

attorneys, and therefore could be manipulated in an abusive manner.³¹ The Commission therefore recommended that a trustee could be elected only if thirty-five percent of the creditors holding allowable claims called for an election and if a majority of those creditors voting voted for someone other than the standing trustee.³²

The House generally accepted the Commission's recommendations except the thirty-five percent recommendation was lowered to twenty percent. The House Judiciary Committee adopted the Commission's recommendation, proposing legislation largely conforming to the Commission's language.³³ The House Report is the most significant piece of legislative history. The report reflects Congressional concern about attorneys attempting to take control of the case:

At the first meeting of creditors, creditors will continue to have the right to elect a trustee of their own choice to serve in the case, subject to certain limitations not imposed under current law. The bill permits creditor election of a trustee only in cases in which at least creditors holding 20 percent in amount of certain scheduled unsecured claims request an election of a trustee. The minimum percentage request requirement is designed to insure that a trustee is elected only in cases in which there is true creditor interest, and to discourage election of a trustee by attorneys for creditors, as is so often the practice under current law. If a significant percentage of creditors does not wish to elect a trustee, it is unfair to impose the will of a few creditors' attorneys on the rest of the creditor body.

It will be more difficult under this procedure for a trustee to be elected unless there is actual creditor interest in the case. In any case where there are significant assets, there is often creditor interest. The problems under current law occur most often in cases where the return to creditors from the estate promises to be small. Thus, they are uninterested, and attorneys can move in to control the case. By adopting the 20 percent requirement, the bill discourages attorney control, but retains the idea of true creditor control, because the theory of creditor control remains valid.³⁴

³¹*Id.* at 103-106.

³²*Id.*, pt. 2 at 183-184.

³³See H.R. REP. NO. 95-595, at 91-93, 95-99 (1973); H.R. 8200, 95th Cong. 1st Sess. § 702 (1977). The Senate Bill recommended that the Commission's requirement that "materially adverse" be limited to permit creditors who hold an insubstantial equity position be permitted to vote. S. 2266, 95th Cong., 2d Sess. § 702(a)(2) (1978). This position was adopted by the House. See discussion *infra* note 150.

³⁴H.R. REP. NO. 95-595, 95th Cong., 1st Sess. at 102-103 (1978).

III. THE PRESENT SCHEME

The right to elect³⁵ a trustee is codified in section 702 of the Bankruptcy Code. Section 702 was enacted into law in 1978.³⁶ There were technical amendments in 1982³⁷ and in 1984.³⁸ The present section 702 reads:

(a) A creditor may vote for a candidate for trustee only if such creditor--

(1) holds an allowable, undisputed, fixed, liquidated, unsecured claim of a kind entitled to distribution under section 726(a)(2), 726(a)(3), 726(a)(4), 752(a), 766(h), or 766(i) of this title;

(2) does not have an interest materially adverse, other than an equity interest that is not substantial in relation to such creditor's interest as a creditor, to the interest of creditors entitled to such distribution; and

(3) is not an insider.

³⁵A individual may be elected as trustee but the bankruptcy court may refuse to confirm the election for failure to meet other criteria. Section 322(a) provides that trustees, including those "selected under section 702," shall post a bond. 11 U.S.C. § 322(a) (1994). *See also* FED. R. BANKR. PRAC. 2010(a) (1991), permitting an elected trustee to file a blanket bond where the trustee is serving in other cases.

Trustees elected under section 702 must meet the qualifications for standing trustees. Courts properly reject their election even though the creditors have voted for them if they do not meet the qualifications. Among those requirements is that the trustee must be "competent" and live or have an office in the district or adjacent district where the bankruptcy is pending. 11 U.S.C. § 321(a)(1) (1994). Where the elected trustee is a creditor or an attorney for a creditor the elected trustee "is not per se disqualified from acting as trustee, such situations require the Court to subject such elections to particularly close scrutiny." *In re Brent Industries*, 96 B.R. 193, 197 (Bankr. N.D. Iowa. 1989). The applicable sections do not provide any further criteria. There is nothing in either section 702 or any other section providing that the election should be overturned if the elected trustee was not "disinterested." *In re Greenberg, Inc.*, 189 B.R. 906 (Bankr. E.D. Pa. 1995) (requiring that the elected trustee be disinterested even though section 702 has no disinterested requirement); *In re Frederick Petroleum*, 92 B.R. 273, 275-76 (Bankr. S.D. Ohio 1988) (disqualifying the elected trustee for reasons of competence); *In re Kam Kuo Seafood Corp.*, 42 B.R. 558 (Bankr. S.D.N.Y. 1984), (failure to comply with mandates of the Bankruptcy Code); *In re Martech USA, Inc.*, 188 B.R. 847 (B.A.P. 9th Cir. 1995), *aff'd without opinion*, 90 F.3d 408 (9th Cir. 1996) (failure to maintain an office in the district as required by section 321(a) of the Bankruptcy Code).

In cases where the bankruptcy court rules that the elected trustee is not qualified, the law is unsettled as to whether the court should appoint the standing trustee or order a new election. *See Martech*, 188 B.R. at 852, n. 3, where the court noted the issue but declined to decide the question because it was not raised on appeal.

³⁶Bankruptcy Reform Act of 1978, Pub. L. 95-598, § 702, 92 Stat. 2549, 2604 (1978).

³⁷Pub. L. No. 97-222, § 7, July 27, 1982, 96 Stat. 237 (1983). This provision amended section 702(a)(1) to include creditors entitled to a distribution for liquidation of a brokerage.

³⁸Pub. L. No. 98-353, Title III, § 472, July 10, 1984, 98 Stat. 380 (1984).

(b) At the meeting of creditors held under section 341 of this title, creditors may elect one person to serve as trustee in the case if election of a trustee is requested by creditors that may vote under subsection (a) of this section, and that hold at least 20 percent in amount of the claims specified in subsection (a)(1) of this section that are held by creditors that may vote under subsection (a) of this section.

(c) A candidate for trustee is elected trustee if--

(1) creditors holding at least 20 percent in amount of the claims of a kind specified in subsection (a)(1) of this section that are held by creditors that may vote under subsection (a) of this section vote; and

(2) such candidate receives the votes of creditors holding a majority in amount of claims specified in subsection (a)(1) of this section that are held by creditors that vote for a trustee.

(d) If a trustee is not elected under this section, then the interim trustee shall serve as trustee in the case.³⁹

Section 702 permits an election if twenty percent of the creditors holding “allowable, undisputed, fixed, liquidated, unsecured claim(s)” request an election and a majority of those voting vote for a particular candidate.⁴⁰ Those voting may not hold an interest which is “materially adverse” to the other unsecured creditors, nor may they be an insider of the debtor.⁴¹

In this section, the specific voting requirements are analyzed. We begin with subsection (b), which sets forth the initial criteria for requesting an election before turning to subsection (a), which sets forth the voting requirements.

A. Requesting An Election— Section 702(b)

The Bankruptcy Code requires that “at least twenty percent in amount” of creditors holding unsecured claims request a trustee election.⁴² The fact that more than twenty percent of eligible creditors may vote for a permanent trustee does not cure this statutory requirement.⁴³ Section 702(b) requires that creditors requesting an election also be eligible to vote for the trustee.⁴⁴ Section 702(a) is therefore frequently relied upon in resolving an election dispute under section 702(b).⁴⁵ Section 702(a) is discussed below,⁴⁶ but the reader should be aware of the connection

³⁹11 U.S.C. § 702(d) (1984).

⁴⁰*Id.* at § 702(a)(1).

⁴¹*Id.* at § 702(a)(2).

⁴²*See supra* text accompanying note 39 for the text of subsection 702(b).

⁴³*In re Oxborrow*, 913 F.2d 751 (9th Cir. 1990).

⁴⁴11 U.S.C. § 702(b).

⁴⁵11 U.S.C. § 702(a).

⁴⁶*See infra* text accompanying notes 95-191.

between the two subsections. Because of the close relationship between these two subsections, section 702(a)'s requirements will be frequently addressed in this section of the article.

While section 702(b) seems to be straightforward, it raises several issues which have given bankruptcy courts difficulty. The subsection provides that twenty percent of the "creditors" must request the election.⁴⁷ In many bankruptcies a single creditor holds a claim in a sufficient amount to satisfy the statutory criteria. In using the word "creditors," an ambiguity was created as to whether a single creditor should be permitted to elect the trustee. The subsection is also silent as to how the "universe of claims" is to be determined in calculating whether the twenty percent requirement has been met. Courts have been confronted with the question of whether the schedules, proofs of claim, or some other mechanism should be determinative in calculating the universe.⁴⁸ Further, questions have arisen as to whether the unsecured portion of undersecured claims should be included in the universe.⁴⁹

1. Single Voters

Section 702(b) provides that "*creditors* may elect one person to serve as trustee. . . ."⁵⁰ Most courts assume without discussion that a single creditor may effect the election of a trustee.⁵¹ *In re Poage*⁵² ruled on the question. In that case, Poage filed a Chapter 7 petition in bankruptcy.⁵³ At the first meeting of creditors, Merrill-Lynch, which held in excess of ninety percent of the scheduled unsecured claims, moved for the election of a trustee.⁵⁴ The interim trustee specifically argued "that since § 702 states that 'creditors' may elect a permanent trustee, Congress did not intend for only one creditor to be able to elect a permanent trustee."⁵⁵ The court rejected the argument, reasoning that voting is based on the "amount" of the claims as opposed to the number of claims.⁵⁶

Although the use of the plural "creditors" is unfortunate, we conclude that a single creditor should be able to effect the election of a Chapter 7 trustee. Bankruptcy Code section 102(7) does support the argument that a single creditor should not be able to force an election. That section provides that "the singular

⁴⁷11 U.S.C. § 702(b).

⁴⁸*See infra* text accompanying notes 62-83.

⁴⁹*See infra* text accompanying notes 84-95.

⁵⁰11 U.S.C. § 702(b) (1984), (emphasis added). *See supra* text accompanying note 39 for the complete text of the section.

⁵¹*In re Ben Franklin Retail Stores*, 214 B.R. 852, 860 (Bankr. E.D. Ill. 1997); *In re Michelex, Ltd.*, 195 B.R. 993, 997 (Bankr. W.D. Mich. 1996).

⁵²92 B.R. 659 (Bankr. N.D. Tex. 1988), followed in *In re Sforza*, 174 B.R. 656, 658 (Bankr. D. Mass. 1994).

⁵³*Id.* at 661.

⁵⁴*Id.* at 662.

⁵⁵*Id.* at 663.

⁵⁶*Id.* at 664.

includes the plural.”⁵⁷ There is no converse section providing that the “plural includes the singular,” thereby permitting the inference that when Congress used the plural “creditors” it did not intend to include a solitary creditor. In other contexts, Congress mandated numerical requirements not only as to the amount of the claim but also as to the number of creditors.⁵⁸ Congress required that two-thirds in amount and one-half in number of the claims in a class of creditors vote for a Chapter 11 plan for that class to be deemed to have voted for the plan.⁵⁹ In involuntary cases, in most cases there must be at least three petitioning creditors who hold claims in excess of \$10,775.00.⁶⁰ Congress’s failure to specify that at least two creditors request an election is evidence of Congressional intent that only one creditor is sufficient.

Admittedly, permitting one creditor to effect an election and determine the trustee does give that creditor significant power over the administration of the estate. Section 702(a), which governs voting eligibility, uses the singular – “creditor.”⁶¹ Theoretically, it is possible that more than one creditor could call for an election, while actually dividing the votes so that a single creditor is able to control the election. In virtually every case the creditor(s) calling for the election will vote for the same candidate. It makes no sense to require that more than one creditor call for an election to comply with section 702(b) and then allow a single creditor to determine the outcome of that election as is permitted by section 702(a). Section 702, however, does promote the right to an election, and a debtor should not be able to frustrate this right simply because the debtor filed a bankruptcy solely to discharge one debt. The legislative history stresses that the paramount concern was attorney, as opposed to creditor, control of the bankruptcy case. Permitting a single creditor whose claims constitute more than a majority of the outstanding claims promotes the objective of creditor control. Debtors should not be permitted to schedule some claims only after the first meeting of creditors in an effort to defeat a single creditor’s rights under section 702.

2. Determining the Universe

a. Use of Schedules or Some Other Mechanism

In determining whether twenty percent of the unsecured creditors have requested an election, bankruptcy courts must have some mechanism for determining the total amount of unsecured claims. Some courts look to the proof of claims on file before the section 341 meeting.⁶² Other courts include claims listed as undisputed on the

⁵⁷11 U.S.C. § 102(7) (1998).

⁵⁸92 B.R. at 664.

⁵⁹11 U.S.C. § 1126(c) (1998) (requiring acceptance of two-thirds in amount and one-half in number of the claims in a class).

⁶⁰11 U.S.C. § 303(b)(2), (2) (1998).

⁶¹See *supra* text accompanying note 39 for the text of section 702(a).

⁶²*In re Lake States Commodities*, 173 B.R. 642 (Bankr. N.D. Ill. 1994). The court in *Lake States Commodities* reasoned that section 702(b) refers directly to creditors described in section 702(a). Section 702(b) requires that the election be requested “by creditors that may vote under subsection (a).” The *Lake States* finding that section 702(a)(1) requires that the

Debtor's schedules.⁶³ Since, however, the section 341 meeting commonly is held before the claims bar date, restricting the calculation to only those claims on file appears to be inconsistent with the policy of the section.⁶⁴

Creditors who attend the first meeting with the purpose of electing a trustee are frequently on an adversarial footing with the debtor. Consequently, the debtor may have listed these claims as disputed⁶⁵ on the schedule; and when a proof of claim is filed, the debtor may have responded with an objection. When the debtor and creditor are in fundamental dispute about the merits of the claim, questions will arise as to whether the creditor should be counted in determining whether the twenty percent requirement of section 702(b) has been met. In *In re San Diego Symphony Orchestra*,⁶⁶ the creditors desiring to elect the trustee filed proofs of claim for wages.⁶⁷ The schedules listed the claims as priority indebtedness, but there was agreement that a substantial amount of the claims were beyond the priority caps set forth in section 507(a)(3).⁶⁸ The creditors filed a proof of claim and the interim trustee filed an objection. The court was called upon to determine the applicable standard to be applied to the claims for purposes of determining the universe of claims under section 702(b).⁶⁹

creditor "hold a claim that is allowable," that the creditor must comply with section 502 which generally governs allowability of claims under the Bankruptcy Code. 173 B.R. at 646. The court seized upon section 502(a) which provides that "[a] claim or interest, proof of which is filed under section 501 of this title, is deemed allowed . . ." 11 U.S.C. § 502(a) (1998). Thus, the court reasoned that unless a proof of claim had been filed, the creditor claim was not allowable within the meaning of section 702(a)(1). Cf. *In re Michelex, Ltd.*, 195 B.R. 993, 1000 (Bankr. W.D. Mich. 1996) (noting that section 502(a) employs the word "allowed," but section 702(a)(1) uses the word "allowable," and arguing that a difference must have been intended). See *supra* text accompanying notes 75-80 for further discussion.

⁶³*In re Michelex, Ltd.*, 195 B.R. 993 (Bankr. W.D. Mich. 1996); *In re Lindell Drop Forge*, 111 B.R. 137, 141 (Bankr. W.D. Mich. 1990).

⁶⁴*In re Tartan Construction Co.*, 4 B.R. 655, 658 (Bankr. D. Neb. 1980). The legislative history of section 702 appears to support the right to vote a claim even though the claim was not filed prior to the section 341 meeting. H.R. REP. NO. 95-595, at 102-103 (1978). See *supra* text accompanying note 34 for the text of the House Report.

⁶⁵In order for a creditor to request an election and vote for the trustee the claim must be "undisputed." See *infra* text accompanying notes 81-88 for further discussion of the "undisputed" requirement.

⁶⁶201 B.R. 978 (Bankr. S.D. Cal. 1996).

⁶⁷Section 702 does not expressly exclude priority claimants from voting as was the case under prior law. Priority claimants are nevertheless excluded from voting. Section 702(a)(1) requires that the creditor own an "unsecured claim of a kind entitled to distribution under section 726(a)(2), 726(a)(3), 726(a)(4), 752(a), 766(h), or 766(i). . ." 11 U.S.C. § 702(a)(1) (1984). Priority claims are provided for in section 726(a)(1). 11 U.S.C. § 726(a)(1) (1994). See *supra* text accompanying note 39 for the text of the section.

⁶⁸11 U.S.C. § 507(a)(3) (1998) (limiting priority wage claims to \$4000.00 per claimant).

⁶⁹201 B.R. at 980.

The court acknowledged that the filing of a proof of claim was prima facie evidence of its validity.⁷⁰ When there was an objection, however, it appeared that the statutory criteria that the claim has to have been “undisputed” was not satisfied.⁷¹ But the court was sympathetic to the creditors’ concern that the debtor or interim trustee could decide their ability to vote by filing a frivolous objection to the claim.⁷²

In arriving at the applicable standard, the court noted that section 303(b) limits creditors who wish to join in involuntary cases to those claims which are not subject to “a bona fide dispute.”⁷³ The court observed that Congress did not include a “bona fide” limitation in section 702. Thus, the court was tempted to conclude that any objection, even one that was not bona fide, could result in disqualifying the creditor from voting.⁷⁴ The court, however, reluctantly embraced the bona fide dispute test in ruling whether the creditor was eligible to request an election: “This Court concludes that the test is no more than the bona fide dispute assessment of § 303(b), and it may well be even less than that.”⁷⁵

Most bankruptcy courts will be reluctant to conduct mini-trials to determine whether a creditor is eligible to request an election.⁷⁶ At one time the bankruptcy rules provided that a claim could be temporarily allowed only for purposes of voting.⁷⁷ This provision was deleted by subsequent changes to the rule.⁷⁸ One court ruled that this change was significant and refused to conduct an inquiry into the substance of the filed claim.⁷⁹ But some level of inquiry needs to be conducted.⁸⁰ Relying exclusively on the schedules permits the debtor to prevent the election of a

⁷⁰*Id.* at 982. See also *In re Michelex, Ltd.*, 195 B.R. 993, 1008 (Bankr. W. D. Mich. 1996) (“When a proper proof of claim is filed before, or at, the § 341 meeting, it supersedes the debtor’s schedules.”); *In re Eddie Haggard Ltd, Inc.*, 190 B.R. 281, 286 (Bankr. N.D. Tex. 1995).

⁷¹*Id.* at 983.

⁷²*Id.*

⁷³*Id.*

⁷⁴201 B.R. at 983.

⁷⁵*Id.* See also *In re Centennial Textiles, Inc.*, 209 B.R. 31, 33 (Bankr. S.D.N.Y. 1997) (“[I]t must appear that the dispute is grounded on more than a mere suspicion.”) “An unsupported allegation of a dispute regarding a claim is insufficient to disqualify a creditor’s claim for qualifying a request for an election, or for voting.” *Id.* at 34.

⁷⁶*In re Lindell Drop Forge Co.*, 111 B.R. 137, 144 (Bankr. W.D. Mich. 1990); *In re Tartan Construction Co.*, 4 B.R. 655, 658 (Bankr. D. Neb. 1980).

⁷⁷FED. R. BANKR. PROC. 207 (1976) (repealed 1983). See *infra* note 108 for the text of former rule 207.

⁷⁸FED. R. BANKR. PROC. 2003(b)(3) (1983). See *infra* note 108 for the text of Rule 2003(b)(3).

⁷⁹*In re Cohoes Industrial Terminal, Inc.*, 90 B.R. 67 (S.D.N.Y. 1988).

⁸⁰The legislative history noted that the existing bankruptcy rules permitted “temporary allowance of claims, and will continue to do so for the purposes of determining who is eligible to vote under this provision.” H.R. REP. NO. 95-595, at 378-79 (1977); S. REP. NO. 95-989, at 92-93 (1978).

trustee by scheduling all unsecured claims as disputed. Relying exclusively on the proofs of claim permits creditors who would otherwise not be eligible to demand an election to do so by filing a proof of claim on the morning of the section 341 meeting.⁸¹ Thus, some investigation should be conducted to determine whether the schedules⁸² and proofs of claim were filed in good faith.

b. Priority and Undersecured claims

In determining the universe of claims from the schedules, schedule F, the schedule for unsecured claims, is obviously going to be consulted. However, many creditors listed on schedule D, the schedule for secured creditors, hold both secured and unsecured claims because that creditor is undersecured.⁸³ Section 507(a) contains caps of the amount of the priority claim of creditors.⁸⁴ The excess is given only general priority status. Courts have been called upon to determine whether the amount of the claim in excess of the priority caps should be treated as part of the universe. Other courts have been required to determine whether the unsecured portion of the undersecured creditor's claim should be part of the universe.

In *In re San Diego Symphony Orchestra*,⁸⁵ a bankruptcy court had to resolve an election dispute. In determining whether twenty percent of the claims had duly requested an election, the court had to determine whether that portion of a wage-priority claim which was above the \$4000.00 priority cap should be treated as a general unsecured claim and therefore part of the universe.⁸⁶ The court concluded that it should be counted and that the wage claimants should be entitled to be part of the twenty percent universe of creditors who could request an election.⁸⁷

⁸¹Most section 341 meetings are held well within the claims bar date. Thus, the creditor could file the proof of claim in such a way as to satisfy all of the statutory criteria on the eve of the section 341 meeting before the interim trustee has time to investigate the claim and object to it.

⁸²On rare occasions the schedules will not be available at the time of the section 341 meeting. For example, in *Matter of Blanchard Management Corp.*, 10 B.R. 186 (Bankr. S.D.N.Y. 1981), an involuntary petition was filed against the debtor and the debtor was uncooperative. *Id.* at 188. Schedules were never filed, but several creditors moved to elect a trustee at the first meeting. *Id.* The court ruled that there could be no election because it was not possible to determine whether the voted claims constituted twenty percent of the universe of claims. *Id.* The court stated that the creditors remedy was to utilize the procedures permitted by Bankruptcy Rule 2005. *Id.* See FED. R. BANKR. PROC. 2005 (1991). That section permits the creditors to request the court to order the arrest of the debtor by the U.S. Marshall Service and bring the debtor before the court. *Id.* at 186. The court suggested that the creditors could subpoena the necessary records to piece together the debtor's financial affairs. *Id.* at 188.

⁸³See 11 U.S.C. § 506(a) (1998), dividing the undersecured creditor's claim into a secured claim and an unsecured claim.

⁸⁴11 U.S.C. § 507(a) (1994).

⁸⁵201 B.R. 978 (Bankr. S.D. Cal. 1996).

⁸⁶*Id.* at 982.

⁸⁷*Id.*

The *San Diego Symphony* case was correctly decided. In most cases, there is no policy basis for depriving these type of creditors of the right to request and then vote for a trustee. In some cases, priority claimants where only part of the claim is entitled to priority should not be permitted to vote. For example, a substantial portion of the claim may be entitled to priority and the assets of the estate may only be sufficient to pay priority claimants. Such a creditor is unlikely to vote for a trustee who is committed to an extensive investigation of the debtor's financial affairs, thereby creating an administrative expense which will be paid ahead of the creditor's priority claim. In that situation, however, the creditor should be prevented from voting the non-priority portion of the claim not because it holds a priority claim. Rather the bar should be based on the grounds that the creditor interest is "materially adverse" to the interest of the general unsecured creditors and therefore disqualified under section 702(a).⁸⁸

Permitting the undersecured creditor's unsecured claim to be part of the universe creates more difficulty. In *Matter of Lindell Drop Forge*,⁸⁹ the court decided that the undersecured creditor's unsecured claim should not be included in the universe.⁹⁰ In reaching this holding the court noted that the value of the collateral at the time of the first meeting will not have been set and therefore the bankruptcy court would not be able to ascertain with any degree of certainty whether the creditors truly held an unsecured claim.⁹¹ Only in cases where the secured creditor was willing to waive its secured claim should the creditor be entitled to request an election.⁹²

The *Lindell Drop* decision begs some questions. Even though the value of collateral may not be capable of precise estimation, a range can usually be established in which a bankruptcy court can take some comfort in knowing the lower and upper limits. If the collateral is valued at its upper limits and the creditor still holds an unsecured claim, the creditor should be permitted to vote the claim in that amount. In some cases, for example claims secured by stock traded on a stock exchange, the claim is capable of valuation with great precision. The mere fact that the claim is partially secured should not disqualify the creditor from requesting an election and voting its unsecured claim. There would be adversity, however, only if the creditors' paramount interest is protecting its security and it is anticipated that there would be some litigation regarding that security.

A more compelling argument for not counting undersecured claims is that these claims are not liquidated.⁹³ In some cases, it may be necessary to value the collateral

⁸⁸See *infra* text at notes accompanying 150-175 for discussion of the "materially adverse" limitation.

⁸⁹111 B.R. 137 (Bankr. W.D. Mich. 1990).

⁹⁰*In re Michelex, Ltd.*, 195 B.R. 993, 1006-1007 (Bankr. W.D. Mich. 1996).

⁹¹*Matter of Lindell Drop Forge*, 111 B.R. at 145-46.

⁹²*Id.* at 146.

⁹³*In re Centennial Textiles, Inc.*, 209 B.R. 31, 35-36 (Bankr. S.D.N.Y. 1997). See *infra* text accompanying notes 115-128 discussing the requirement that the indebtedness must be liquidated and fixed.

for purposes of the valuation of the claim. The unsecured creditor could be in a position “materially adverse” to that of the bankruptcy estate.⁹⁴

B. Voting Eligibility— Section 702(a)

Section 702(a) places limitations on the right of a creditor to request an election and vote. Specifically, the claim must be “allowable,” “fixed,” “liquidated,” “unsecured,” the claimant must not “have an interest materially adverse” to the interests of the unsecured creditors, and the claimant must not be an “insider.”⁹⁵ These criteria are discussed separately below.

1. Subsection (a)(1)

a. Allowable

Most courts look to section 502, which governs allowability of claims, and related sections to define “allowable” under section 702(a)(1). For example, it seems clear that a creditor who has benefited from a avoidable preferential transfer will not be entitled to either request an election or vote in that election. Section 502(d) of the Bankruptcy Code provides that the court shall disallow the claim unless the transferee who has received the preference has paid the trustee’s claim or returned the property to the estate.⁹⁶ The creditor will also not be permitted to request an election and vote in that election.⁹⁷

One court ruled that in order for a claim to be “allowable” a proof of claim must have been filed.⁹⁸ This court reasoned that section 502(a) of the Bankruptcy Code requires that a proof of claim be filed in order for the claim to be “allowed.”

This view was criticized in *In re Michelex, Ltd.*⁹⁹ The court noted that the definitions of “allowable” and “allowed” differed.¹⁰⁰ ‘Allowable’ means ‘PERMISSIBLE: not forbidden not unlawful or improper.’¹⁰¹ ‘Allow’ or ‘allowed’

⁹⁴*Id.* at 35. See *infra* text accompanying notes 150-175 for further discussion of the “materially adverse” requirement.

⁹⁵11 U.S.C. § 702(a)(1)-(3) (1984). See *supra* text accompanying note 39 for the text of the statute.

⁹⁶11 U.S.C. § 502(d) (1998).

⁹⁷*In re Centennial Textiles*, 209 B.R. at 33. The creditor’s claim could also be found to be “materially adverse” to the interest of the other creditors and will be disqualified for that reason. See *infra* text accompanying notes 150-175.

⁹⁸*In re Lake States Commodities, Inc.*, 173 B.R. 642, 646 (Bankr. N. D. Ill. 1994). See also *In re DB Drilling, Inc.*, 73 B.R. 953, 955 (Bankr. N.D. Tex. 1978) (“[A] claim should be allowed for voting purposes if it is in substantial compliance with the requirements of the Code and the Official Bankruptcy Forms; if the name and address of the creditor and the amount of its claim are substantially as shown in the schedules; and there is no objection to the allowance of the claim.” citing *In re Flexible Conveyer Co.*, 156 F. Supp. 164 (N.D. Ohio 1957).

⁹⁹195 B.R. 993, 999-1006 (Bankr. W.D. Mich. 1996).

¹⁰⁰*Id.* at 1000.

¹⁰¹*Id.*

means “to accept as true as true as represented: ADMIT, CONCEDE, ACKNOWLEDGE.”¹⁰² The court reasoned that the two words meant different things and only “allowable” was used in the statute.¹⁰³ The court therefore declined to adopt section 502(a)’s requirement of a filed proof of claim in construing section 702(a)(1).¹⁰⁴ In addition, the court supported its holding by analyzing the legislative history which stressed creditor control of the process.¹⁰⁵ The 1978 change promulgated a threshold requirement of twenty percent creditor participation. It had been adopted so as to discourage frenzies among the creditors to get control of the estate.¹⁰⁶ Since trustee elections are uncommon, a rule which looked only to filed proofs of claim as of the time of the first meeting would result in many instances in a single creditor obtaining control because its claim was the only one on file.

The policy reasons advanced by the *Michelex* court are convincing. A single creditor could take control in those frequent cases where the other creditors are unaware of their right to vote if only filed proof of claims were permitted to vote. The very reason for a twenty percent requirement is to frustrate the efforts of a single creditor or a small group of creditors who hold less than twenty percent of the claims which will be receiving a dividend to take over the bankruptcy administration. Therefore, the *Michelex* court was correct in rejecting the approach that only those creditors holding a filed proof of claim are entitled to vote and have their claims be determined as part of the universe of claims.

b. Undisputed

The case of *In re San Diego Symphony Orchestra*, is discussed above.¹⁰⁷ Recall that the courts have generally eschewed suggestions that the debtor’s designation on the schedules, the creditors’ proofs of claims, or even objections to proofs of claim as being conclusive. Recall that in determining whether a claim is “undisputed” most courts have declined to conduct a mini-trial, but they do make an inquiry to determine whether the objection is frivolous.

Bankruptcy Rule 2003(b)(3) previously permitted “temporary allowance” of a claim after “notice and hearing.”¹⁰⁸ In 1991 this provision was deleted. But one

¹⁰²*Id.* (quoting WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 58 (1986)).

¹⁰³*Id.* at 1000-1.

¹⁰⁴195 B.R. at 1000.

¹⁰⁵*Id.* at 1000-1.

¹⁰⁶*Id.* at 1001-1004. The 20 percent requirement was promulgated “to ensure that a trustee is elected only in cases in which there is true creditor interest, and to discourage election of a trustee by attorneys for creditors.” *Id.* at 1003, (quoting H.R. REP. NO. 95-595 (1977)), reprinted in 2 Collier on Bankruptcy, Part II, p. 102. See *supra* pp.12-13 for the full text of the House report.

¹⁰⁷See *supra* text accompanying notes 85-87.

¹⁰⁸FED. R. BANKR. PROC. 2003(b)(3) (1983) provides:

Notwithstanding objection to the amount of allowability of a claim for the purpose of voting, the court may, after such notice and hearing as it may direct, temporarily allow it for purpose in an amount that seems proper to the court.

Rule 2003 (b)(3) is based upon prior rule 207(a). That provision provided:

court relied on this rule to permit the creditor to vote.¹⁰⁹ The case had started as a Chapter 11 and had been converted to a Chapter 7. The creditor's claim had been "liquidated" by entry of an order in the Chapter 11. At the time of conversion, the case was on appeal to the circuit court. The court concluded that the claim should be permitted to vote in the amount established by the bankruptcy judge.¹¹⁰ This was true even though the matter was on appeal; the debtor had disputed the amount of the claim in its schedules, and was still disputing the claim on appeal.¹¹¹

The court in *In re Centennial Textiles, Inc.*¹¹² reasoned that the withdrawal from the bankruptcy court of the ability to grant "temporary voting" privileges in 1991 undercut the court's ability to make significant inquiry into the amount or substance of the claim. In *Centennial*, at the time of the section 341 meeting the interim trustee had filed a adversary complaint against the creditor seeking to avoid a preferential transfer. The creditor conceded that it could not vote its total claim but sought to have at least part of it allowed. The court refused to estimate on the claim for voting purposes. Because of the amendment to Rule 2003(b)(3) the court felt that it lacked the authority to temporarily allow disputed claims for voting purposes.¹¹³

We have previously expressed our views concerning the adoption of a rigid system based only upon schedules, proofs of claim, and/or objections to proofs of claim to determining voting privileges under section 702.¹¹⁴ The problem with complete reliance on either the schedules or the proofs of claim is that it gives too much discretion in parties who are clearly interested in deciding who gets to vote. If reliance on the schedules became the norm, the debtor would be tempted to list as disputed claims for which there is no legitimate dispute. If reliance on proofs of claim became the norm, a creditor could file a proof of claim on the very day of the section 341 meeting and control the election even though there may be some legitimate basis for disputing those claims. Objections to proofs of claim can be every bit as frivolous as any other pleading. In order to ensure fair elections, there must be some level of scrutiny by an independent fact-finder. The authorities unanimously agree that a "mini-trial" to determine if a claim is "disputed" would unduly delay the administration of the estate at the initiation of the case. However, the bankruptcy court should undertake some examination to determine whether the claimant is entitled to vote.

Except as hereinafter provided, a creditor is entitled to vote at a meeting if he has filed a proof of claim at or before the meeting, unless objection is made unless the proof of claim is insufficient on its face. Notwithstanding objection to the amount or allowability of a claim for the purpose of voting, the court may temporarily allow it for that purpose in such amount as to the court seems proper.

FED. R. BANKR. PROC. 207(A) (repealed 1983).

¹⁰⁹*In re Cohoes Industrial Terminal*, 90 B.R. 67 (S.D.N.Y. 1988).

¹¹⁰*Id.* at 69.

¹¹¹*Id.* at 69-70.

¹¹²209 B.R. 31, 34 (Bankr. S.D.N.Y. 1997).

¹¹³*Id.* at 33-34.

¹¹⁴*See supra* text accompanying notes 50-61.

c. Fixed

The statute provides that a creditor's claim must be "fixed" for the creditor to vote for the trustee.¹¹⁵ Few cases discuss "fixed" in the context of section 702. *In re Michelex, Ltd.*¹¹⁶ relied upon the Supreme Court's decision in *Farrey v. Sanderfoot*,¹¹⁷ and defined "fixed" as follows:

'Disputed' and 'unliquidated' debts are to be designated on a debtor's schedule. However, claims not 'fixed' are not designated. Rather, Schedule F requires that 'contingent' debts be designated. 'Fixed' means to 'fasten a liability upon. . . . If a debt is not 'fixed' the liability is not yet fastened. "A claim is 'fixed' under § 702(a)(1) so long as it is not a 'contingent claim.'"¹¹⁸ Therefore, those scheduled debts listed as 'contingent' should be deleted as not 'fixed.'¹¹⁹

We have failed to discover one case that defines "fixed" in a meaningful manner other than the language offered by the *Michelex* court. The legislative history offers no guidance. We call for an amendment to the statute below.¹²⁰ Under *Michelex*, a claim is "fixed" if it is not "contingent."¹²¹

d. Liquidated

A "creditor's claim must be liquidated if the creditor wants to vote for the trustee."¹²² Generally, a claim is liquidated if it is capable of precise dollar determination.¹²³

Few courts have struggled with the question of whether a claim which is partially liquidated and partially unliquidated satisfies the statutory criteria. For example, in

¹¹⁵11 U.S.C. § 702(a)(1) (1984).

¹¹⁶195 B.R. 993 (Bankr. W.D. Mich. 1996).

¹¹⁷500 U.S. 291 (1991).

¹¹⁸*Citing In re Klein*, 110 B.R. 862, 871 (Bankr. N.D. Ill. 1990), *rev'd on other grounds*, 119 B.R. 971 (Bankr. N.D. Ill. 1990).

¹¹⁹*Id.* at 1007, n. 32.

¹²⁰*See infra* text accompanying notes 283-300.

¹²¹Creditors filing involuntary petitions must hold claims "not contingent as to liability." 11 U.S.C. § 303(b)(1) (1994). Although the Bankruptcy Code does not define "contingent," cases construing section 303(b)(1) generally conclude that contingent claims are claims where liability depends on the occurrence of some future event. *In re Duty Free Shops Corp.*, 6 B.R. 38, 39 (Bankr. S.D. Fla. 1980) ("A contingent claim is one which may arise upon the occurrence of a future event."); *In re Longhorn 1979-II Drilling Program*, 32 B.R. 923, 926-29 (Bankr. W.D. Okla. 1983).

¹²²11 U.S.C. § 702(a)(1) (1984).

¹²³The court in *In re Centennial Textiles, Inc.*, 209 B.R. 31, 34 (Bankr. S.D.N.Y. 1997) defined the test as follows: "A debt is liquidated within the meaning of section 702 if the amount due and the date on which it was due are fixed or certain, or when they are ascertainable by reference to: (1) an agreement or (2) a simple formula." *Citing In re Potenza*, 75 B.R. 17, 19 (Bankr. D. Nev. 1987); *In re Poage*, 92 B.R. 659, 665 (Bankr. N.D. Tex. 1988).

In re Klein,¹²⁴ the creditor, USF&G, filed a claim in excess of \$30,000,000.00 for liability on a blanket surety bond. There was no dispute that the claim was partially unliquidated because USF&G had a right to bring an action against third parties for part of the \$30,000,000.00 which it had paid on the bond. But the court was also able to identify at least \$10,000,000.00 of the claim for which there was no right of action against a third party and which was liquidated.¹²⁵ The court concluded that USF&G should be permitted to vote the claim to the extent of \$10,000,000.00.¹²⁶ In reaching this holding, the court rejected the reasoning of the creditors favoring the interim trustee that if any portion of the claim was not subject to liquidation then the creditor should be permitted to vote no portion of the claim.¹²⁷ The court reasoned that it would be absurd to exclude a claim where \$29,000,000.00 was liquidated and \$1,000,000.00 was unliquidated. Yet that would be the result of the logic of those creditors opposed to the elected trustee were embraced.¹²⁸

e. Unsecured

Creditors holding an unsecured claim are generally permitted to vote for the trustee. The Bankruptcy Code divides the claim of a creditor holding an undersecured claim into two claims—a secured and an unsecured claim.¹²⁹ A few courts have ruled on the issue of whether the undersecured creditor can vote the unsecured claim.¹³⁰ Where the creditor has been asserting its secured interest in a manner which is detrimental to the best interests of the unsecured creditors, the courts have held that the creditor may not vote the claim.¹³¹

We argued above that undersecured creditors should be permitted to divide their claim as permitted by section 506(a) of the Bankruptcy Code¹³² into a secured claim and unsecured claim.¹³³ While the value of the collateral may not be subject to a precise valuation, the bankruptcy court should be permitted to affix the highest value in the possible range of values for the collateral and permit the creditor to vote the excess. As we noted above, cases can occur where the interest of the undersecured creditor is materially adverse to the interests of the general unsecured creditors. In those cases, the creditor should not be permitted to vote because of its failure to satisfy the “material adversity” requirement.¹³⁴

¹²⁴119 B.R. 971 (Bankr. N.D. Ill. 1990), *appeal dismissed*, 940 F.2d 1075 (7th Cir. 1991).

¹²⁵*Id.*

¹²⁶*Id.*

¹²⁷*Id.* at 981.

¹²⁸*Id.* Where, however, the creditor’s claim is arguably fully secured by cross-guarantees, it seems clear that the claim is not liquidated within the meaning of section 702. *In re Centennial Textiles, Inc.*, 209 B.R. 31, 34-35 (Bankr. S.D.N.Y. 1997).

¹²⁹*In re Barack*, 201 B.R. 978 at 983-4.

¹³⁰*Id.*

¹³¹*In re Frederick Petroleum Corp.*, 92 B.R. 273, 275 (Bankr. S.D. Ohio 1988).

¹³²11 U.S.C. § 506(a) (1978).

¹³³*See supra* text accompanying notes 83-95.

¹³⁴*See infra* text accompanying notes 150-175.

f. Entitled to Distribution

In order to vote a creditor must be “entitled to distribution under sections 726(a)(2), 726(a)(3), 726(a)(4), 752(a), 766(h), or 766(i).”¹³⁵ Section 726(a)(2) requires that claimants must have either filed a proof of claim or fit within the Bankruptcy Code’s exceptions to the proof of claim requirement.¹³⁶ Section 726(a)(3) provides that claimants who have filed tardy claims are entitled to a distribution after section 726(a)(2) claimants.¹³⁷ Section 726(a)(4) permits distributions to creditors who holds claims which are the nature of a penalty.¹³⁸ Noticeably absent are section 726(a)(1) claims (claims for section 507 priority claims)¹³⁹ and section 726(a)(5) claims for interest.¹⁴⁰ Thus, creditors who hold

¹³⁵11 U.S.C. § 702(a)(1) (1984). *See supra* text accompanying note 39 for the complete text of the statute.

¹³⁶(a) Except as provided in section 510 of this title 11 USCS property of the estate shall be distributed—

* * *

(2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is--

- (A) timely filed under section 501(a) of this title;
- (B) timely filed under section 501(b) or 501(c) of this title or; or
- (C) tardily filed under section 501(a) of this title, if--

(i) the creditor that holds such claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and

(ii) proof of such claim is filed in time to permit payment of such claim . . .

11 U.S.C. § 726(a)(2) (1994).

¹³⁷(a) Except as provided in section 510 of this title, property of the estate shall be distributed—

* * *

(3) third, in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title, other than a claim of the kind specified in paragraph

(2)(C) of this subsection

11 U.S.C. § 726(a)(3) (1994).

¹³⁸(a) Except as provided in section 510 of this title, property of the estate shall be distributed--

* * *

(4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim.

11 U.S.C. § 726(a)(4) (1994).

¹³⁹11 U.S.C. § 507(a) (1994).

¹⁴⁰(a) Except as provided in section 510 of this title, property of the estate shall be distributed--

* * *

(5) fifth, in payment of interest at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection.

claims only for administrative expenses and creditors who hold claims only for interest expense are not permitted to vote.

There are two views regarding the correct construction of the “entitled to a distribution” provision. We discussed these cases above in regard to the “allowable” limitation.¹⁴¹ Their analysis also applies to this provision.

In re Lake States Commodities, Inc.,¹⁴² concluded that a creditor was required to file a proof of claim to be a creditor “entitled to distribution.” This conclusion flowed from the language of section 726. The court reasoned that each of 726’s subsections incorporated into section 702 requires the filing of a proof of claim.¹⁴³ More significantly, the section requires that the creditor hold a claim which is “allowable.”¹⁴⁴ A condition precedent for “allowability” is that the creditor file a proof of claim.¹⁴⁵

The court in *In re Michelex Ltd.*,¹⁴⁶ disagreed with this approach. The court noted that on some occasions even untimely claims are entitled to distribution under section 726.¹⁴⁷ Further, section 702(a)(1) contemplates that creditors holding claims which filed after the first meeting are entitled to vote. Thus, filing a proof of claim prior to the first meeting of creditors is not a condition precedent for voting.¹⁴⁸

We urge adoption of the *Michelex* analysis. As that court noted, in rare cases creditors will receive a dividend even if their proofs of claim were untimely.¹⁴⁹ The present statutory scheme calls for an early first meeting of creditors, a prompt selection of a trustee, and a more extended time period for filing proofs of claim. Congress was aware of this schedule when section 702 was enacted. Section 702, by employing the terms “allowable” and “entitled to a distribution,” does suggest that filing a proof of claim is a condition of voting. But other convincing reasons have been offered for use of that language. The word “allowable” likely was chosen to affirm Congressional intent to permit only those claims which were legitimate and not subject to challenge. It is likely that Section 702(a)(1)’s reliance on the distribution scheme set forth in section 726 was based on the desire to permit only general unsecured creditors to select the trustee. Those creditors are the most dependent upon the trustee to maximize any recovery from the estate.

11 U.S.C. § 726(a)(5) (1994).

¹⁴¹See *supra* text accompanying notes 96-106.

¹⁴²173 B.R. 642 (Bankr. N.D. Ill. 1994).

¹⁴³*Id.* at 646.

¹⁴⁴See *supra* discussion at text accompanying notes 96-106.

¹⁴⁵11 U.S.C. § 502(a) (1999) provides:

A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

¹⁴⁶195 B.R. 993, 1001 (Bankr. W.D. Mich. 1996).

¹⁴⁷*Id.* at 999; 11 U.S.C. § 726(a)(2)(C) (1998).

¹⁴⁸*Accord In re Tartan Constr. Co.*, 4 B.R. 655 (Bankr. D. Neb. 1980).

¹⁴⁹195 B.R. at 1001.

2. Subsection (a)(2)

a. Materially Adverse

The creditors must not be adverse to the interests of the unsecured creditors if they want to vote.¹⁵⁰ If they hold a position adverse to the debtor, they may vote.¹⁵¹ In *In re DB Drilling, Inc.*,¹⁵² the case was initially brought as an involuntary petition. Three of the five petitioning creditors voted for a trustee other than the interim trustee.¹⁵³ Objection was made to these votes because those creditors were demonstrably hostile to the debtor.¹⁵⁴ The court rejected the argument that these creditors held materially adverse claims, reasoning that the fact that the creditors' had joined in the involuntary petition "can only be construed as favorable to the two dissenting creditors' interests as unsecured creditors. . . ."¹⁵⁵ While they were clearly adverse to the debtor, their interests were not in any way adverse to the interests of the unsecured creditors.

Where the creditor has received a preference, that creditor holds a materially adverse claim.¹⁵⁶ Therefore, the creditor may not request an election and may not

¹⁵⁰Present section 702(a)(2) provides that a creditor may vote if the creditor "does not have an interest materially adverse, *other than an equity interest that is not substantial in relation to a creditor's interest as a creditor*, to the interest of creditors entitled to such distribution." 11 U.S.C. § 702(a)(2) (1999) (emphasis added). The italicized language was included by the Senate and adopted without change in the compromise bill. S. 2266, 95th Cong. (1978); FED. R. BANKR. PROC. 702(a)(2); Compromise Bill, 124 CONG. REC. H11063 (daily ed. Sept. 28, 1978).

We have not discovered any definitive case law construction of this language. One court reached the obvious conclusion, in dictum, that a shareholder who had "100% control" of the debtor-corporation should not be permitted to vote. *In re Oxborrow*, 104 B.R. 356, 358 (E. D. Wash. 1989), *aff'd on other grounds*, 913 F.2d 751 (9th Cir. 1990). The section offers no "bright-line" tests. Instead, it calls for the court to analyze the creditor's claim and determine whether the size of the claim in relation to the size of the creditor's equity interest. If the claim is predominate the creditor should be entitled to vote; if the equity interest dominates, the "creditor" should not vote. The House Report suggests that the court balance "various factors" in determining material adversity:

It requires a balancing of various factors, such as the nature of the adverse interest, the size of the adverse interest, the degree to which it is adverse, and so on. Thus, a creditor with a very small equity position would not automatically be excluded from voting solely because he holds some equity position in the debtor. H.R. REP. NO. 95-595, at 378 (1977). Balancing of factors will also be necessary to determine whether the creditor holds an insubstantial equity interest.

¹⁵¹*In re Blesi*, 43 B.R. 45, 47 (Bankr. D. Minn. 1984).

¹⁵²73 B.R. 953 (Bankr. N. D. Tex. 1987).

¹⁵³*Id.* at 954.

¹⁵⁴*Id.* at 954-5.

¹⁵⁵*Id.* at 955.

¹⁵⁶*In re Lang Cartage Corp.*, 20 B.R. 534, 536-37 (Bankr. E.D. Wis. 1982).

vote.¹⁵⁷ However, where the claim that the creditor received a preference is based on “mere suspicion,” the creditor will not be disqualified.¹⁵⁸

The claim must be “materially” adverse. Where there is a dispute as to the amount of the claim, the claim is not materially adverse.¹⁵⁹ A creditor may be successful in establishing a high value on its claim; therefore, the other creditors will receive less.¹⁶⁰ This alone does not establish material adversity.¹⁶¹

One court held that where the creditor had received an \$11,000.00 post-petition transfer that the creditor was not disqualified.¹⁶² The creditor held a \$265,000.00 claim and the court was convinced that it was unlikely that the possibility of being forced to disgorge an \$11,000.00 post-petition transfer would influence the creditor’s vote.¹⁶³ The court did, however, reduce the voting amount of the claim by \$11,000.00.¹⁶⁴ An opposite result was reached by another bankruptcy court.¹⁶⁵ In that case the creditor held a claim in excess of \$2,300,000.00 but had allegedly received a \$20,000.00 preference. The court found that only the dollar amount of the preference claim was relevant. The court reasoned that it was “more appropriate to determine the materiality of the adverse interest based solely on the dollar amount (of the preference), without comparison with other claims. . . .”¹⁶⁶

In the case of *In re Klein*,¹⁶⁷ the district court affirmed the reasoning of the bankruptcy judge regarding “material adversity.” The creditor, USF&G seeking to elect a trustee, held a claim against a third party.¹⁶⁸ The bankruptcy estate also held a claim against that same third party. If USF&G had been successful, then the third party’s liability to the bankruptcy estate would have been reduced by the amount of USF&G’s recovery. The court reasoned that USF&G was adverse to the interest of the bankruptcy estate: “Since USF&G has an incentive to recover from the adversary defendants directly rather than receive a diluted share of the adversary defendants’ assets from the estate, USF&G has an interest adverse to the estate.”¹⁶⁹

¹⁵⁷*Id.* at 536.

¹⁵⁸*In re Metro Shippers*, 63 B.R. 593, 599 (Bankr. E.D. Pa. 1986).

¹⁵⁹*In re Cohoes Indus. Terminal, Inc.*, 90 B.R. 67 (S.D.N.Y. 1988).

¹⁶⁰*Id.* at 70.

¹⁶¹*Id.*

¹⁶²*In re Metro Shippers*, 63 B.R. at 600.

¹⁶³This result appears to be consistent with the legislative history. Both the House and Senate Reports conclude that a creditor who also holds “a very small equity position” should not be excluded from voting. H.R. REP. NO. 95-595, at 378-79 (1977); S. REP. NO. 95-989, at 92-93 (1978). See *supra* discussion at note 106.

¹⁶⁴See *In re Metro Shippers*, 63 B.R. at 599-600.

¹⁶⁵*In re NNLC Corp.*, 96 B.R. 7 (Bankr. D. Conn. 1989).

¹⁶⁶*Id.* at 10.

¹⁶⁷119 B.R. 971 (N.D. Ill. 1990), *appeal dismissed*, 940 F.2d 1075 (9th Cir. 1991).

¹⁶⁸*Id.* at 975-76.

¹⁶⁹*Id.* at 976-77.

The court eventually ruled, however, that USF&G should have been entitled to vote.¹⁷⁰ In holding in favor of USF&G, the court provided useful analysis regarding the time at which the adverse interest had to exist. First, the court noted that transactions which had been “completed prior to the election” were not relevant in determining adversity.¹⁷¹ Since USF&G specifically agreed to “forgo” its adverse interest prior to the election, the court concluded that there no longer was any adversity.¹⁷² Finally, the court antedated the date at which the adversity could be removed to the time of hearing before the bankruptcy judge.¹⁷³ The court reasoned that the creditor should be permitted to remove the adversity after the first meeting so as to discourage interim trustees from raising an objection to voting the claim at the first meeting.¹⁷⁴ Discussions regarding the creditor’s right to vote and the creditor’s willingness to forgo any part of the claim so as to remove the adversity should be held prior to the first meeting.¹⁷⁵

The “material adversity” requirement is not capable of precise applicability. Instead, bankruptcy courts are instructed to make a determination of whether the creditor’s vote will be motivated by what would be in the best interest of the unsecured creditors as a group. In most instances, creditors who have received preferences will not vote for a trustee who will aggressively pursue that claim. But where the claim is an insignificant one viewed from the perspective of the creditor, it is unlikely that the potential preference action will influence the choice of a trustee.

Under this view, the size of the potential claim against the creditor should not be compared with the size of the creditor’s claim against the estate. The creditor may hold an unsecured claim which is twenty times greater than the preference action against it. But the existence of the preference action may well be the primary motivating factor in that creditors vote for trustee. The assets of the estate may be sufficient to pay less than five percent of the claims. In that case, it would be to the creditor’s advantage to vote for a trustee who will not aggressively pursue that claim. The creditor would be well-advised to trade his claim against the estate for the preference claim back against the creditor.

For these same reasons, creditors should be permitted to remove the adverse interest up to the time for hearing on the motion to resolve the election dispute. Creditors should be permitted to give an actual demonstration of their true interest by settling the preference action with the interim trustee to remove the adverse interest or by entering into an agreement to forgo pursuit of their own claims. For this reason, we approve of the court’s reasoning in *Klein*.

¹⁷⁰*Id.* at 982.

¹⁷¹119 B.R. at 975.

¹⁷²*Id.* at 977.

¹⁷³*Id.* at 983.

¹⁷⁴*Id.* at 983-4.

¹⁷⁵*Id.* at 984.

3. Subsection (a)(3)– Insiders.

Section 101 of the Bankruptcy Code provides a detailed definition of “insiders.”¹⁷⁶ Insiders may not vote in trustee elections.¹⁷⁷ Generally speaking, insiders are deemed to be so closely connected to the debtor either by legal relationship or by family relationship that their vote would most likely be motivated by what is in the best interest of the debtor rather than what may be in the best interest of the unsecured creditors.

The courts have not always limited themselves to the confines of the statute. This is justifiable in some instances because the statutory definition employs the word “includes,” suggesting that a less than literal construction was intended.¹⁷⁸ Instead, the relationships listed are illustrative and not exclusive. For example, the debtor’s attorney is not on the list, but one court, properly prevented the attorney from voting an attorney’s fees claim.¹⁷⁹

In the *Blesi* case, discussed in the introduction,¹⁸⁰ a single creditor, who was the debtor’s business partner, was permitted to elect the trustee.¹⁸¹ The court acknowledged that the creditor was a partner and therefore an insider, but concluded

¹⁷⁶Insider includes--

(A) if the debtor is an individual--

(i) relative of the debtor or of a general partner of the debtor;
 (ii) partnership in which the debtor is a general partner;
 (iii) general partner of the debtor; or
 (iv) corporation of which the debtor is a director, officer, or person in control;

(B) if the debtor is a corporation--

(i) director of the debtor;
 (ii) officer of the debtor;
 (iii) person in control of the debtor;
 (iv) partnership in which the debtor is a general partner;
 (v) general partner of the debtor; or
 (vi) relative of a general partner director officer or person in control of the

debtor;

(C) if the debtor is a partnership--

(i) general partner in the debtor;
 (ii) relative of a general partner in general partner of or person in control of the
 debtor;
 (iii) partnership in which the debtor is a general partner;
 (iv) general partner of the debtor; or
 (v) person in control of the debtor;

(D) if the debtor is a municipality elected official of the debtor or relative of an elected official of the debtor;

(E) affiliate or insider of an affiliate as if such affiliate were the debtor; and

(F) managing agent of the debtor.

11 U.S.C. § 101(31) (1999).

¹⁷⁷*In re Vermont Real Estate Inv. Trust*, 20 B.R. 33 (Bankr. D. Vt. 1982).

¹⁷⁸*See In re Blesi*, 43 B.R. at 45.

¹⁷⁹*In re Montagna*, 31 B.R. 10 (Bankr. W.D. Pa. 1983).

¹⁸⁰*See supra* text accompanying notes 2 through 15.

¹⁸¹*Blesi*, 43 B.R. at 48.

that the creditor was not an insider for purposes of section 702(a)(3). “[T]he point of the insider definition is to invalidate the voting of a creditor who is so tied to or controlled by the Debtor as to in effect be an alter-ego of the Debtor.”¹⁸²

The argument adopted by the *Blesi* court was rejected by the court in *In re Baton Rouge Marine Repair & Drydock, Inc.*¹⁸³ In that case the creditor was an insider of one of the debtor’s affiliates, thereby making the creditor an insider of the debtor.¹⁸⁴ The creditor argued that there was a history of “bad blood” between the debtor and the creditor.¹⁸⁵ Therefore, the creditor was not “tainted” with bad motives and his interests and those of the debtor “divulged.”¹⁸⁶ In rejecting the argument the court observed:

The definition of “insider” is a mechanical test, with no statutory hint of authority to apply a discretionary exclusion related to complicity between the debtor and the party potentially to be classed as an insider. The Court cannot ignore an explicit statutory test to apply a vague expression of Congressional intent.¹⁸⁷

Cases like *Blesi* and *Baton Rouge Marine* should be viewed differently from a case where court expands the statutory definition to exclude a creditor closely connected to the debtor from voting. As was pointed out above, by employing the word “includes,” Congress supplied a list which is non-exclusive. But in *Blesi* a relationship specifically listed in the statute, partners, was found not be an insider relationship for purposes of section 702(a)(3).

Although it seems clear that the judge in the *Baton Rouge Marine* case would not be willing to accept any distinction, *Blesi* and *Baton Rouge Marine* can be distinguished. In *Blesi*, the insider had gone so far as to take judgment against the debtor.¹⁸⁸ In *Baton Rouge Marine*, there were only unspecified allegations of “bad blood.”¹⁸⁹ If a court were inclined to stray from the literal language of the statute, objective evidence, such as entry of judgment or the initiation of a law suit, should be required. Oral testimony about a history of bad blood can be too easily manufactured.

Even if there is a well-documented history of adversity between the debtor and the insider, the Supreme Court has ruled that the Bankruptcy Code should be construed literally.¹⁹⁰ Only in cases where there is an ambiguity in the language of the statute has that court demonstrated a willingness to attempt to discern Congressional

¹⁸²*Id.* at 47.

¹⁸³57 B.R. 19 (Bankr. M.D. La. 1985).

¹⁸⁴See 11 U.S.C. § 101(31)(E) (1999), providing that “affiliates or insider of an affiliate were the debtor.”

¹⁸⁵*In re Baton Rouge*, 57 B.R. at 22.

¹⁸⁶*Id.*

¹⁸⁷*Id.*

¹⁸⁸43 B.R. at 46.

¹⁸⁹57 B.R. at 22.

¹⁹⁰*United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 240-41 (1989).

intent.¹⁹¹ The policy supporting the insider limitation is to prevent creditors who are alter egos of the debtor, and therefore adverse to the interests of the unsecured creditors, from voting. In a few cases, insiders do not fit this description. But section 702(a)(3) was not drafted to permit exceptions. Therefore, insiders, regardless of their relationship with the debtor, should not be permitted to vote.

IV. ELECTION PROCEDURES.

A. *Rule 2003*

The first meeting of creditors are governed by Bankruptcy Rule 2003.¹⁹² The rule mandates that the first meeting be held “no fewer than 20 and no more than 40 days

¹⁹¹Bank of Am. Nat’l Trust & Savings Ass’n v. 203 N. LaSalle St. Partnership, 119 S. Ct. 1411 (1999).

¹⁹²Rule 2003 provides:

Rule 2003. Meeting of Creditors or Equity Security Holders

(a) Date and place. In a Chapter 7 liquidation or a Chapter 11 reorganization case, the United States trustee shall call a meeting of creditors to be held no fewer than 20 and no more than 40 days after the order for relief. In a Chapter 12 family farmer debt adjustment case, the United States trustee shall call a meeting of creditors to be held no fewer than 20 and no more than 35 days after the order for relief. In a Chapter 13 individual’s debt adjustment case, the United States trustee shall call a meeting of creditors to be held no fewer than 20 and no more than 50 days after the order for relief. If there is an appeal from or a motion to vacate the order for relief, or if there is a motion to dismiss the case, the United States trustee may set a later date for the meeting. The meeting may be held at a regular place for holding court or at any other place designated by the United States trustee within the district convenient for the parties in interest. If the United States trustee designates a place for the meeting which is not regularly staffed by the United States trustee or an assistant who may preside at the meeting, the meeting may be held not more than 60 days after the order for relief.

(b) Order of meeting.

(1) Meeting of creditors. The United States trustee shall preside at the meeting of creditors. The business of the meeting shall include the examination of the debtor under oath and, in a Chapter 7 Liquidation case, may include the election of a trustee or of a creditors’ committee. The presiding officer shall have the authority to administer oaths.

(2) Meeting of equity security holders. If the United States trustee convenes a meeting of equity security holders pursuant to § 341(b) of the Code, the United States trustee shall fix a date for the meeting and shall preside.

(3) Right to vote. In a Chapter 7 Liquidation case, a creditor 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 objection is made to the claim or the proof of claim is insufficient on its face. A creditor of a partnership may file a proof of claim or writing evidencing a right to vote for the trustee for the estate of a general partner notwithstanding that a trustee for the estate of the partnership has previously qualified. In the event of an objection to the amount or allowability of a claim for the purpose of voting, unless the court orders otherwise, the United States trustee shall tabulate the votes for each alternative presented by the dispute and, if resolution of such dispute is necessary to determine the result of the election, the tabulations for each alternative shall be reported to the court.

after the order for relief.”¹⁹³ Where the debtor refused to file schedules and therefore the first meeting of creditors was delayed, an election held beyond the 40 days mandated by Rule 2003(a) will not be invalidated.¹⁹⁴

Trustee elections are governed by subsections (b)(1), (b)(3), and (d) of the rule. Subsection (b)(1) and (b)(3) provides:

(b) Order of meeting.

(1) Meeting of creditors. The United States trustee shall preside at the meeting of creditors. The business of the meeting shall include the examination of the debtor under oath and, in a Chapter 7 liquidation case, may include the election of a trustee or of a creditors’ committee. The presiding officer shall have the authority to administer oaths.

* * *

(3) Right to vote. In a Chapter 7 Liquidation case, a creditor 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 objection is made to the claim or the proof of claim is insufficient on its face. A

(c) Record of meeting. Any examination under oath at the meeting of creditors held pursuant to § 341(a) of the Code shall be recorded verbatim by the United States trustee using electronic sound recording equipment or other means of recording, and such record shall be preserved by the United States trustee and available for public access until two years after the conclusion of the meeting of creditors. Upon request of any entity, the United States trustee shall certify and provide a copy or transcript of such recording at the entity’s expense.

(d) Report to the court. The presiding officer shall transmit to the court the name and address of any person elected trustee or entity elected a member of a creditors’ committee. If an election is disputed, the presiding officer shall promptly inform the court in writing that a dispute exists. Pending disposition by the court of a disputed election for trustee, the interim trustee shall continue in office. If no motion for the resolution of such election dispute is made to the court within 10 days after the date of the creditors’ meeting, the interim trustee shall serve as trustee in the case.

(e) Adjournment. The meeting may be adjourned from time to time by announcement at the meeting of the adjourned date and time without further written notice.

(f) Special meetings. The United States trustee may call a special meeting of creditors on request of a party in interest or on the United States trustee’s own initiative.

(g) Final meeting. If the United States trustee calls a final meeting of creditors in a case in which the net proceeds realized exceed \$1,500, the clerk shall mail a summary of the trustee’s final account to the creditors with a notice of the meeting, together with a statement of the amount of the claims allowed. The trustee shall attend the final meeting and shall, if requested, report on the administration of the estate.

FED. R. BANKR. P. 2003.

¹⁹³*Id.* In cases where the bankruptcy court has entered an order requiring the joint administration of cases, FED. R. BANKR. P. 1015(b), the creditors are nevertheless entitled to elect their own trustee in both cases. FED. R. BANKR. P. 2009(b).

¹⁹⁴*In re Metro Shippers*, 63 B.R. at 599.

creditor of a partnership may file a proof of claim or writing evidencing a right to vote for the trustee for the estate of a general partner notwithstanding that a trustee for the estate of the partnership has previously qualified. In the event of an objection to the amount or allowability of a claim for the purpose of voting, unless the court orders otherwise, the United States trustee shall tabulate the votes for each alternative presented by the dispute and, if resolution of such dispute is necessary to determine the result of the election, the tabulations for each alternative shall be reported to the court.¹⁹⁵

Subsection (b) provides that the United States trustee is to preside over Chapter 7 trustee elections.¹⁹⁶ Creditors who have filed a proof of claim “or a writing setting forth facts evidencing a right to vote” are permitted to vote.¹⁹⁷ Subsection (d) also requires the United States Trustee file a report of the election to the bankruptcy court:

(d) Report to the court. The presiding officer shall transmit to the court the name and address of any person elected trustee or entity elected a member of a creditors’ committee. If an election is disputed, the presiding officer shall promptly inform the court in writing that a dispute exists. Pending disposition by the court of a disputed election for trustee, the interim trustee shall continue in office. If no motion for the resolution of such election dispute is made to the court within 10 days after the date of the creditors’ meeting, the interim trustee shall serve as trustee in the case.¹⁹⁸

Effective December 1, 1999, subsection (d) accords the creditors ten days from the date that the United States trustee issues the report of election to motion to resolve an election dispute.¹⁹⁹ New subsection (d) provides:

(1) Report of undisputed election. In a Chapter 7 case, if the election of a trustee or a member of a creditors’ committee is not disputed, the United States trustee shall promptly file a report of the election, including the name and address of the person or entity elected and a statement that the election is undisputed.

(2) Disputed election. If the election is disputed, the United States trustee shall promptly file a report stating that the election is disputed, informing the court of the nature of the dispute, and listing the name and address of any candidate elected under any alternative presented by the

¹⁹⁵FED. R. BANKR. P. 2003(b)(1), (3).

¹⁹⁶The bankruptcy court does have supervisory authority over section 341 meetings even though the rule expressly gives authority to the United States Trustee. *United States Trustee v. Vance*, 189 B.R. 386, 391 (W.D. Va. 1995) (holding that the bankruptcy judge has the authority to enter an order continuing a section 341 meeting).

¹⁹⁷FED. R. BANKR. P. 2003(b)(3).

¹⁹⁸FED. R. BANKR. P. 2003(d).

¹⁹⁹*Id.*

dispute. No later than the date on which the report is filed, the United States trustee shall mail a copy of the report to any party in interest that has made a request to receive a copy of the report. Pending disposition by the court of a disputed election for trustee, the interim trustee shall continue in office. Unless a motion for the resolution of the dispute is filed no later than 10 days after the United States trustee files a report of a disputed election for trustee, the interim trustee shall serve as trustee in the case.²⁰⁰

The purpose of this change is to afford creditors supporting the elected trustee additional time to file a motion to resolve a disputed election. Cases have occurred where the United States Trustee did not file a report under Rule 2003(d) in sufficient time for the creditors to file their Rule 2003(d) motion.²⁰¹

For purposes of trustee elections, objections to a proof of claim must be made on or before the first meeting of creditors or it is waived. Furthermore, the objection cannot be a general objection, it must be made with sufficient particularity to “justify disallowance of a claim.”²⁰²

Rule 2003(b)(3)’s requirement that the creditors must have filed a proof of claim or other written evidence to establish the bona fides of that claim should be reconsidered. As presently drafted, trustees could be elected who do not enjoy the support of the majority of the creditors eligible to vote.²⁰³ Elections are unusual, with the standing trustee becoming the permanent trustee after the first meeting of creditors.²⁰⁴ The procedure delineated in Rule 2003(b)(3) permits a minority of creditors to “steal” an election. This can be done by keeping their intentions to hold an election secret, filing proofs of claim the day of the section 341 meeting, and objecting to anyone voting who has not filed a proof of claim and who does not have writings which complies with the rule.

B. Voting By Proxy

Bankruptcy Rule 2006 governs the solicitation of proxies, and therefore it covers proxy solicitation for trustee elections.²⁰⁵ A “proxy” is defined as “a written power

²⁰⁰*Id.*

²⁰¹*See infra* text accompanying notes 192-196 for further discussion.

²⁰²*In re Lake States Commodities, Inc.*, 173 B.R. 642, 647 (Bankr. N.D. Ill. 1994), *citing* 4 COLLIER ON BANKRUPTCY, ¶ 702-11 (15th ed. 1994).

²⁰³Recall that twenty percent of the unsecured creditors can call for an election with a majority of those voting electing the trustee. *See supra* text accompanying notes 43-49.

²⁰⁴215 11 U.S.C. § 702(d) (1994).

²⁰⁵Rule 2006 provides:

(a) Applicability. This rule applies only in a liquidation case pending under Chapter 7 of the Code.

(b) Definitions.

(1) Proxy. A proxy is a written power of attorney authorizing any entity to vote the claim or otherwise act as the owner’s attorney in fact in connection with the administration of the estate.

(2) Solicitation of proxy. The solicitation of a proxy is any communication, other than one from an attorney to a regular client who owns a claim or from an attorney

to the owner of a claim who has requested the attorney to represent the owner, by which a creditor is asked, directly or indirectly, to give a proxy after or in contemplation of the filing of a petition by or against the debtor.

(c) Authorized solicitation.

(1) A proxy may be solicited only by: (A) a creditor owning an allowable unsecured claim against the estate on the date of the filing of the petition; (B) a committee elected pursuant to § 705 of the Code; (C) a committee of creditors selected by a majority in number and amount of claims of creditors (i) whose claims are not contingent or unliquidated; (ii) who are not disqualified from voting under § 702(a) of the Code; and (iii) who were present or represented at a meeting of which all creditors having claims of over \$500 or the 100 creditors having the largest claims had at least five days notice in writing and of which meeting written minutes were kept and are available reporting the names of the creditors present or represented and voting and the amounts of their claims; or (D) a bona fide trade or credit association, but such association may solicit only creditors who were its members or subscribers in good standing and had allowable unsecured claims on the date of the filing of the petition.

(2) A proxy may be solicited only in writing.

(d) Solicitation not authorized. This rule does not permit solicitation (1) in any interest other than that of general creditors; (2) by or on behalf of any custodian; (3) by the interim trustee or by or on behalf of any entity not qualified to vote under § 702(a) of the Code; (4) by or on behalf of an attorney at law; or (5) by or on behalf of a transferee of a claim for collection only.

(e) Data required from holders of multiple proxies. At any time before the voting commences at any meeting of creditors pursuant to § 341 of the Code, or at any other time as the court may direct, a holder of two or more proxies shall file and transmit to the United States trustee a verified list of the proxies to be voted and a verified statement of the pertinent facts and circumstances in connection with the execution and delivery of each proxy, including:

(1) a copy of the solicitation;

(2) identification of the solicitor, the forwarder, if the forwarder is neither the solicitor nor the owner of the claim, and the proxyholder, including their connections with the debtor and with each other. If the solicitor, forwarder, or proxyholder is an association, there shall also be included a statement that the creditors whose claims have been solicited and the creditors whose claims are to be voted were members or subscribers in good standing and had allowable unsecured claims on the date of the filing of the petition. If the solicitor, forwarder, or proxyholder is a committee of creditors, the statement shall also set forth the date and place the committee was organized, that the committee was organized in accordance with clause (B) or (C) of paragraph (c)(1) of this rule, the members of the committee, the amounts of their claims, when the claims were acquired, the amounts paid therefor, and the extent to which the claims of the committee members are secured or entitled to priority;

(3) a statement that no consideration has been paid or promised by the proxyholder for the proxy;

(4) a statement as to whether there is any agreement and, if so, the particulars thereof, between the proxyholder and any other entity for the payment of any consideration in connection with voting the proxy, or for the sharing of compensation with any entity, other than a member or regular associate of the proxyholder's law firm, which may be allowed the trustee or any entity for services rendered in the case, or for the employment of any person as attorney, accountant, appraiser, auctioneer, or other employee for the estate;

(5) if the proxy was solicited by an entity other than the proxyholder, or forwarded to the holder by an entity who is neither a solicitor of the proxy nor the owner of

of attorney authorizing any entity to vote the claim or otherwise act as the owner's attorney in fact in connection with the administration of the estate."²⁰⁶ The rule prohibits oral solicitations.²⁰⁷ The reader should note, however, that neither Rule 2006 nor any other provision prohibits a party from encouraging a creditor qualified to vote to attend the first meeting and voting for a particular candidate.

The rules do not prescribe that a particular form be followed in the proxy solicitation letter, and therefore the proxy will not be invalidated as long as the solicitation letter was not materially misleading.²⁰⁸ The proxy also does not have to specifically provide that the proxy holder has the authority to vote for the creditor in a particular trustee election. Where there are multiple consolidated bankruptcies the proxy does not have to list each bankruptcy in order for the proxy holder to vote the claim.²⁰⁹

The rule also places limitations on who may solicit proxies. Rule 2006(c)(1) provides that proxies may be solicited only by: 1) a "creditor owning an allowable unsecured claim;" 2) a creditors' committee section under section 705 of the Bankruptcy Code;²¹⁰ 3) a committee of creditors which meets the section 702 voting

the claim, a statement signed and verified by the solicitor or forwarder that no consideration has been paid or promised for the proxy, and whether there is any agreement, and, if so, the particulars thereof, between the solicitor or forwarder and any other entity for the payment of any consideration in connection with voting the proxy, or for sharing compensation with any entity, other than a member or regular associate of the solicitor's or forwarder's law firm which may be allowed the trustee or any entity for services rendered in the case, or for the employment of any person as attorney, accountant, appraiser, auctioneer, or other employee for the estate;

(6) if the solicitor, forwarder, or proxyholder is a committee, a statement signed and verified by each member as to the amount and source of any consideration paid or to be paid to such member in connection with the case other than by way of dividend on the member's claim.

(f) Enforcement of restrictions on solicitation. On motion of any party in interest or on its own initiative, the court may determine whether there has been a failure to comply with the provisions of this rule or any other impropriety in connection with the solicitation or voting of a proxy. After notice and a hearing the court may reject any proxy for cause, vacate any order entered in consequence of the voting of any proxy which should have been rejected, or take any other appropriate action.

FED. R. BANKR. P. 2006.

²⁰⁶FED. R. BANKR. P. 2006(b)(1).

²⁰⁷FED. R. BANKR. P. 2006(c)(2) states that "[a] proxy *may* be solicited only in writing." (emphasis added.) By using the word "may," the drafters did not implicitly authorize oral solicitations. *In re Eddie Hagggar Ltd., Inc.*, 190 B.R. 281, 285-86 (Bankr. N.D. Tex. 1995). The *Hagggar* court ruled, however, that the rule was not violated when discussions were held about the potential election of a Chapter 7 trustee in a Chapter 11 creditors' committee prior to the conversion to Chapter 7.

²⁰⁸*In re Ben Franklin Retail Stores, Inc.*, 214 B.R. 852, 861 (Bankr. N.D. Ill. 1997).

²⁰⁹*Id.* at 861-62.

²¹⁰11 U.S.C. § 705(a) (1990) provides:

At the meeting under section 341(a) of this title, creditors that may vote for a trustee under section 702(a) of this title may elect a committee of not fewer than three, and

requires; and 4) a “bona fide trade or creditor association” which solicits its own members.²¹¹ Where proxies are solicited by a duly constituted Chapter 11 committee, which did not conform to Rule 2006(c)(1)’s requirements, the rule is violated.²¹²

Rule 2006(c)(2)(d)(4) specifically prevents proxy solicitation by attorneys.²¹³ Of course, there is no prohibition against an attorney advising his own client how to legally solicit proxies.²¹⁴ Moreover, the rule requires that parties voting “two or more proxies” file with the clerk of the court “a verified statement of the pertinent facts and circumstances” surrounding the solicitation.²¹⁵

Generally, a court will not invalidate an election for a single violation of rule 2006. Violations of the rule are likely to be held to be harmless where the objection to voting the proxy comes from the interim trustee as opposed to a competing group of creditors.²¹⁶ The court in *In re Metro Shippers*,²¹⁷ held that an attorney’s violation of the rule should not result in negating the election. The court emphasized that it held considerable discretion in enforcing the rule, that the errors were harmless, and that the court was convinced that the attorney had not acted in bad faith.²¹⁸ Moreover, the court was concerned that the interim trustee did not enjoy the support of a majority of those creditors eligible to vote.²¹⁹ The court in *In re Brent Industries, Inc.*,²²⁰ however, refused to confirm the elected trustee for multiple violations of the rule.

The proxy solicitation rule reflects an overriding concern about attorneys and/or an isolated group of creditors taking over a bankruptcy estate instead of deferring to

not more than 11, creditors, each of whom holds an allowable unsecured claim of a kind entitled to distribution under section 726(a) of this title.

²¹¹FED. R. BANKR. P. 2006(c)(1). See *supra* note 205 for the text of the rule.

²¹²*In re Eddie Haggard Ltd., Inc.*, 190 B.R. at 286.

²¹³*In re GIC Government Securities*, 56 B.R. 105 (Bankr. M.D. Fla. 1985) (attorney was also a creditor, but the letter of solicitation emphasized status as an attorney); *In re Eddie Haggard Ltd., Inc.*, 190 B.R. at 285. The rule’s prohibition is based upon the belief that solicitation by an attorney is unethical, FED. R. BANKR. P. 2006, Advisory Committee’s Note (citing *In re Darland Co.*, 184 F. Supp. 760, 763-64 (S.D. Iowa 1960)), and that it would encourage unwanted attorney control over the election of trustees. FED. R. BANKR. P. 2006(d).

²¹⁴*In re Eddie Haggard Ltd., Inc.*, 190 B.R. at 284.

²¹⁵FED. R. BANKR. P. 2006(e). See *In re Eddie Haggard Ltd., Inc.*, at 286 (holding that failure to file an acknowledged or notarized proxy in violation of FED. R. BANKR. P. 9010(c) required the court to reject the vote. The court, however, ruled that the error had been waived because the violation had not be raised during the election and that the error was harmless because amended proxies in compliance with Rule 9010(c) were subsequently filed.).

²¹⁶*In re Radford Enterprises, Inc.*, 31 B.R. 213 (Bankr. N.D. Ohio 1983) (construing former rule 208 which governed solicitation of proxies).

²¹⁷63 B.R. 593, 599 (Bankr. W.D. Pa. 1986).

²¹⁸*Id.* at 598-99.

²¹⁹We argue below that the Bankruptcy Code should be amended to give the bankruptcy discretion to order a new election. See *infra* text accompanying notes 283-300.

²²⁰96 B.R. 193 (Bankr. N.D. Iowa 1989).

congressional legislative intent like the bankruptcy courts. The Advisory Committee Notes to Rule 2006 stress that the courts are to exercise their discretion in arriving at results consistent with the policy objectives of the Bankruptcy Code and the concomitant rules.²²¹ In doing this, the bankruptcy courts must necessarily make an independent assessment of whether elections dominated by proxy voting accurately reflects the creditors' wishes.

V. REVIEW

There have been a surprising number of cases resolving procedural issues attendant to review of trustee elections. Discussed below is Rule 2003(d)'s requirement that a motion to resolve an election dispute must be filed in ten days of the first meeting. The burden it places on the creditors favoring the elected trustee has spawned significant litigation.²²² While several parties are interested in the outcome of trustee elections, it seems clear that only the creditors who voted either for or against the election winner have standing to contend that the election did not comply with applicable law.²²³ Once the bankruptcy judge enters an order resolving the election dispute, the law is unsettled as to whether an appeal can be taken.²²⁴ The courts are divided as to whether an order resolving an election dispute can be appealed either as a final or even a collateral order.

A. *By the Bankruptcy Judge*

1. Ten Day Requirement

Rule 2003(d) requires the United States Trustee to "promptly" file a report of the disputed election. The rule further provides that an aggrieved party must file a motion to resolve the dispute within ten days.²²⁵ "If no motion for the resolution of such election dispute is made to the court within 10 days after the date of the creditors' meeting, the interim trustee shall serve as trustee in the case."²²⁶ Rule 2003(d) requires parties who have standing and who supported the elected trustee to file a motion within ten days of the "creditors' meeting." Most courts construe the ten day limitation as "jurisdictional" and is not subject to enlargement.²²⁷

Thus, a motion filed within ten days of receipt of the United States Trustee's report has been viewed as untimely and the appeal will be dismissed.²²⁸ The appeal will be dismissed even though the creditor voting for someone other than the interim

²²¹Fed. R. Bankr. P. 2006, Advisory Committee's notes, subdivision (f) ("Courts have been accorded a wide range of discretion in the handling of disputes involving proxies.").

²²²*See infra* text accompanying notes 225-234.

²²³*See infra* text accompanying notes 235-247.

²²⁴*See infra* text accompanying notes 248-282.

²²⁵FED. R. BANKR. P. 2003(d)(2).

²²⁶FED. R. BANKR. P. 2003(d).

²²⁷Rule 9006(b)(2) specifically excludes Rule 2003(d) from the court's ability to enlarge time. FED. R. BANKR. P. 9006(b)(2).

²²⁸FED. R. BANKR. P. 2003(d).

trustee was told by the United States Trustee that he should be able to file his motion within ten days of receipt of the report.²²⁹ As discussed above, Bankruptcy Rule 2003(d) has been amended, effective December 1, 1999, to give parties supporting the elected trustee ten days from the day the United States trustee files the 2003(d) report to file their motion to resolve the disputed election.

A majority of judges of a bankruptcy appellate panel ruled that Rule 2003(d)'s ten day limitation was in violation of the Rules Enabling Act²³⁰ and found the limitation period invalid.²³¹ The court reasoned that an individual who met the statutory criteria was in fact trustee from the moment of the election. By providing that the election could be overturned by failure to file a motion within ten days, the rule constituted "an invalid attempt to invalidate an election under Section 702."²³² The court suggested that the rule be amended to require the bankruptcy court to schedule the matter for hearing upon receiving a notice from the United States Trustee.²³³

In addition, the court found that the rule violated the Rules Enabling Act by "(1) impermissibly shift[ing] the burden to the creditors who voted for the trustee to bring the dispute to the court's attention despite [the] belief that the election was valid . . . and (2) provide[ing] unreasonably short time frame in which to file the motion to resolve an election dispute."²³⁴

Rule 2003(d) does demonstrate a hostility to the election of the trustee which is inconsistent with expressed Congressional philosophy of creditor control of the administration of the estate. An individual may meet the section 702 qualifications but will not be permitted to serve. A technical objection to the election can be raised, and the burden of filing a motion to resolve the election falls upon those creditors who have voted for the trustee. Failure to file the motion within ten days will result in voiding the election. As drafted, the rule demonstrates a hostility to elections which is inconsistent with the policy of creditor control of the estate.

2. Standing

As collateral administrative matters, trustee elections create standing questions. Debtors should not enjoy standing to appeal an order confirming a trustee,²³⁵ nor should creditors who did not participate in the election.²³⁶ There seems to be little

²²⁹*In re* Carla Leather, Inc. 50 B.R. 764, 769-71 (S.D.N.Y. 1985); *Cf. In re* National Sugar Ref. Co., 39 B.R. 578, 581 (Bankr. S.D.N.Y. 1984).

²³⁰28 U.S.C. § 2075 (1998). That section precludes court-enacted rules that "shall not abridge, enlarge or modify any substantive right."

²³¹*In re* American Eagle Mfg., Inc. 231 B.R. 320, 332 (B.A.P. 9th Cir. 1999).

²³²*Id.* at 332.

²³³*Id.* at 331-2.

²³⁴*Id.*

²³⁵*In re* Weston, 18 F.3d 860, 863-64 (4th Cir. 1994) (debtors do not have standing to appeal because they are not "persons aggrieved" by the outcome of the election).

²³⁶*Id.* at 864. A creditor which did not participate in an election is not aggrieved by its results. *But see In re* American Eagle Mfg. Inc., 231 B.R. 320, 328-29 (B.A.P. 9th Cir. 1999).

doubt that creditors voting in the election have standing to challenge the result.²³⁷ Most courts hold that the interim trustee has standing.²³⁸ One court reached this conclusion and reasoned that the interim trustee has an expectation of receiving fees and commissions which would be frustrated by the trustee's removal.²³⁹ This reasoning was rejected by another court which held that a candidate for an election lacked standing. That court argued that until he was elected the candidate and his election confirmed he had no right to commissions.

Surprisingly, most courts hold that the trustee-candidate lacks standing.²⁴⁰ One court did hold that the trustee candidate had a sufficient interest due to an economic interest in potential commissions.²⁴¹ Another court ruled that such an interest was too remote and speculative. The candidate, himself, has "no interest to be affected by the underlying bankruptcy case."²⁴²

Recall that the *Blesi* court ruled that the debtor had standing to object to the election.²⁴³ That court noted that the advisory note to Bankruptcy Rule 2003 stated that the bankruptcy court should resolve election disputes "when an interested party presents the dispute to the court."²⁴⁴ The court reasoned that the debtor should be considered to be an interested party because creditor participation at 341 meetings is typically low and the debtor had the "most information" regarding claim holders.²⁴⁵

Although unexpressed in the cases, there appears to be an underlying concern about the fairness of the election which affects the courts rulings on standing. Where, for example, there has been substantial creditor participation in the election at the first meeting there appears to be little justification for according standing to the

²³⁷*In re Sandhurst Sec., Inc.*, 96 B.R. 451, 454 (Bankr. S.D.N.Y. 1989).

²³⁸*In re Metro Shippers*, 63 B.R. at 593, 598 (Bankr. E.D. Wis. 1982) (suggesting that the expectation that the interim trustee would earn commissions gave the interim trustee standing as a matter of due process). *But see In re GIC Government Sec., Inc.*, 56 B.R. 105, 108 (Bankr. M.D. Fla. 1985).

²³⁹*In re Metro Shippers, Inc.*, 63 B.R. at 598.

²⁴⁰*In re Sandhurst Sec., Inc.*, 96 B.R. 451, 454 (Bankr. S.D.N.Y. 1989), relying upon *In re Grossman*, 225 F. Supp. 1020 (S.D.N.Y. 1915). *See also, In re G.I.C. Gov't Sec., Inc.*, 56 B.R. at 105.

²⁴¹*In re Metro Shippers, Inc.*, 63 B.R. at 593.

²⁴²*In re Sandhurst Sec., Inc.*, 96 B.R. at 454. The *Sandhurst* decision also relied upon the old case of *In re Grossman*, 225 F. Supp. at 1020, (held that a candidate lacked standing.). *Sandhurst* concluded that if Congress intended to overrule *Grossman* it had a duty to makes its "intent specific." 96 B.R. at 455 (quoting *Midlantic Natl. Bank v. New Jersey Dept. of Env'tl Protection*, 474 U.S. 494, 501 (1986), *reh'g denied* 475 U.S. 1090 (1986)). However, in *In re American Eagle Mfg., Inc.*, 231 B.R. at 329, the court distinguished the *Sandhurst* case on the basis that the bankruptcy court had confirmed the election of the elected trustee who was defending his election on appeal. At that point the elected trustee had been confirmed as permanent trustee, had filed suit against an insider of the debtor, and had incurred substantial fees.

²⁴³*In re Blesi*, 43 B.R. at 48.

²⁴⁴FED. R. BANKR. P. 2003 (Advisory Committee Notes).

²⁴⁵43 B.R. at 48.

United States Trustee, the interim trustee, the elected trustee, and especially the debtor. *Blesi's* holding was premised on the court's belief that creditor participation at the first meeting of creditors was typically low.

Where, however, the call for an election comes as a surprise and creditors are seeking to vote claims filed shortly before the first meeting, creditors opposed to the elected trustee may not have even attended the meeting. In those situations, someone should be permitted to appear at the motion to resolve the disputed election and make an argument opposing the election. In our view, both the United States trustee and the interim trustee should have standing in these surprise election cases. But even in surprise elections, we cannot find any justification in the cases for giving the debtor standing. If neither the United States trustee nor the interim trustee choose to contest the election before the bankruptcy court, it is highly doubtful that the debtor's arguments will be anything but self-serving.

Although the candidate-trustee is clearly interested in having his election confirmed, in most instances he would not have standing. Before the election is confirmed the candidate-trustee has no economic interest in the case.²⁴⁶ If the creditors nominating and voting for him choose not to file their motion to resolve the election before the bankruptcy court, the trustee's decision to press ahead with the matter suggests that attorneys or other professionals desire to control the bankruptcy case.²⁴⁷ This, of course, is precisely what Congress wanted to avoid when it enacted section 702.

B. Appeals

1. Standard of Review

Few cases reviewing trustee elections under section 702 provide analysis supporting their standard of review. As in other cases, conclusions of law are reviewed *de novo* and findings of fact are reviewed for clear error.²⁴⁸ Where the issue was whether the motion to resolve an election was timely filed, one court reviewed the matter *de novo*.²⁴⁹ However, another court held the bankruptcy court's calculations as whether section 702(b)'s twenty percent requirement was met would be reviewed on an abuse of discretion standard.²⁵⁰ In most cases, section 702(b) calculations are made based on a written record. In those cases, a *de novo* review is more appropriate.

²⁴⁶In cases where the trustee has been administering the estate and has incurred expense, then the trustee has standing.

²⁴⁷FED. R. BANKR. P. 2003(d).

²⁴⁸*In re Oxborrow*, 104 B.R. 356, 360 (Bank. E.D. Wash. 1989), *aff'd*, 913 F.2d 751 (9th Cir. 1990).

²⁴⁹*In re Conco Bldg. Supplies, Inc.*, 102 B.R. 190, 191 (B.A.P. 9th Cir. 1989).

²⁵⁰*In re Oxborrow*, 913 F.2d 751, 754 (9th Cir. 1990).

2. Appealable Orders

In *In re Martech USA, Inc.*²⁵¹ the debtor filed a Chapter 11 petition, but the case was converted to Chapter 7. Debtor's creditors appeared at the first meeting of creditors and voted for Joseph Pardo as the trustee. The bankruptcy court refused to appoint Pardo because he was a New York resident and did not have an office in Alaska, the place of filing.²⁵² The creditors appealed.²⁵³

The United States Trustee joined those creditors who voted against Pardo in resisting the appeal.²⁵⁴ They argued that appellate jurisdiction did not exist because the order denying Pardo's election and appointing the standing trustee was not final.²⁵⁵ The court held that the order was final, thereby deciding the case on its merits.²⁵⁶ The court reasoned as follows:

Orders that determine and affect substantive rights and have the potential to cause irreparable harm to the losing party are immediately appealable so long as they finally determine the discrete issue to which they are addressed. Chapter 7 trustees play an important role in bankruptcy cases, making numerous decisions which under the mootness doctrine cannot be undone by an appellate court ruling. A trustee's actions on behalf of the estate should be supported with the certainty that the trustee's capacity to so act is valid. Forcing the Appellants to wait to the end of the bankruptcy case to appeal an important decision made at the beginning of the case would cause irreparable harm. The order resolving the election dispute should be considered final since it conclusively determined a discrete issue.²⁵⁷

The court also ruled that even if the order was not final, that it would treat the notice of appeal as a motion for leave to appeal and grant the motion.²⁵⁸

The Seventh Circuit in *In re Klein*,²⁵⁹ took an opposite position. In that case the bankruptcy court refused to confirm the elected trustee, instead entering an order confirming the interim trustee. An appeal was taken to the district court, which reversed, confirming the original election.²⁶⁰ The Seventh Circuit declined to get to the merits of the election, instead ruling that it lacked appellate jurisdiction.

²⁵¹188 B.R. 847 (B.A.P. 9th Cir. 1995), *aff'd mem.*, 90 F.3d 408 (9th Cir. 1996). *See also In re Oxborrow*, 913 F.2d at 751.

²⁵²*Id.* at 849.

²⁵³The court ruled that those creditors who had voted for Pardo had standing to appeal. *Id.* at 850.

²⁵⁴*Id.* at 849.

²⁵⁵*Id.* at 849.

²⁵⁶188 B.R. at 850.

²⁵⁷*Id.* at 849-50 (citations omitted).

²⁵⁸*Id.* at 850.

²⁵⁹940 F.2d 1075 (7th Cir. 1991).

²⁶⁰The district court's opinion is discussed at text accompanying notes 167-175.

First, the court ruled that the order confirming the elected trustee was not “final.”²⁶¹ The order did not resolve any “substantive rights.”²⁶² The trustee election merely resolved “one procedural question along the way.”²⁶³

The court also refused to find jurisdiction by treating the case as a “collateral order.”²⁶⁴ As a collateral order, the issue must meet the following criteria: “The order must conclusively determine the disputed question, resolve an important issue completely separate from the merits of the action, and be effectively unreviewable on appeal from a final judgment.”²⁶⁵ The court noted that the second and third prongs overlapped with the test being whether the appellant would potentially suffer an “irreparable harm” if there was no review.²⁶⁶ In ruling that the collateral order doctrine was not satisfied, the court concluded the Supreme Court’s decision in *Richardson-Merrell Inc. v. Koller*²⁶⁷ controlled.²⁶⁸

The *Koller* court declined to review as a collateral order the ruling of the district court disqualifying an attorney. The Supreme Court acknowledged that a review of the disqualification after the conclusion of the merits of the litigation may create additional litigation expense.²⁶⁹ But this was insufficient to permit an interlocutory appeal.²⁷⁰ The Seventh Circuit had previously permitted an attorney to appeal his court appointment as counsel in a case.²⁷¹ The attorney protested his appointment because he feared that he would receive no reimbursement for his services.²⁷² In *Conticommodity Services, Inc. v. Ragan*,²⁷³ the court ruled that the conclusion of the merits of the suit would make “moot” the argument the attorney wished to advance on appeal.

Unlike the *Ragan* decision, the *Klein* court stressed that the interim trustee’s actions were the subject of “the surveillance of the bankruptcy judge.”²⁷⁴ In addition, the “interim trustee possesses no such interest which is both distinct and needful of immediate review.”²⁷⁵

²⁶¹28 U.S.C. § 158(d) (1999). See also, *In re New York Produce American & Korean Auction Corp.*, No. 89-C8550, 1990 U.S. Dist. LEXIS 11459 (S.D.N.Y. Aug. 31, 1990).

²⁶²940 F.2d at 1077.

²⁶³*Id.*

²⁶⁴*Id.* at 1078. See also *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949).

²⁶⁵940 F.2d at 1078 (*quoting* *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 468 (1978)).

²⁶⁶*Id.*

²⁶⁷472 U.S. 424 (1985)

²⁶⁸940 F.2d at 1077.

²⁶⁹472 U.S. at 430.

²⁷⁰*Id.* at 436.

²⁷¹826 F.2d at 603.

²⁷²*Id.* at 601.

²⁷³*Id.* at 600, 601-02 (7th Cir. 1987).

²⁷⁴*In re Klein*, 940 F.2d at 1078.

²⁷⁵*Id.*

The court's concern about mootness is well-justified in trustee election cases. The trustee elections are statements of preference for a particular individual to control the bankruptcy case. Bankruptcy trustees are accorded significant discretion in administering the case. Thus, the sale of estate assets will not be avoided even if it is established that there were aspects to the sale which were erroneous.²⁷⁶ Most bankruptcy courts accord the trustee considerable discretion regarding decisions to initiate litigation, the valuation of assets, and to settle litigation.²⁷⁷ If an appeal could only be taken from an issue regarding a trustee election at the time the estate is closed, there would be nothing left to be done.

Virtually every decision of significance has been made prior to the entry of the final order closing the bankruptcy case.²⁷⁸ In fact, the case cannot be closed until all of the assets of the estate have either been abandoned or liquidated.²⁷⁹ A reversal of the bankruptcy court's decision either confirming or denying confirmation of the election of a trustee will accomplish nothing.

Therefore, all three prongs of the collateral order test are met. First, the order either confirming or denying the election does "conclusively determine the disputed question."²⁸⁰ Second, the order does "resolve an important issue completely separate from the merits of the action."²⁸¹ Third, if the losing party is required to wait until the estate is closed to appeal, the order is "effectively unreviewable on appeal."²⁸²

VI. RECOMMENDATIONS

After exploring the cases and legislative history, we offer some recommendations for changes to section 702 and the supporting rules and sections. Some of these suggestions are "house-keeping" changes; others call for a fundamental change from present law.

Section 702(b) presently provides that "creditors may elect one person to serve as trustee . . ."²⁸³ We recommend that section 702(b) be amended to provide that a

²⁷⁶Section 363(m) of the Bankruptcy Code provides that a "reversal or modification on appeal" of an order approving the sale of real estate does not affect the "validity of a sale or lease" to parties acting in "good faith." 11 U.S.C. § 363(m) (1999). *See, e.g., In re Edwards*, 962 F.2d 641, 645 (7th Cir. 1992).

²⁷⁷Rule 6009 permits the trustee to commence or defend litigation without court approval. FED. R. BANKR. P. 6009 (1983). The courts have interpreted this rule to give the trustee considerable discretion in litigation matters. *Sandra Cotton, Inc. v. Bank of New York*, 87 B.R. 272, 274 (W.D.N.Y. 1988). The trustee is accorded wide discretion in the administration of estate assets. *In re Siegel*, 204 B.R. 6, 9 (Bankr. W.D.N.Y. 1996).

²⁷⁸Our research has failed to discover one core where the appeal come after the assets of the case were fully administered.

²⁷⁹11 U.S.C. § 350(a) (1984).

²⁸⁰*In re Martech USA, Inc.* 188 B.R. 847, 849-50 (B.A.P. 9th Cir. 1995) *aff'd mem.*, 90 F.3d 408 (9th Cir. 1996).

²⁸¹*Id.*

²⁸²*Id.*

²⁸³11 U.S.C. § 702(b) (1984). *See supra* text accompanying note 39 for the text of the section.

“creditor may elect one person to serve as trustee. . . .” This amendment will resolve the issue of whether a single creditor can satisfy section 702(b)’s twenty percent requirement. Under section 102(7) of the Bankruptcy Code, “the singular includes the plural.”²⁸⁴ Therefore, the proposed amendment will not change present law that more than one creditor can effect an election. While amended section 702(b) will read “creditor,” section 102(7) mandates that this includes “creditors.”

Present section 702(a) requires that the creditor’s claim be “undisputed.” This limitation has created problems because it is unclear whether the dispute has to be bona fide or whether the objection to the claim can be frivolous. We recommend that section 702(a)(1) be amended to provide that the claim cannot be subject to a “bona fide dispute.” The advantage to this proposal is that it prevents the debtor from being able to affect the outcome of the election by making frivolous objections to proofs of claim or by checking the “disputed” box on the bankruptcy schedules. The proposed amendment would have the additional advantage of permitting the courts to rely on that body of case law defining the identical language under section 303(b)(1), which governs involuntary petitions.²⁸⁵ Because the phrase “bona fide dispute” is incapable of precision, bankruptcy judges will be required to conduct summary investigations of the merits of the claim.

Section 702(a)(1) requires that the creditor’s claim be “fixed.” The Bankruptcy Code does not define this term, nor could we discover an independent definition in the cases. The *Michelex* court concluded that a fixed claim was one that was non-contingent.²⁸⁶ Under section 303(b)(1) of the Bankruptcy Code, creditors filing involuntary petitions must hold claims which are “not contingent.”²⁸⁷ Cases construing that section hold that a contingent claim is one where liability depends on the occurrence of some future event.²⁸⁸ We recommend that section 702(a)(1) be amended to substitute “not contingent” for “fixed.” This amendment will enable the courts to rely on that body of case law that has developed under section 303.

Section 702(a) requires that creditors voting for the trustee hold an unsecured claim. Under section 506(a) of the Bankruptcy Code, undersecured creditors hold both a secured and an unsecured claim.²⁸⁹ It would seem to be axiomatic that undersecured creditors should be able to vote their unsecured claim. Some courts have failed to make this distinction and therefore have denied the franchise to the undersecured creditor. We therefore recommend that section 702(a) be amended to specifically provide that the creditor must “hold an . . . unsecured claim (whether under section 506(a) of title 11 or otherwise). . . .” As we note above, in some instances the undersecured creditor should be disqualified because it holds an interest which is “materially adverse” to the interest of the unsecured creditors. The undersecured creditor should not be disqualified, however, merely because it holds a secured claim.

²⁸⁴11 U.S.C. § 102(7) (1978).

²⁸⁵11 U.S.C. § 303(b)(1) (1994).

²⁸⁶*See supra* text accompanying notes 90-92

²⁸⁷11 U.S.C. § 303(b)(1) (1994).

²⁸⁸*See supra* note 121.

²⁸⁹11 U.S.C. § 506(a) (1978).

We recommend that the section 702(a)(3) be deleted. Recall that that provision excludes insiders from voting.²⁹⁰ Those cases which permit insiders to vote where the record reveals that the insider is demonstrably in an adversary position with the debtor correctly discern the policy supporting the present exclusion for insiders. Insiders are excluded because there is a concern that those votes would reflect what is in the best interest of the debtor as opposed to the unsecured creditors. But the Supreme Court has clearly indicated that the Bankruptcy Code is to be construed literally.²⁹¹ Given this directive there is no discretion for the bankruptcy court to permit an insider to vote no matter what the record may reveal with regard to the insider's relationship with the debtor.

By deleting the exclusion for insiders, insiders will be permitted to vote in some cases. In most cases, however, the insider interest's will be materially adverse to the interests of the unsecured creditors. The insider will be disqualified under section 702(a)(2). Insiders presumptively hold materially adverse interests to the unsecured creditors, but they should be permitted to establish that in the particular case they do not hold an adverse interest.

The cases generally assume that the interim trustee will become the permanent trustee if the bankruptcy court refuses to confirm the election of the creditors' candidate. In many instances, making the interim trustee the permanent trustee is the only acceptable result from entry of an order refusing to confirm the election. For example, if the bankruptcy court were to rule that the creditors seeking an election did not meet the twenty percent test mandated by section 702(b), the creditors should not be permitted to seek more votes in a new election. Cases do occur, however, where a new election should be ordered. If the bankruptcy court rules that the candidate cannot be confirmed because the candidate cannot meet the statutory qualifications for trustee,²⁹² the creditors should be given the opportunity to elect another trustee. A new election should also be available if votes were discarded because the proxy rules were violated. Those creditors should not be deprived of the right to vote because a third party violated the proxy solicitation rules.²⁹³

Much of the judicial concern with trustee elections seems to be directed at what we have labeled "surprise elections." The form giving creditors notice of the bankruptcy and the first meeting of creditors, does not inform the creditors that an election may occur.²⁹⁴ Because trustee elections are atypical, amending the form will not cause the creditors to prepare for an election which is unlikely to occur. We recommend that section 702(d) be amended to require creditors who will be seeking an election to file a notice of that intent with the clerk of the bankruptcy court no less than fifteen days prior to the first meeting.²⁹⁵ The clerk should then be required to

²⁹⁰See *supra* text accompanying notes 176-191.

²⁹¹See *e.g.* *Nobleman v. American Savings Bank*, 508 U.S. 324 (1993); *United States v. Ron Pair Enterprises*, 489 U.S. 235 (1989).

²⁹²See *supra* note 35.

²⁹³Where the bankruptcy judge has ordered a new election, interlocutory appeals should not be permitted. See *infra* discussion at text accompanying notes 248-282.

²⁹⁴Form 9, Official Bankruptcy Forms.

²⁹⁵If the notice of the first meeting was not sent in time for the creditors to file the notice, a second meeting to conduct the election should be held.

send this notice to the creditors and other parties in interest. Because the creditors have the right to elect a trustee by statute, the creditors should not bear the expense of serving the notice. In large cases, of more than 250 creditors for example, the notice could be sent to the largest twenty creditors as reflected on the debtor's bankruptcy schedules.

The notice of intent to elect a trustee serves the interests of the creditors, who will have the opportunity to prepare for an election. It serves the interests of the courts because the court can be assured that those creditors who wanted to participate were given a meaningful opportunity to do so. It will frustrate the attempts of the minority of creditors and/or their attorneys to steal the election.²⁹⁶

Finally, we recommend that section 158(a) of the judicial code be amended to permit interlocutory appeals to the district court in trustee election cases.²⁹⁷ Providing a statutory right to appeal has been done in other situations. The section presently permits an interlocutory appeal in cases where the bankruptcy court has entered an order under section 1121(d) of the Bankruptcy Code²⁹⁸ reducing or increasing the time to file a chapter 11 plan. This amendment was overruled in *In re Klein*,²⁹⁹ at least insofar as appeals to the district court are concerned. As we argued above, the result in *Klein* effectively makes trustee election decisions unreviewable.³⁰⁰

VII. CONCLUSION

Congress has permitted unsecured creditors to elect their bankruptcy trustee for over a century. The 1898 act was drafted in such a manner that it presumed that most trustees would be elected, with the court appointing the trustee in the unusual case where there was no election. In reality, most trustees were selected by the court. Although the legislative history does not cite to specific examples, surprise elections by a minority of creditors occurred in enough cases that Congress imposed a twenty percent requirement on those calling for an election.

²⁹⁶In addition, under the notice procedure, only the creditors should have standing to challenge or support the election in further legal proceedings. As was discussed above, *see supra* text accompanying notes 235-247, we believe that in some cases standing was given to the debtor, the interim trustee, and the United States Trustee because of concerns that creditors who were interested in the election did not participate because of lack of notice.

²⁹⁷Section 158(a)(2) provides:

The district courts of the United States shall have jurisdiction to hear appeals

* * *

from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title.

28 U.S.C. § 158(a)(2) (1994).

²⁹⁸Section 1121(d) provides:

On request of a party in interest made within the respective periods specified in subsections (b) and (c) of this section and after notice and hearing, the court may for cause reduce or increase the 120-day period or the 180-day period referred to in this section.

11 U.S.C. § 1121(d) (1978).

²⁹⁹940 F.2d 1075 (7th Cir. 1991).

³⁰⁰*See supra* text accompanying notes 259-266.

By legislating against the abuse by attorneys taking over control of the estate, Congress may have signaled to the courts and the rules drafters a hostility to elections which we do not believe exists or was intended. Perhaps the greatest manifestation of this hostility is Rule 2003(d)'s ten day requirement. Even though the recent amendment has softened its impact, duly elected trustees can be deprived of office because an arguably disinterested party, the interim trustee for example, makes an arguably frivolous, technical objection to the election. The election is now under dispute, and the creditors will have the burden of filing their motion within ten days of the United States Trustee's report.

Also troubling, is the prospect that duly-elected trustees may be mooted out of office if the courts embrace the Seventh Circuit's reasoning in *In re Klein*. If interlocutory appeals cannot be taken, the bankruptcy judge's interpretation of section 702 will be unreviewable.

In suggesting amendments to section 702, the supporting rules, and the statutes providing for appeals, we believe that we have struck the appropriate balance. The suggested changes promote true creditor control of the bankruptcy case, while at the same time discouraging those parties opposed to the election process in general from prevailing on the basis of technicalities.