

Best Practices: Use of Examiners in Non-Individual Chapter 11 Cases

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I. Management of a Chapter 11 Debtor and Appointment of a Trustee

The general rule in chapter 11 proceedings, unlike chapters 7 and 13, is that there is no trustee appointed and instead, the debtor remains “in possession” of its business and operations. However, there are instances when it is appropriate to appoint a trustee to displace management and take over operations, or, in a less drastic form of relief, appoint an examiner to assess the debtor’s operations and/or address particular concerns.

Accordingly, section 1104(a) provides that at any time after commencement of the case but before confirmation of a plan, on request of any party in interest or the United States Trustee and after notice and hearing, the Court *shall* order the appointment of a trustee under certain circumstances. This section sets forth that a trustee shall be appointed for cause, including fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor. 11 U.S.C. § 1104(a)(1). It also provides for appointment of a trustee where doing so is “in the interests of creditors, any equity security holders, and other interests of the estate.” 11 U.S.C. § 1104(a)(2).

Further, section 1104(e) provides that the United States Trustee *shall* move for the appointment of a trustee under section 1104(a) if there are reasonable grounds to suspect that the debtor’s management or any one of its officers participate in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor’s public financial reporting. Some of the interesting questions raised by this provision are the meaning of “reasonable grounds,” and who will enforce it.

Appointment of a chapter 11 trustee is a drastic measure, because it completely removes the management of the debtor. A chapter 11 trustee's duties are set forth in section 1106(a), which provides:

A trustee shall—

- (1) perform the duties of the trustee, as specified in paragraphs (2), (5), (7), (8), (9), (10), (11), and (12) of section 704 (a);
- (2) if the debtor has not done so, file the list, schedule, and statement required under section 521 (a)(1) of this title;
- (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;
- (5) as soon as practicable, file a plan under section 1121 of this title, file a report of why the trustee will not file a plan, or recommend conversion of the case to a case under chapter 7, 12, or 13 of this title or dismissal of the case;
- (6) for any year for which the debtor has not filed a tax return required by law, furnish, without personal liability, such information as may be required by the governmental unit with which such tax return was to be filed, in light of the condition of the debtor's books and records and the availability of such information;
- (7) after confirmation of a plan, file such reports as are necessary or as the court orders; and
- (8) if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (c).

Thus, a chapter 11 trustee completely replaces the prior management of a chapter 11 debtor. Given that chapter 11 trustees are eligible for percentage compensation under 11 U.S.C. § 326, appointment of a chapter 11 trustee can also be expensive, depending on the terms of the appointment and the debtor's operations.

II Examiners as an Alternative

Appointment of an examiner to investigate the affairs of the debtor can be a less drastic and less expensive alternative to the appointment of a trustee. Section 1104(c) provides that if the Court does not order the appointment of a trustee, then any time before confirmation, on request of a party or the U.S. Trustee, after notice and hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including any allegation of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the debtor's affairs, if (1) such appointment is in the interests of creditors and the estate, or (2) the debtor's unsecured debts, other than for goods, services or taxes, exceed \$5.0 million. Although the language of the section is mandatory, most courts have found that the court retains discretion to direct the nature, extent and duration of the examiner's investigation. *See, e.g., In re Revco D.S., Inc.*, 898 F.2d 498 (6th Cir. 1990); *In re Bradlees Stores*, 209 B.R. 36 (Bankr S.D.N.Y. 1997).

Like trustees, an examiner needs to be a disinterested person. 11 U.S.C. § 1104(d). The duties of an examiner are set forth in section 1106(b):

(b) An examiner appointed under section 1104 (d) of this title shall perform the duties specified in paragraphs (3) and (4) of subsection (a) of this section, and, except to the extent that the court orders otherwise, any other duties of the trustee that the court orders the debtor in possession not to perform.

The Code does not contain other requirements for who may be an examiner, therefore, the best person is determined on a case-by-case basis, which makes sense given that the specific duties of an examiner can vary from case to case.

Examiners are typically paid on an hourly basis by the bankruptcy estate, and need to file fee applications, like other professionals, pursuant to 11 U.S.C. § 330. In appropriate cases, examiners may also retain professionals, who would similarly be paid by the bankruptcy estate.

I was appointed as an examiner in a case, and I think it is a good example of how an examiner can address concerns without being overly disruptive of the case. In the chapter 11 case of *In re Triple Diamond Plastics*, case number 09-35938 pending in the Northern District of Ohio, Western Division, Bankruptcy Judge Mary Ann Whipple addressed the secured creditor's motion for the appointment of a trustee by entering an order for the appointment of an examiner instead. *See* docket no. 239, 240. That order directed the U.S. Trustee's office to file a motion for the appointment, which they did, and the Court approved my appointment. *See* docket no. 256, 269. Following an FBI background check, I was able to investigate the issues directed by Judge Whipple, and then I filed a report of my investigation. *See*, docket 321. After my report was completed, I filed a motion to be discharged in order to ensure that I had done what the Court requested, as well as a fee application, both of which were granted. *See* docket no. 335 (motion for discharge). In that case, I was appointed at a time when the debtor had been successfully operating in the case for a period of time, and plan confirmation proceedings had already begun. I believe that I was able to address the issues of concern raised by the creditor, and then the debtor was able to confirm its plan.

If you need additional information about examiners and more sample forms, I recommend the American Bankruptcy Institute publication “*The Bankruptcy Court’s Watchdog: The Appointment, Role and Power of Examiners Today*” by John C. (Kit) Weitnauer.