



Commercial Fraud Task Force Committee

ABI Committee News

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Shine the Light: The Use of Examiners to

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The Appointment of an Examiner

Given the highly charged atmosphere in today's financial world and the perceived corporate fraud epidemic, there is every reason to believe that the use of examiners in chapter 11 cases will continue to increase. Practitioners will need to be knowledgeable regarding the scope, parameters and limits of an examiner.

11 U.S.C. §1104(c)(1) provides for the appointment of an examiner as a "lesser included remedy" short of the appointment of a chapter 11 trustee. Section 1104 provides for the appointment of the examiner "for cause" when the moving party has made a showing that such appointment is in the interests of creditors, equity security-holders and the estate. Section 1104(c)(2), however, makes appointment of a trustee mandatory, upon motion by a party in interest, if "the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services or taxes, or owing to an insider, exceed \$5,000,000."

The appointment of an examiner is somewhat analogous to the appointment of an equity receiver in that the order of appointment, and not a statute, will have the greatest effect in defining the examiner's role. See *In re Revco D.S. Inc.*, 898 F.2d 498 (6th Cir. 1990). In *Revco*, the Office of the U.S. Trustee moved for an examiner to investigate a leveraged buyout of the debtor, which had preceded the bankruptcy filing. All parties in interest vigorously opposed such appointment, citing factors including cost and delay. The Sixth Circuit reversed the decisions of the bankruptcy court and the district court, both of which had denied the appointment. The court

noted the nondiscretionary aspects of the §1104(c) and found that since the \$5 million qualifying debt threshold was met, the bankruptcy court lacked the discretion to deny appointment of an examiner. Addressing the parties' concerns regarding delay and cost, the Sixth Circuit stated (emphasis supplied):

[T]he bankruptcy court retains broad discretion to direct the examiner's investigation, including its nature, extent, and duration. Section 1104(b) plainly states that the court shall appoint an examiner "to conduct such an investigation of the debtor as is appropriate."

The Scope of the Examiner's Duties and Authority

In general, the investigatory scope of an examiner's authority, without any special limitation by the appointing court, is construed broadly. In *In re FiberMark Inc.*, 339 B.R. 321 (Bankr. D. Vt. 2006), the bankruptcy court described the broad parameters of an examiner's role as follows (emphasis supplied):

The Bankruptcy Code provides bankruptcy courts with the power to appoint an independent examiner for the purpose of investigating matters related to the debtor's estate, "including an investigation of any allegations of fraud, dishonesty, or gross mismanagement ..." 11 U.S.C. §1104(c). An examiner's investigation is conducted under Fed. R. Civ. P. 2004 and is broader than the scope of civil discovery. *The investigation of an examiner in bankruptcy, unlike civil discovery under Rule 26(c), is supposed to be a "fishing expedition," as exploratory and groping as appears proper to the examiner.*

The scope of an examiner's authority can, however, vary widely, depending on the contents of the order of the appointing court. The Code provides substantial "running room" for the court to custom-tailor the examiner's authority, and to either expand or contract it. The bankruptcy courts have retained broad discretion to limit or expand the scope of the examiner's authority. *In re Patton's Busy Bee Disposal Service Inc.*, 182 B.R. 681 (Bankr. W.D.N.Y. 1995).

Thus, the range of an examiner's powers and duties can be delineated as follows:

(1) *Examiner with Expanded Authority.* This can include all of the duties and powers of a chapter 11 trustee. 11 U.S.C. §1106(b). Although not often expanded to that extent, an examiner's powers can mirror those of a chapter 11 trustee. As a practical matter, very few initial appointing orders go this far, since, if the court were so disposed, it would simply appoint a chapter 11 trustee and be done with it. If, however, the examiner's initial findings show the need for activity beyond investigation, a subsequent order of the bankruptcy court can expand the examiner's powers up to and including all powers vested in a chapter 11 trustee.

An example of an appointment going beyond the normal investigatory functions was found in *In re Patton's Busy Bee Disposal Service Inc.*, 182 B.R. 681 (Bankr. W.D.N.Y. 1995). The examiner was authorized and directed by the bankruptcy court, in the order appointing the examiner, to both investigate potential avoidance actions and to actually file and prosecute actions to recover avoidable transfers.

(2) *Examiner with "Standard" Authority.* An appointing order can mirror the statute and include the standard investigatory provisions, as set out in §§1104(c) and 1106(b). These include:

"an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor or by current or former management of the debtor (§1104(c))" (and to) "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" (§1106(b), which, unless the court orders otherwise, directs the examiner to perform the duties of a trustee set out in §1106(a)(3) and (4)).

(3) *Examiner with Limited Authority.* There are occasions where the appointing court determines that the estate is best served by the examiner investigating only discrete areas and thus does not grant the examiner a "roving commission," as is usually the case. Examples of the limited scope of an examiner's authority can include cases where the order directs only the investigation of:

- (a) potential avoidance actions,
- (b) transfers to insiders,
- (c) specific transactions involving the debtor and
- (d) claims of insiders.

Use of Examiners in Recent Cases

An ongoing case that has brought forth substantial interest regarding the use and cost of the examiner is *New Century TRS Holdings Inc.* By way of background, the examiner in *New Century* is Michael Missal of K&L Gates. The examiner in *WorldCom*, former U.S. Attorney General Richard Thornburgh, was also from the same firm. In *WorldCom*, the examiner's report brought down "big game" by tightly tying *WorldCom's* former CEO Bernard Ebbers to serious financial wrongdoing. The contents of the examiner's report paved the way for the indictment, conviction and sentencing of Ebbers.

The news to date in *New Century* has been the fees generated by the examiner, his firm and by debtor's counsel in responding to the examiner's investigation. As of Nov. 30, 2007, according to papers filed by the creditors' committee in the case, the examiner and his firm had charged the *New Century* estate more than \$13 million in fees for a five-and-a-half-month period since his appointment. Further, debtor's counsel had estimated that the fees charged the estate for responding to the examiner's investigation were approximately \$3.3 million. The detail cited by the committee in its attempt to reign in the examiner is impressive in its scale: 21 partners, 31 associates and 17 paraprofessionals, on average, were billing time on the matter, not including the examiner, who, at an hourly rate of \$725, had billed an average of 230 hours per month in his investigation. As of November 2007, the examiner's team of 90 or so financial and legal professionals had spent more than 40,000 hours reviewing millions of pages of documents, "analyzing reams of financial data" and interviewing dozens of individuals.

The moral of the story is that once appointed, the examiner has a job to do. Full investigations of companies with far-ranging and complicated financial structures take time and money, hopefully leading to a product—the report—that can have a corresponding financial benefit to the estate.

Strategies for Parties Opposing Appointment of an Examiner

For parties opposed to appointment of an examiner, the best strategy may be to fight hard to limit the examiner's authority to the greatest extent possible through narrowing the relief in the appointing order. As shown in *Revco*, full-out opposition to an examiner in a "\$5,000,000 threshold" case is futile, no matter how compelling the facts. In "for cause" cases, an examiner with limited powers may be a more acceptable alternative to the appointment of a chapter 11 trustee if appointment of a trustee is sought. Further, a vigorous opposition to the appointment of an examiner has a "the debtor doth protest too much" sound and gives the bankruptcy court pause to wonder what the debtor doesn't want the examiner to find.

In conclusion, there is every reason to believe that examiners will be playing an increasing role in chapter 11 cases. A working knowledge regarding the role of examiners will be a necessary arrow in the quiver of bankruptcy practitioners in the busy years to come.