United States Bankruptcy Court
Northern District of Illinois
Eastern Division

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Appearance of Counsel:

Attorneys for Debtors:
Jeffrey M. Schwartz
Steven P. Blonder
Much Shelist, P.C.
191 North Wacker Drive, Suite 1800
Chicago, Illinois 60606

Attorneys for the District of Columbia:
Kevin H. Morse
Clark Hill PLC
130 East Randolph Street Suite 3900
Chicago, Illinois 60601

Shantel Chapple Knowlton
Edelson PC
350 North LaSalle Street Suite 1400
Chicago, Illinois 60654

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	Case No. 23 B 12544
	)	
VELSICOL CHEMICAL LLC, et al.,	)	Chapter 11
	)	
Debtors.	)	Judge David D. Cleary

ORDER DENYING MOTION OF THE DISTRICT OF COLUMBIA PURSUANT TO 11 U.S.C. § 1183(b)(2) FOR ORDER AUTHORIZING THE TRUSTEE TO INVESTIGATE THE CONDUCT, ASSETS, LIABILITY AND FINANCIAL CONDITION OF THE DEBTORS

This matter comes before the court on the motion of the District of Columbia ("District") pursuant to 11 U.S.C. § 1183(b)(2) for an order ("Trustee Motion") authorizing the subchapter V trustee ("Trustee") to investigate the conduct, assets, liability and financial condition of Velsicol Chemical, LLC ("Velsicol Chemical"), Velsicol Chemical Holdings Corporation ("Velsicol Holdings") and Resnovae Holdings Corporation ("Resnovae") (collectively, "Debtors"). The District presented the Trustee Motion on October 16, 2024. The court offered an opportunity to file written responses or other papers, but no party requested a briefing schedule. The court heard argument at the initial presentation of the Trustee Motion and then took this matter under advisement.

Having heard the arguments of the parties and reviewed the Trustee Motion as well as the history of this bankruptcy case, the court will deny the Trustee Motion.

I. JURISDICTION

The court has subject matter jurisdiction under 28 U.S.C. § 1334(b) and the district court's Internal Operating Procedure 15(a). This is a core proceeding under 28 U.S.C. § 157(b)(2)(A). Venue is proper under 28 U.S.C. § 1409(a).

II. BACKGROUND

Debtors filed for relief under subchapter V of chapter 11 of the Bankruptcy Code on September 21, 2023. Matthew Brash was appointed as the subchapter V trustee the next day.

In December 2023, the District filed a motion pursuant to Fed. R. Bankr. P. 2004 ("2004 Motion") to obtain documents relating to the financial condition of the Debtors and seeking authorization to conduct examinations under oath of each of the Debtors and certain related individuals and entities, including Resnovae's individual shareholders and predecessor owner Arsenal Capital Partners ("Arsenal"). At that time, the District asserted that a prepetition sale, the disposition of the proceeds from that sale, the relationship between Arsenal and the Resnovae shareholders and distributions to those shareholders were all related to the financial condition of the Debtors. The Debtors opposed the 2004 Motion, and the parties submitted memoranda in support of their positions. On February 23, 2024, the court issued a twelve page order granting the 2004 Motion. *In re Velsicol Chem. LLC*, No. 23 B 12544, 2024 WL 765083 (Bankr. N.D. Ill. Feb. 23, 2024).

During the eight months following the entry of that order, the District took the deposition of Timothy Horn as designee of the Debtors. It also reviewed documents provided by the Debtors. The District obtained information during its Rule 2004 examinations regarding the closely held nature of the Debtors as well as the compensation and distributions paid to the Resnovae shareholders during a multi-year period prior to filing these chapter 11 cases. Also during this period, the District met multiple times with the Trustee, the Debtors and other creditors.

III. CONTENTIONS OF THE PARTIES

In the Trustee Motion, the District expressed concern about the level of funding for Debtors' proposed chapter 11 plan, in light of the prepetition transfers from the Debtors to the Resnovae shareholders. As a result, the District argued that the Trustee's investigation of the transfers is relevant to the formulation of a plan. "The creditors must know whether any of these distributions to insiders is [sic] recoverable and available for creditors before voting on a new plan." (Trustee Motion, ¶ 24.) The District asserted that the cause to expand the Trustee's duties is the concern about whether "every single dollar is being included here[.]" At the presentation of the Trustee Motion, the District suggested that an additional reason for the Trustee to investigate is to determine whether it is appropriate to convert Debtors' cases from chapter 11 to chapter 7. In the Trustee Motion, the District also raised concerns about whether Debtors will operate successfully in the post-confirmation period. It alleged that it requested financial information from the Debtors that was not provided.[1]

The District stated that it would provide the materials it obtained through its Rule 2004 examinations to the Trustee and allow the Trustee to use this information in his investigation. The District seeks an order requiring the Trustee to file a statement of the findings of his investigation. If the Trustee determines that any of the transfers are recoverable, the District would look for those causes of action to be included in a chapter 11 plan; if they are not included, the District represented that it would then seek standing for the Trustee to prosecute those claims himself.[2]

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[1] The District did not attach copies of Rule 2004 subpoenas to the Trustee Motion, and it has not filed a motion to compel compliance with any such subpoenas. The parties brought no further disputes regarding the Rule 2004 examinations to the court for resolution.

[2] Whether a subchapter V trustee can pursue causes of action is not before the court.

Debtors oppose the relief requested in the Trustee Motion. First, Debtors contend that the Trustee Motion is a disguised objection to confirmation of the chapter 11 plan. Indeed, at the time the District filed the Trustee Motion, Debtors had not yet filed an amended plan.[3] Debtors acknowledged that any chapter 11 plan must satisfy the "best interests of creditors" test; in other words, that creditors must receive at least as much as they would in a chapter 7 liquidation. Second, they argue that the Trustee Motion is unnecessary. Debtors asserted that they have been transparent about the prepetition transfers to insiders. On top of that transparency, the District conducted an extensive investigation, and now simply wishes to move the cost of completing that investigation from itself to the bankruptcy estate. Third, the Debtors assert that there is no cause to grant the Trustee Motion. Like many subchapter V debtors, these Debtors are closely held and employ most of their shareholders. Debtors also suggested that if the insiders are sued, they are unlikely to continue their employment with the Debtors.

Creditor Chem-Dyne Site Trust ("Chem-Dyne") appeared by counsel and voiced its support for the Trustee Motion, taking the position that there should be additional investigation of the prepetition transfers. Chem-Dyne did not take its own Rule 2004 examinations. The U.S. Trustee appeared at the hearing but took no position.

The Trustee also appeared at the hearing on October 16, although without counsel because he has not requested authority to employ attorneys. The Trustee did not take a position on the Trustee Motion. He acknowledged that he has had numerous "colorful" discussions with the Debtors about an amended plan. His goal is for this case to reach confirmation with a consensual plan.

[3] Pursuant to the court-ordered deadline set on October 16, Debtors filed their amended plan on November 13, 2024 at EOD 184.

IV. DISCUSSION

By this motion, the District asks the court to require the subchapter V trustee to perform the duties of a chapter 11 trustee as set forth in §§ 1106(a)(3) and (4). These are not usually duties of a subchapter V trustee, and apply only "***if*** the court, ***for cause*** and on request of a party in interest … so ***orders***[.]" 11 U.S.C. § 1183(b)(2) (emphasis added).

11 U.S.C. §§ 1106(a)(3) and (4) provide that a trustee shall:

> (3) except to the extent that the court orders otherwise, investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;
>
> (4) as soon as practicable--
>
> > (A) file a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate; and
> >
> > (B) transmit a copy or a summary of any such statement to any creditors' committee or equity security holders' committee, to any indenture trustee, and to such other entity as the court designates[.]

The District did not cite any case law in support of the Trustee Motion. The plain language of § 1183 without question permits expansion of duties but only after a finding of cause ***and*** if the court orders such expansion in its discretion.

In order to prevail on the Trustee Motion and obtain a court order expanding the Trustee's duties, the District must first prove that "cause" exists to do so.

> The Bankruptcy Code does not specify what constitutes "cause" for the Court to expand a Subchapter V Trustee's duties under section 1183(b)(2)…. The Court located one decision in which a bankruptcy court expanded a Subchapter V Trustee's duties under section 1183(b)(2) where there existed "the potential issue of intercompany claims." "Cause" to expand a Subchapter V Trustee's duties is also likely to exist where there are "significant questions such as the debtor's true financial condition, what property is property of the estate, the debtor's

> management of the estate as debtor in possession, and the accuracy and completeness of the debtor's disclosures and reports."

In re Corinthian Commc'ns, Inc., 642 B.R. 224, 233 (Bankr. S.D.N.Y. 2022) (citations omitted).

In this case, there have been no allegations of potential intercompany claims. Nor are there significant questions before the court regarding the true financial condition of the Debtors, their management of the estate as debtors-in-possession, or the accuracy of their disclosures. To the extent that the District wishes to raise these questions it does not explain why, after obtaining authority to conduct Rule 2004 examinations and requesting documents pursuant to that authority, it seeks to drop out of the process and hand over responsibility to the subchapter V trustee.

In the 2004 Motion, the District argued that the examinations and additional documents it sought "may lead to potential assets and/or causes of action for the benefit of creditors." (2004 Motion, ¶ 20.) And, in its order granting the 2004 Motion, the court wrote:

> So long as the discovery requested under Rule 2004 relates to "the acts, conduct, or property[,] ... the liabilities and financial condition of the debtor, ... any matter which may affect the administration of the debtor's estate, or ... any other matter relevant to the case or to the formulation of a plan" it is proper.

Velsicol Chem., 2024 WL 765083, at *5. And, adding that following the examinations, "the District can then decide whether those documents support a claim for relief." *Id.*

But, when asked at the October 16 hearing whether the District had concluded anything following its Rule 2004 examinations, or whether it had demanded that the Debtors file avoidance actions, the District replied only that it had tried to discuss this with the Debtors but had not received any of the financial information it sought. There have been no motions to compel compliance with outstanding requests for production of documents. *Supra*, n.1. Moreover, at the hearing on this motion, the Trustee raised no issues with the Debtors' conduct

during these bankruptcy cases. This is not a case with a "continued lack of disclosure to the Subchapter V Trustee[.]" *Corinthian*, 642 B.R. at 234.

At its presentation of the Trustee Motion, the District argued that the Code contemplates the automatic appointment of an examiner in a chapter 11 case. It is true that the Code provides for appointment of an examiner without the need to demonstrate cause – *but not in a subchapter V case*. *Compare* 11 U.S.C. § 1104(c) (appointment of an examiner if "such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or the debtor's fixed, liquidated, unsecured debts … exceed $5,000,000") *with* 11 U.S.C. § 1181(a) (§ 1104 does not apply in a subchapter V case). The Code does not provide for an examiner in a subchapter V case. The expansion of a subchapter V trustee's duties is permitted only (1) if cause exists and (2) then the court orders the expansion. It is entirely within the discretion of the court. This standard cannot be compared to the lower standard in § 1104(c) for appointment of an examiner, which is not applicable in subchapter V. The difference in the standards is intentional and reflected by the functional difference between a subchapter V case and a regular chapter 11 case.

The duties of a subchapter V trustee are found in certain legislatively selected subsections of 11 U.S.C. § 704. Although a subchapter V trustee is appointed in a chapter 11 case, he or she is not a "chapter 11 trustee" as that term has been traditionally understood under 11 U.S.C. § 1104. Instead, the subchapter V trustee "*assist[s]* the debtor in possession, *provide[s] oversight*, and … *help[s]* facilitate negotiation of a consensual plan of reorganization. The Subchapter V trustee appears at status conferences and provides the Court with valuable information on the progress of the case…. Bankruptcy courts rely on the Subchapter V trustee to provide candid advice concerning a debtor's efforts to comply with its duties under the Code." *In re New York*

Hand & Physical Therapy PLLC., No. 21-35911, 2023 WL 2962204, at *1 (Bankr. S.D.N.Y. Apr. 14, 2023) (citations omitted) (emphasis added). The Trustee has done so here, and neither his "valuable information" nor his "candid advice" suggest a basis for finding that cause exists.

Moreover, the Trustee in this case is not represented by counsel. Expanding his duties would place an additional burden on the process here and undermine the very purpose of subchapter V, which is "to provide a more cost-effective and streamlined option for small businesses to reorganize[.]" *Gregory Funding v. Ventura*, 638 B.R. 499, 502 (E.D.N.Y. 2022). Subchapter V trustees bill the bankruptcy estate for their time, and if this motion were granted the effect would be to transform the cost of the District's investigation into an administrative expense.

In fact, while the District indicated a willingness to turn over any documents it received from its Rule 2004 examinations, there is no assurance that those materials will satisfy the requirement of § 1106(a)(3) that the Trustee conduct an investigation. The Trustee would have to determine for himself whether those documents are sufficient to comply with the duty to investigate, or whether additional information must be sought, or indeed whether he must start over from the beginning.

Here, creditors were authorized to conduct their 2004 examinations on February 23, 2024 – nearly nine months ago. True, the Code provides statutory authority to expand the subchapter V trustee's duties to investigate and report on certain topics in justified circumstances. But, in this case, there is no cause and the discretionary expansion is not justified.

The Trustee represented to the court that he has been actively involved in negotiating an amended chapter 11 plan, and diligently working toward consensus. Debtors timely filed an amended chapter 11 plan, as the court ordered them to do. Subchapter V cases are meant to

proceed more efficiently and cost-effectively than larger chapter 11 cases, and the court will not slow down the progress of these Debtors toward confirmation by saddling the Trustee with the responsibility and cost to conduct an investigation of "the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan[.]" The court permitted the District and other creditors to conduct significant investigations pursuant to Fed. R. Bankr. P. 2004. The District, of course, may take whatever action it determines is warranted by existing law and by factual contentions that have evidentiary support.

V. CONCLUSION

The Trustee has been fulfilling his duties under the Code and has no complaints about the Debtors doing so as the parties continue to work towards the formulation of a plan. Because of this, and for all of the reasons stated above, the court finds that the District has not shown that cause exists to order the Trustee to perform the duties of a chapter 11 trustee as set forth in §§ 1106(a)(3) and (4). Therefore, **IT IS ORDERED THAT** the Trustee Motion is **DENIED**.

ENTERED:

Date: November 22, 2024

DAVID D. CLEARY
United States Bankruptcy Judge