

July 1, 2009

## WEATHERING THE STORM The Appointment of an Examiner

With the economic crisis leading to the failure of many businesses, bankruptcy cases are on the rise. In many of the cases grabbing headlines, such as Lehman Brothers, Nellson Nutraceutical, New Century and SemCrude, courts have shown a willingness to appoint examiners to investigate, report on and make recommendations regarding possible issues of mismanagement, fraud or other improprieties relating to the affairs of the debtor or its former or current management. These investigations can include speaking with and even deposing creditors of the debtors, even if the creditors themselves are not the targets of the investigation. It is therefore important to have a clear idea of what an examiner may, and may not, do in a bankruptcy context.

An examiner is an official appointed by the bankruptcy court to investigate issues or problems identified with the debtor. As a court-appointed fiduciary, an examiner is in a unique position to investigate alleged improprieties from a neutral standpoint, without biases or client influence. The court may order the examiner to investigate any aspect of the case, the business, or events leading up to the bankruptcy case, and report its findings to the court and the parties. *Collier on Bankruptcy-15th Edition Rev. P 1106.01*. However, an examiner is *not* a trustee, and may not be assigned all the duties and powers which a trustee might have, as courts in chapter 11 cases generally want to leave the debtor-in-possession in control of its company. See *In re International Distribution Centers, Inc.*, 74 B.R. 221 (S.D.N.Y. 1987) (“As opposed to a trustee’s accountability for administration of the estate, an examiner’s duties are primarily investigative.”). In any case where a debtor has more than \$5 million of unsecured liabilities, the appointment of an examiner is required under Section 1104 of the Bankruptcy Code if a party in interest requests one. 11 U.S.C. § 1104(c)(2). In addition, courts have discretion to appoint an examiner if in the interest of the estate, even where the amount of unsecured debt does not reach the \$5 million threshold. 11 U.S.C. § 1104(c)(1). As a practical matter, examiners are sometimes appointed in cases in which a motion has been made to appoint a trustee, but the court feels that such a remedy would be too drastic or premature based on the record before it.

Generally, the examiner’s role is to investigate “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. . . .” 11 U.S.C. § 1104(c). The Bankruptcy Code goes on to say that an examiner shall “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.” 11 U.S.C. § 1106(a)(3). While some courts have interpreted this to give the examiner broader powers than civil discovery, such as in *In re FiberMark Inc.*, 339 B.R. 321 (Bankr. D. Vt. 2006) (“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 exact powers of the examiner will vary from case to case. The examiner has the ability to subpoena documents and witnesses and take Rule 2004 examinations (similar to depositions) in the process of conducting its examination.

Based on the examiner’s findings and recommendations, the court may decide to allow further action, including commencement of criminal or civil suits. In carrying out these duties, courts have held that examiners may employ accountants, lawyers, or other professionals or agents to assist them if required. Although the Code does not explicitly give the examiner the power to employ professionals, such assistance may be necessary in matters where the issues to be investigated are large or complex. *Collier on Bankruptcy-15th Edition Rev. P 1104.03[5]*. Further, while an examiner may recommend the prosecution of actions on behalf of the debtor in possession, it may not pursue litigation which arises as a result of its own examination report, as this could create a situation in which the

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examiner recommends litigation in the hope of being retained for that purpose. *Collier on Bankruptcy-15th Edition Rev. P 1106.05[4]*.

Recently, courts have expanded on the examiners' traditional investigatory role to play a greater part in the debtors' ongoing operations. For example, in *In re Enron Corp.*, 326 B.R. 497 (S.D.N.Y. 2005), the court expanded the examiner's role over the life of the case to include serving as a "facilitator of a chapter 11 plan in the ENA chapter 11 case," and as a "fiduciary protecting the interests of the ENA estate and as a plan facilitator for ENA, working with the Debtors and the Creditors' Committee to facilitate the chapter 11 plan process for ENA and its subsidiaries". *Id.* at FN5. Similarly, in *In re Adelfia Communications Corp.*, 336 B.R. 610 (Bankr. S.D.N.Y. 2006), the bankruptcy court noted that examiners can be employed outside their initial investigatory role to provide closer supervision of the debtors in the course of their dealings. *Id.* at 652-653. In addition, some courts have expanded the powers of an examiner in specific cases to include serving as a mediator between the debtor and creditors in plan negotiations. See generally *Collier on Bankruptcy-15th Edition Rev. P 1104.03[b]*. However, since an examiner is appointed under a "markedly less stringent standard than a trustee," courts should employ additional powers sparingly, so as not to make the examiner a *de facto* trustee. *Collier on Bankruptcy-15th Edition Rev. P 1106.01*.

In addition, the examiner may be required to perform any other duties that the court orders the debtor in possession *not* to perform. 11 U.S.C. 1104(b). Courts may deny such duties to the debtor in possession in extraordinary cases where the court determines that cause exists to divest the debtor of such duties or that such a delegation of duties would be in the best interest of the estate. *Collier on Bankruptcy-15th Edition Rev. P 1106.05[1]*.

Courts have resorted more and more to employing examiners, in part to restore a measure of public confidence in the debtors and their professionals. A number of recent large Chapter 11 cases have been precipitated by rapid declines in a company's value, allegations of fraud by management and the analysis of complex financial structures and transactions. The examinations being conducted in these cases include not only investigations of the actions of management, but also an investigation of certain transactions conducted by the company and certain of their creditors. For example, in the pending bankruptcy case of *Lehman Brothers*, the court has appointed an examiner, partly in the hope of restoring public confidence in the financial markets. Providing additional oversight to Lehman to ensure that its management is held accountable is in the best interests of all concerned. In the *SemCrude* cases, the discovery of massive trading losses by insiders led to a rapid loss in value and an immediate bankruptcy filing. An examiner was appointed to investigate these issues, which included an investigation of certain eve of bankruptcy transactions between the debtors and certain creditors. The examiner issued an extensive report based not only on interviews with creditors but also a review of documents and practices by forensic accountants. This model for the use of examiners can be expected to continue as the economy gets worse, and more allegations of fraud or incompetence are made against the executives or boards of debtor corporations.

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