

The court incorporates by reference in this paragraph and adopts as the findings and orders of this court the document set forth below. This document has been entered electronically in the record of the United States Bankruptcy Court for the Northern District of Ohio.



Dated: December 14 2007

Mary Ann Whipple
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
WESTERN DIVISION

In Re:)	SIPA Liquidation Proceeding
)	
Continental Capital Investment Services,)	Adv. Pro. No. 03-3370
Inc. and Continental Capital Securities,)	
Inc.,)	JUDGE MARY ANN WHIPPLE
)	
Debtor.)	
)	
Securities Investor Protection)	
Corporation,)	
)	
Plaintiff,)	
v.)	
)	
Continental Capital Investment Services,)	
Inc. and Continental Capital Securities,)	
Inc.,)	
)	
Defendants.)	

ORDER RE: 2004 EXAMINATION OF SUSAN ELLO

Thomas S. Zaremba is the Trustee for the liquidation of Continental Capital Investment Services, Inc. and Continental Capital Securities, Inc. under the Securities Investor Protection Act of 1970, 15 U.S.C. § 77aaa *et seq.* (“SIPA”). The Trustee filed a motion seeking a court order directing Susan M. Ello to appear for questioning and to produce documents. The subject matter of

the requested examination is the purchase and source of funds used to purchase two pieces of real estate, one located in Toledo, Ohio and one located in Perrysburg, Ohio. Ello and Merle Pheasant object to the motion. Pheasant is the defendant in a separate pending adversary proceeding filed against him by the Trustee, Adv. Pro. No. 05- 3322,¹ and is also a creditor in this SIPA liquidation proceeding. The court held a hearing on the Trustee's contested motion on December 11, 2007. For the reasons stated by the court at the hearing and set forth below, the court will grant the motion and allow the Trustee's requested examination of Ello to proceed.

The Trustee wants to question Ello to find out whether Pheasant's assets and/or by extension assets traceable to the Debtors were used to acquire the real estate, apparently having been so informed by tipsters not identified to the court. Pheasant objects on the grounds that the requested examination amounts to premature and inappropriate proceedings in aid of execution that could not otherwise be conducted in the adversary proceeding. He argues that no judgment has been entered against him and further that he believes that the Trustee's claims in the adversary proceeding are baseless. Under these circumstances, Pheasant asserts that the requested examination amounts to harassment of him and a waste of the resources of the estate. Ello objects on the grounds that she is an innocent third party who had and has nothing to do with the Debtors, as a result of which as to her the requested examination amounts to an unfair and costly intrusion into her personal business.

The Trustee brings his motion under Rule 2004 of the Federal Rules of Bankruptcy Procedure.² An examination under Rule 2004 by a party in interest "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...." The issue here is whether the Trustee's requested examination of Ello about the real estate relates to property of the Debtors or is otherwise a matter which may affect the administration of the debtor's estate.

The broad scope of examination allowed under Rule 2004, and in marked contrast to the scope of discovery in adversary proceedings under Bankruptcy Rule 7026, incorporating Rule 26 of the Federal Rules of Civil Procedure, is sometimes likened by courts to a permissible "fishing

¹The adversary proceeding was commenced in this court and then transferred to the United States District Court for the Northern District of Ohio because Pheasant demanded a jury trial and all parties did not consent to this court conducting the jury trial. The District Court transferred the adversary proceeding back to this court after striking the jury demand because Pheasant had filed a claim in the liquidation proceeding.

²The Rules of Bankruptcy Procedure generally apply in SIPA liquidation proceedings. *See* SIPA §§ 78fff(b); 78fff-1(a), (b).

expedition.” *See, e.g., Bank One, Columbus, N.A. v. Hammond (In re Hammond)*, 140 B.R. 197, 201 (S.D. Ohio 1992). Rule 2004 may be used to search for assets that have been intentionally or unintentionally concealed. *See In re Bennett Funding Group, Inc.*, 203 B.R. 24, 28 (Bankr. N.D.N.Y. 1996). Indeed the fundamental purpose of a Rule 2004 examination is to determine the condition, extent, and location of the debtor’s estate in order to maximize distribution to unsecured creditors. *Longo v. McLaren (In re McLaren)*, 158 B.R. 655, 657 (N.D. Ohio 1992).

Broad though it may be, the scope of examination under Rule 2004 is not without limits. The Trustee’s motion tests those limits. In particular, where an adversary proceeding has been separately initiated, “courts are wary of attempts to utilize Rule 2004 to avoid the restrictions of the Fed. R. Civ. P. in the context of adversary proceedings.” *Bennett Funding*, 203 B.R. at 28. The general rule is that once an adversary proceeding or a contested matter under Bankruptcy Rule 9014 has commenced, discovery occurs under Fed. R. Bankr. P. 7026, *et seq.*, incorporating the discovery rules of the Federal Rules of Civil Procedure, rather than through a Rule 2004 examination. *Intercontinental Enters., Inc. v. Keller (In re Blinder, Robinson & Co., Inc.)*, 127 Bankr. 267, 274 (D. Colo. 1991). But courts have made several distinctions in the application of that rule. One distinction is that discovery that could not be pursued under Rule 26 or otherwise in the adversary proceeding will not automatically be precluded under Rule 2004 if the examination is otherwise within the broad scope thereof. *See In re Int’l Fibercom, Inc.*, 283 B.R. 290 (Bankr. D. Az. 2002). Another distinction is where persons are not parties to or involved in the adversary proceeding. *In re Buick*, 174 B.R. 299, 305 (Bankr. D. Colo. 1994); *see Blinder, Robinson*, 127 B.R. at 275. And yet another distinction is where there are possible frauds. *See In re Sun Med. Mgmt., Inc.*, 104 B.R. 522, 524 (Bankr. M.D. Ga. 1989).

The court finds that the Trustee’s request implicates in some measure each of these distinctions. The Trustee’s second amended complaint against Pheasant, filed on November 27, 2007, alleges claims for: turnover of property of the Debtors’ estates; for avoidance and recovery of alleged preferential transfers under 11 U.S.C. § 547; for avoidance and recovery of alleged actually and constructively fraudulent transfers under 11 U.S.C. § 548, state law and state law incorporated through 11 U.S.C. § 544; for common law fraud; and for violations of the Ohio Securities Act. There is no suggestion in the second amended complaint or in Pheasant’s answer filed on December 7, 2007, or otherwise that Ello is a witness or has any information about the Trustee’s claims and Pheasant’s defenses. Ello is not a party to the adversary. The Trustee also readily acknowledges that

Ello could not be subject to discovery or examination in the adversary proceeding. Since the Trustee's requested examination admittedly cannot be pursued in the adversary proceeding and Ello is not involved therein, two of the distinctions under which other courts have allowed Rule 2004 examinations to proceed exist in this case. *Cf. Bennett Funding*, 203 B.R. at 30 (court declines to permit rule 2004 examination of a party to adversary proceeding regarding alleged receipt of fraudulent transfers). And while there is no accusation that Ello has committed fraud, there are allegations of fraud in the second amended complaint against Pheasant and the examination of Ello is intended in part to determine whether there is any claim that she is in turn the recipient of a fraudulent transfer from him and any remedies that may flow therefrom to protect the interests of the estate. Thus, the third distinction found by courts from the general "pending proceeding" rule is also implicated under the circumstances presented.

The Trustee acknowledges that if Pheasant transferred assets to Ello without consideration there are only two potential actions that could be pursued against her. The first is if the Trustee has a claim against Ello to avoid transfers made to her of Pheasant's property. The second is if the Trustee has a claim against Ello to recover from her under 11 U.S.C. § 550(a)(2) any avoided transfers of property of the Debtors as an immediate or mediate transferee of their property from Pheasant. *See Suhar v. Burns (In re Burns)*, 322 F.3d 421, 427-29 (6th Cir. 2003); *Taunt v. Hurtado (In re Hurtado)*, 342 F.3d 528, 532 (6th Cir. 2003) (avoidance of transfers and recovery under § 550(a) are independent remedies). The Trustee emphasizes that he does not know if either, both or neither of these circumstances is present, but that he should be permitted to investigate because the first circumstance could, at a minimum, have an affect on administration of the estate and the second would additionally involve recovery of property of the Debtors. The court agrees. Both reasons for inquiry bring the requested examination of Ello within the scope of Rule 2004.

Ello and Pheasant also vigorously question why the Trustee ought to be allowed to do this now. After all, as the Trustee acknowledges, he can actually recover assets from Ello under either circumstance discussed above only if he ultimately prevails in the adversary proceeding against Pheasant. Pheasant argues that the Trustee is not only a long way from prevailing, he will never prevail. But if he does, as to any transfer of Debtor's assets, the Trustee has until one year after avoidance of a transfer to recover it from a transferee. 11 U.S.C. § 550(f). As to any fraudulent transfer of Pheasant's assets, however, the timing issue is more acute from the estate's perspective because it is generally backward looking and not forward looking. The basic reach back period on

avoiding transfers under the Ohio Uniform Fraudulent Transfer Act law is four years, but it may be as small as one year depending on the claim. *See* Ohio Rev. Code Ann. § 1336.09 (2007). The problem is that the Trustee does not know when, if at all, any transfers of Pheasant's property to Ello occurred and thus when the reach back period may expire. The liquidation proceeding commenced in 2003. This adversary has now been pending for more than two years. As a fiduciary who has received information of unverified veracity that asset transfers have occurred, the unknown timing issue is a compelling reason to investigate sooner rather than later so as to ascertain whether there are any independent remedies available to protect any interest of the estate and when they must be asserted. As to the merits of the claims against Pheasant, it cannot be said before discovery has been completed that the claims are baseless. The benefit of any doubt in that regard must necessarily tip in favor of the Trustee in this case, who has a statutory duty broader than a chapter 7 bankruptcy trustee's to "as soon as practicable, investigate the acts conduct, property, liabilities, and financial condition of the debtor, the operation of its business, and any other matter, to the extent relevant to the liquidation proceeding..." SIPA § 78fff-1(d)(1).

While the court will permit the Rule 2004 examination of Ello to proceed, it is mindful of Ello's position and expects the Trustee likewise to be mindful that the inquiry must be carefully tailored to the matters addressed in the motion so as not to be unnecessarily costly or unreasonably intrusive. *In re Wilcher*, 56 B.R. 428, 434 (Bankr. N.D. Ill. 1985)("Rule 2004 may not be used as a device to launch into a wholesale investigation of a non-debtor's private business affairs.").

IT IS THEREFORE ORDERED that the Trustee's Motion for Rule 2004(a) Examination [Doc. #901] is GRANTED; and

IT IS FURTHER ORDERED that it shall be conducted at a reasonably mutually convenient time to be developed by the parties and counsel.