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Jeffery A. Deller

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# Examining the Examiner: Waiver of the Attorney-Client Privilege and the Outer Limits of an Examiner's Powers in Bankruptcy

Jeffery A. Deller, Esq.<sup>1</sup>

## I. INTRODUCTION

Until recently, the role of examiners in Chapter 11 bankruptcies was relatively minor. The wave of accounting scandals, corporate misconduct, and the resulting Chapter 11 bankruptcies of Enron and WorldCom in recent years have made the appointment of an examiner in contentious bankruptcies the flavor of the day.<sup>2</sup> Against this backdrop, this article discusses the traditional role of an examiner in bankruptcy proceedings, as well as the current state of an examiner's duties in a Chapter 11 bankruptcy.<sup>3</sup> Towards this end, the role of a bankruptcy trustee will be examined and contrasted with the duties of an examiner. This article will discuss how the differences between the powers and duties of a trustee and those of an examiner can become blurred in complex

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1. Mr. Deller is a shareholder in the Pittsburgh law firm of Klett Rooney Lieber & Schorling, P.C., and he is the Vice Chair of the American Bar Association's Business Bankruptcy Sub-Committee on Trustees and Examiners. Mr. Deller's practice includes representing debtors and creditors in insolvency related matters, such as out-of-court restructurings and bankruptcy litigation. The author is grateful to the insightful comments provided by attorneys Michael Rhodes and Sam Toney during the process of writing this article.

2. Loomis, *Court-Approved Examiners Become More Common as Scandal Taints Chapter 11*, N.Y.L.J., Aug. 15, 2002.

3. There are two general forms of bankruptcy proceedings. The first general form is liquidation bankruptcy or straight bankruptcy, whose statutory origins are Chapter 7 of the Bankruptcy Code. See 11 U.S.C. §§ 701-766 (2004). In a typical Chapter 7 liquidation, a bankruptcy trustee is appointed to collect and liquidate all non-exempt property for the benefit of creditors. The second general form of bankruptcy proceedings are rehabilitative bankruptcies -- also known as reorganizations or restructurings. The rehabilitation bankruptcy provisions of the Bankruptcy Code are found at Chapters 9, 11, 12, and 13 of the Bankruptcy Code. See 11 U.S.C. §§ 901-946; 1101-1174; 1201-1231; 1301-1330 (2004). Professor David Epstein has described "rehabilitation" bankruptcy as bankruptcy cases wherein "creditors look to future earnings of the debtor . . . to satisfy their claims. The debtor generally retains its assets and makes payments to creditors, usually from postpetition earnings, pursuant to a court-approved plan." See Epstein et al, *Bankruptcy* at § 1-5 (West 1993). Rehabilitation cases under Chapter 9 are for municipalities. Rehabilitation cases under Chapters 12 and 13 are for farmers and individual consumer debtors with regular income, respectively. Chapter 11 is rehabilitation or reorganization for corporations and, in some instances, for individuals who are not eligible for any meaningful Chapter 12 or 13 relief.

reorganization cases. This article will explore this issue in the context of whether an examiner has the power to waive the attorney-client privilege of a debtor in bankruptcy. As this paper demonstrates, the powers of bankruptcy examiners are often illusory.

## II. POWERS AND DUTIES OF TRUSTEES AND EXAMINERS

It is widely recognized that the appointment of a trustee or examiner in a Chapter 11<sup>4</sup> bankruptcy is an extremely rare event.<sup>5</sup> The reason behind this rarity is that in a Chapter 11 environment, there is a strong presumption that the debtor should remain in possession of its assets.<sup>6</sup> Consistent with this presumption, clear and convincing evidence of "cause" for any such appointment must be demonstrated before a trustee or examiner can be appointed by

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4. Unlike Chapter 11, a trustee is appointed automatically under Chapter 7 of the Bankruptcy Code to wind-up and liquidate the affairs of the debtor. See 11 U.S.C. § 701 and 702. The governmental entity that has oversight for trustees appointed in bankruptcy (both in Chapter 11 and Chapter 7) is the United States Department of Justice through the office of the United States Trustee. Pursuant to Section 701 of the Bankruptcy Code, "Promptly after the order for relief under [Chapter 7], the United States Trustee shall appoint one disinterested person . . . as interim trustee." See 11 U.S.C. § 701(a). The Bankruptcy Code further provides that the interim trustee may become trustee if either (a) the interim trustee is duly elected by unsecured creditors holding at least 20 percent of allowed, undisputed, fixed, liquidated unsecured claims, or (b) no other trustee is elected by the creditors at the meeting of creditors. See 11 U.S.C. § 702.

5. In re Cardinal Industries, Inc., 109 B.R. 755 (Bankr. S.D. Ohio 1990). Prior to the adoption of the Bankruptcy Code in 1978, the appointment of a trustee was more routine in reorganization cases. In fact, the precursor to the Bankruptcy Code, known as the Bankruptcy Act or Chandler Act, expressly contemplated the appointment of a bankruptcy trustee in some instances. For example, under the Bankruptcy Act, corporate debtors desirous of reorganizing their affairs could file for protection under Chapters X or XI of the Bankruptcy Act. "Under Chapter X of the prior Bankruptcy Act, the bankruptcy court was required to appoint one or more trustees upon approval of a Chapter X petition if the liquidated, non-contingent debts in the case exceeded \$250,000 or more." See LAWRENCE P. KING ET AL., COLLIER ON BANKRUPTCY at ¶ 1104.LH[1][a] (15<sup>th</sup> ed. 2004) [hereinafter KING]. If the corporation's debts were less than \$250,000, the court had the discretion to either appoint one or more trustees or to continue the debtor in possession. *Id.* Under Chapter XI of the Bankruptcy Act, the court was permitted to appoint a trustee for cause shown. *Id.* However, as Chapter XI relief did not sufficiently enable corporate debtors to restructure secured debt or significantly impair the interests of equity holders, Chapter XI of the Bankruptcy Act was often an unworkable solution to large corporate debtors. *Id.* Moreover, as Chapter X's mandatory trustee provisions were equally unappealing, corporate debtors found themselves reluctant to commence a case under Chapter X. *Id.* To avoid the bugaboo associated with the trustee provisions of Chapter X, and the limitations imposed on large corporate debtors in Chapter XI, Congress re-wrote the rehabilitative provisions of bankruptcy when it adopted the Bankruptcy Code. *Id.* at ¶ 1104.LH[1][b]-[e]. For an outstanding history of bankruptcy law in the United States, see DAVID A. SKEEL, DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (Princeton University Press 2001).

6. Committee of Dalkon Shield Claimants v. A.H. Robbins Co., Inc., 828 F.2d 239 (4th Cir. 1987); In the Matter of Cajun Electric Power Cooperative, Inc., 69 F.3d 746 (5th Cir. 1995), rehearing granted and result reversed, 74 F.3d 599 (5th Cir. 1996).

the court.<sup>7</sup> Absent a strong showing that the appointment of a trustee or examiner is both warranted and in the best interest of creditors, courts will permit a debtor in Chapter 11 to remain “in possession” of its assets and business operations.<sup>8</sup>

In reorganization cases, the general presumption is that allowing the debtor’s current management to retain control of the corporation makes a Chapter 11 reorganization more attractive to debtors than a Chapter 7 liquidation.<sup>9</sup> As a result, the rationale goes, recovery for creditors is maximized and preservation of jobs is enhanced due to the fact that the Chapter 11 debtor does not have to waste resources responding to turnover in management.<sup>10</sup>

In addition, examiners provide an awesome vehicle for investigating legal and equitable claims and causes of action that may exist against various third-parties.<sup>11</sup> Unlike a Chapter 11 trustee, however, examiners traditionally do not take over the day-to-day control of a business enterprise; rather, such activities are usually left to the business’ personnel, who are running the debtor-in-possession’s operations.<sup>12</sup> Consequently, the appointment of an examiner may be a more attractive vehicle in some Chapter 11 contexts as there is little, if any, business interruption occasioned by the appointment of an examiner.<sup>13</sup>

#### A. *Appointment, Powers, and Duties of Chapter 11 Trustees*

Ordinarily, when a debtor files a Chapter 11 bankruptcy it becomes a “debtor-in-possession,” and the current officers, directors, and managers of the debtor remain in place.<sup>14</sup> These officers, directors, and managers generally are not displaced as a result of a Chapter 11 bankruptcy filing and continue to operate the business of the debtor, subject to fiduciary duties imposed by applicable

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7. *In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3d Cir. 1989).

8. *See e.g.*, *In re Ionosphere Clubs, Inc.*, 113 B.R. 164 (Bankr. S.D.N.Y. 1990).

9. *See KING, supra* note 5 at ¶ 1104.02[1].

10. *Id.*

11. *See In re Big Rivers Electric Corp.*, 284 B.R. 580, 585 (W.D. Ky. 2002) (highlighting examiner’s broad investigatory duties); *see also* First Interim Report of Neal Batson, Court Appointed Examiner, *In re Enron Corp.*, NO. 01-16034 at 1-5 (Bankr. S.D.N.Y.) (Sept. 21, 2001) (summarizing investigative duties of the Enron examiner).

12. *See* 11 U.S.C. § 1106(b), which omits from an examiner’s duties the duty to possess the debtor’s assets or operate its business.

13. *See KING, supra* note 5 at ¶ 1104.03[1].

14. *See* CFTC v. Weintraub, 471 U.S. 343, 355 (1985); *In re Pease*, 195 B.R. 431, 433 (Bankr. D.Neb. 1996) (“Upon the commencement of a Chapter 11 bankruptcy case, the debtor becomes a ‘debtor in possession’ with a fiduciary duty to creditors.”); *see also* 11 U.S.C. § 1107 (describing the rights, powers, and duties of a debtor-in-possession).

bankruptcy and non-bankruptcy law.<sup>15</sup> Indeed, the willingness to leave a Chapter 11 debtor “in possession” of property of the bankruptcy estate is premised on the assumption that officers, directors, and employees of the debtor can be depended upon to carry out the fiduciary responsibilities of a trustee.<sup>16</sup> Of course, one important fiduciary duty<sup>17</sup> omitted from the duties statutorily imposed by the Bankruptcy Code upon a debtor-in-possession is the duty of investigating its own acts, conduct, and affairs.<sup>18</sup> As a result of this omission, litigation seeking the appointment of a bankruptcy trustee often arises in a context<sup>19</sup> in which creditors con-

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15. See *supra* note 15.

16. *Weintraub*, 471 U.S. at 355.

17. Justice Cardozo wrote that many “forms of conduct permissible in a workday world for those acting at arms’ length, are forbidden to those bound by fiduciary ties.” *Meinhard v. Salmon*, 164 N.E. 545, 546 (1928). According to Justice Cardozo, the concept of “fiduciary duty” is “something stricter than the morals of the marketplace.” *Id.* To Justice Cardozo, fiduciary duty is “the punctilio of an honor most sensitive.” *Id.* In a bankruptcy proceeding, the fiduciary duty of a debtor-in-possession (and trustee) flows primarily to the creditors of the bankruptcy estate. See John T. Roache, Note, *The Fiduciary Obligations of a Debtor in Possession*, 1993 U. ILL. L. REV. 133, 144 (1993). These duties include the duties of loyalty, care, and good faith. See Ramesh K.S. Rao et al., *Fiduciary Duty a la Lyonnais: An Economic Perspective on Corporate Governance in a Financially Distressed Firm*, 22 J. Corp. L. 53, 60-61 (1996); Richard M. Cieri et al., *The Fiduciary Duties of Directors of Financially Troubled Companies*, 3 J. Bankr. L. & Prac. 405, 406 (1994). These duties encompass the duty to conserve assets and to maximize distribution to creditors, *United States v. Aldrich*, 795 F.2d 727, 730 (9th Cir. 1986) and *In re Microwave Prods. of Am.*, 102 B.R. 666, 671 (Bankr. W.D. Tenn. 1989), and to avoid self-dealing and conflicts of interest. See e.g., *In re Ben Franklin Retail Stores, Inc.*, 225 B.R. 646 (Bankr. N.D. Ill. 1998), *aff’d in part and rev’d in part*, 2000 WL 28266 (N.D. Ill. 2000); *In re Bellvue Place Assoc.*, 171 B.R. 615, 623-24 (Bankr. N.D. Ill. 1994). In the Chapter 11 context, when the conduct of the debtor-in-possession becomes so egregious as to rise to the level of illegal or fraudulent conduct, courts have held that debtor’s counsel must take corrective measures or face losing fees. *In re Smitty’s Truck Stop, Inc.*, 210 B.R. 844 (10th Cir. 1997)(the failure to investigate and disclose conflicting claims to funds paid to an attorney as a retainer requires disgorgement of the retainer and denial of fees); *In re Wild Horse Enterprises, Inc.*, 136 B.R. 830 (Bankr. C.D. Cal. 1991)(debtor’s attorney is a fiduciary to the estate and has a duty to remind the debtor of duties under the Bankruptcy Code); *FDIC v. O’Melveny & Meyers*, 969 F.2d 744 (9th Cir. 1992)(securities case where court held that attorney has duty to avoid public harm when it is discovered that client is engaging in fraud), *rev’d on other grounds*, 512 U.S. 79 (1994); *In re Harp*, 166 B.R. 740 (Bankr. N.D. Ala. 1993)(lawyers representing debtors-in-possession are charged with responsibilities of insuring that when the interest of the bankruptcy estate conflicts with the interest of the debtor’s principal, that the interest of the bankruptcy estate prevail).

18. See 11 U.S.C. § 1107(a) (2004).

19. Litigation relating to breaches of fiduciary duty can occur outside of a bankruptcy context as well. As a general proposition, officers and directors of a solvent corporation have fiduciary duties to stockholders rather than creditors. See e.g., *Koehler v. Black River Falls Iron Co.*, 67 U.S. 715 (1862); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). However, when a corporation becomes insolvent, or as it slides into bankruptcy, the fiduciary duties of the corporation’s officers and directors shift from the stockholders to the creditors. *FDIC v. Sea Pines Co.*, 692 F.2d 973, 977 (4th Cir. 1982). As described by the United States Court of Appeals for the Fourth Circuit:

tend that officers, directors, and employees of a debtor-in-possession have breached their respective fiduciary duties either prior or subsequent to a bankruptcy filing.<sup>20</sup>

In this context, Section 1104(a) of the Bankruptcy Code sets forth the grounds for appointment of a trustee in a Chapter 11

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The law by the great weight of authority seems to be settled that when a corporation becomes insolvent, or in a failing condition, the officers and directors no longer represent the stockholders, but by the fact of insolvency, become trustees for the creditors, and that they cannot by transfer of its property or payment of cash, prefer themselves or other creditors.

Davis v. Woolf, 147 F.2d 629, 633 (4th Cir. 1945); see also, Alexander et al. v. Hillman, 296 U.S. 222 (1935).

20. See KING supra note 5 at ¶ 1104.02[3][b]. Officers and directors of corporations usually hide behind the “business judgment” defense to claims that they breached their respective duties. Case law is somewhat mixed as to whether the business judgment defense is viable when officers and directors are looking at breach of duty claims that arise out of, or relate to, conduct occurring during the administration of a bankruptcy estate. For example, in one case, the United States Bankruptcy Court for the Northern District of Florida held that a bankruptcy fiduciary did not breach its duty when the complained of conduct fell within the sound business judgment of the debtor and was made in good faith and on a reasonable basis. In the Matter of Southern BioTech, Inc., 37 B.R. 318 (Bankr. N.D. Fla. 1983). Other courts have rejected the sound business judgment rule in the bankruptcy context, and have held bankruptcy fiduciaries to the standard of “reasonable care and due diligence.” For example, the Ninth Circuit Court of Appeals wrote in the case of *In re Ridgen*:

The dissent voices some reservations and concern about our discussion of the fiduciary duty of the bankruptcy trustee. The dissent maintains that the nature of the trustee’s duty varies depending upon whether he or she is acting on behalf of the individual debtor or corporate debtor. In the latter case, the dissent maintains that the trustee’s role is in the nature of a corporate manager and that his actions should therefore be measured by the business judgment rule rather than by the fiduciary standard of reasonable care and due diligence. To support this contention the dissent relies on the recent Supreme Court decision in [*CFTC v. Weintraub*, 471 U.S. 343 (1985)]. The Supreme Court in *Weintraub* held that the trustee in bankruptcy of a debtor corporation, rather than the corporation’s directors, had the power to waive the debtor corporation’s attorney-client privilege. . . . *Weintraub*’s holding is limited. Nowhere does the Supreme Court in *Weintraub* state that as a general rule the conduct of the trustee of a corporate debtor is analyzed under the business judgment rule. *Weintraub* does contain some language discussing the nature of the role of the trustee of a corporate debtor. The Supreme Court, in an effort to support its holding in that case . . . , discussed the way in which the trustee plays a role most analogous to that of a solvent corporation’s management. Nonetheless, we do not believe that *Weintraub* compels or requires us to reformulate the standard by which we judge the conduct of a trustee in the context of corporate debtors generally. In the absence of a clear statement from the Supreme Court that the business judgment rule now applies whenever analyzing the conduct of a corporate debtor’s trustee, we are unwilling to adopt such a rule. . . . The majority in this case remains convinced. . . that the reasonable care and due diligence standard is the one by which we judge the conduct of the trustee, regardless of whether the debtor is an individual or a corporation.

In *re Ridgen*, 795 F.2d 727, 731 n. 1 (9th Cir. 1986). The Ninth Circuit went further in *Ridgen* and held that reasonable care and due diligence is exercised appropriately when “an ordinarily prudent person would exercise [the same degree of care and due diligence] in similar circumstances.” *Id.* at 730.

bankruptcy proceeding. Specifically, Sections 1104(a)(1) and (2) of the Bankruptcy Code authorize the appointment of a trustee for "cause," and provide as follows:

[O]n request of a party in interest . . . the court shall order the appointment of a trustee:

(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or

(2) if such appointment is in the interest of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities or the amount of assets or liabilities of the debtor.<sup>21</sup>

Under this section of the Bankruptcy Code, examples of "cause" expressly include fraud, dishonesty, and gross mismanagement of the debtor.<sup>22</sup> The examples of "cause" set forth in Section 1104(a)(1), however, do not comprise an exhaustive list.<sup>23</sup> For example, the existence of a conflict of interest among the debtor's existing management may constitute "cause" for the appointment of a trustee.<sup>24</sup> The lack of creditor confidence in the debtor's management may also constitute "cause" for the appointment of a trustee.<sup>25</sup> No matter what "cause" is alleged, where such "cause" is proven<sup>26</sup> to exist, a court must order the appointment of a trustee

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21. 11 U.S.C. § 1104(a).

22. 11 U.S.C. § 1104(a)(1). See also *In re Sharon Steel Corp.*, 871 F.2d at 1227 and the cases cited therein.

23. See 11 U.S.C. § 102(3) ("includes" and "including" are not limiting"); *In re Lilley*, 91 F.3d 491, 494 (3d Cir. 1996).

24. See, e.g., *In re Cajun Elec. Power Coop., Inc.*, 191 B.R. 659, 661 (M.D. La. 1995); *aff'd*, 74 F.3d 599 (5th Cir. 1996), *cert. denied*, 117 S.Ct. 51 (1996); *In re Fiesta Homes of Georgia, Inc.*, 125 B.R. 321, 325 (Bankr. S.D.Ga. 1990); *In re L.S. Good & Co.*, 8 B.R. 312, 315 (Bankr. N.D.W.Va. 1980).

25. *In re Madison Management Group, Inc.*, 137 B.R. 275, 281 (Bankr. N.D. Ill. 1992); *Cardinal Industries*, 109 B.R. at 765.

26. With respect to whether the appointment of a trustee is in the best interest of creditors and other parties-in-interest, courts "eschew rigid absoluteness and look to the practical realities and necessities" of the case. *In re Madison Management Group, Inc.*, 137 B.R. at 282 (citing *In re Hotel Associates, Inc.*, 3 B.R. 343, 345 (Bankr. E.D. Pa. 1980)). Among the factors considered are (i) the trustworthiness related to the management of the debtor, and (ii) the benefits derived by the appointment of a trustee, balanced against the cost of appointment. *In re Madison Management Group, Inc.*, 137 B.R. at 282 (citations omitted).

if the appointment is in the best interest of creditors and other parties-in-interest in the case.<sup>27</sup>

Once appointed, the powers and duties of a Chapter 11 trustee are quite vast,<sup>28</sup> as a trustee assumes the same fiduciary duties to creditors as a debtor-in-possession,<sup>29</sup> plus some additional ones.<sup>30</sup> The additional duties assumed by a bankruptcy trustee include the duty to “investigate the acts, conduct, assets, liabilities, and financial condition of the debtor.”<sup>31</sup>

Upon the appointment of a trustee,<sup>32</sup> all property of the debtor passes to an estate represented by the trustee.<sup>33</sup> Thus the debtor and its management team are simply no longer in control of the business operations of the Chapter 11 debtor.<sup>34</sup> Under the Bank-

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27. See 11 U.S.C. § 1104(a); *In re Sharon Steel Corp.*, 871 F.2d at 1226; *In re Nicolet, Inc.*, 80 B.R. 733, 738 (Bankr. E.D. Pa. 1987).

28. *Weintraub*, 471 U.S. at 352.

29. The debtor-in-possession is accountable for all property received, examines claims and objects to improper claims, furnishes information regarding the administration of the estate if such information is requested by interested parties, files monthly operating reports, files monthly operating reports, files tax returns, files a plan of reorganization or recommends conversion or dismissal of the case if no plan is filed. See 11 U.S.C. §§ 704, 1106 and 1107. The debtor in possession also is authorized to operate its business. 11 U.S.C. § 1108.

30. See 11 U.S.C. §§ 704, 1106 and 1107.

31. See 11 U.S.C. § 1106(3). Another additional duty is the duty to “collect and reduce to money the property of the estate for which such trustee serves, and to close such estate as expeditiously as is compatible with the best interests of parties in interest.” 11 U.S.C. § 704(1). Section 1109 of the Bankruptcy Code appears to define the term “party-in-interest” as “including the debtor, the trustee, a creditors’ committee, an equity security holders’ committee, a creditor, and equity security holder, or any indenture trustee.” 11 U.S.C. § 1109(b).

32. As in Chapter 7, trustees in Chapter 11 may also be elected by creditors if the court deems it appropriate to order the appointment of a trustee. See 11 U.S.C. § 1104(b). The Bankruptcy Code provides that “on the request of a party in interest made not later than 30 days after the court orders the appointment of a trustee ..., the United States trustee shall convene a meeting of creditors for the purpose of electing one disinterested person to serve as trustee in the case.” *Id.* For a discussion of who constitutes a “disinterested person” under the Bankruptcy Code, see Kurt F. Gwynne, *Employment of Turnaround Management Companies, “Disinterestedness” Issues Under the Bankruptcy Code, and Issues Under Delaware General Corporation Law*, 10 AM. BANKR. INST. L. REV. 673 (2002).

33. 11 U.S.C. § 542(a).

34. See 11 U.S.C. §§ 323, 541, and 1106. It can be argued that the trustee appointment provisions of Section 1104 of the Bankruptcy Code are by no means the only manner by which a change of corporate governance of a debtor-in-possession may be properly effectuated in bankruptcy. Under Sections 1107 and 1108 of the Bankruptcy Code, a Chapter 11 debtor-in-possession is free to manage its assets and operate its business, subject to general bankruptcy court oversight. For example, a Chapter 11 debtor-in-possession is free to “enter into such transactions” in the ordinary course of business without first obtaining prior court approval. See 11 U.S.C. § 363(c)(1). Where the debtor desires to enter into transactions that are outside the ordinary course of business, the debtor-in-possession is permitted to enter into them after first obtaining court approval upon notice and hearing. See 11 U.S.C. § 363(b). Examples of transactions that would require prior court approval



ruptcy Code, the trustee is accountable for all property received and has the duty to maximize the value of the estate.<sup>35</sup> The trustee, therefore, is not only directed to investigate the debtor's financial affairs, but he or she also is empowered to sue officers, directors, and other third-parties to recover, on behalf of the estate, fraudulent or preferential transfers of the debtor's property.<sup>36</sup> Without the necessity of bankruptcy court approval, a Chapter 11 trustee is also empowered to operate the debtor's business and sell, use, and lease property of the bankruptcy estate in the ordinary course<sup>37</sup> of business.<sup>38</sup>

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include a debtor-in-possession's retention, payment, or replacement of non-ordinary course professionals. See *In re Pannebaker Custom Cabinet Corp.*, 198 B.R. 453 (Bankr. M.D. Pa. 1996); *In re Bartley Lindsay Co.*, 137 B.R. 305, 309 (D. Minn. 1991); see also 11 U.S.C. §§ 327(a) and (b). Some courts have utilized Sections 327, 363, 1107, and 1108 of the Bankruptcy Code to authorize the appointment of a "responsible officer" or "person in control" of a Chapter 11 debtor's assets and operations. See *In the Matter of FSC Corp.*, 38 B.R. 346, 349 (Bankr. W.D. Pa. 1983); accord *In re Harper Industries, Inc.*, 18 B.R. 773, 775 (Bankr. S.D. Ohio 1982). For example, in *FSC Corp.*, the United States Bankruptcy Court for the Western District of Pennsylvania upheld the appointment of a responsible officer to perform the duties of a debtor-in-possession when all of the debtor's officers and directors had resigned, thereby leaving the debtor with no management. While the lack of a board of directors could have been cause for the appointment of a trustee under 11 U.S.C. § 1104, the bankruptcy court in *FSC* nevertheless upheld the appointment of a responsible officer because (a) the parties who had a financial stake in the outcome of the case consented to the appointment and (b) Sections 226 and 303 of Delaware Corporation Law authorized a court of competent jurisdiction to appoint a custodian or "other representative" to act for the corporation's board of directors. See *FSC Corp.*, 38 B.R. at 349-51; see also *In re Gaslight Club, Inc.*, 782 F.2d 767, 772 (7th Cir. 1986)(replacement person in control authorized where creditors with financial stake consented and nothing under applicable state law precluded the replacement of management); *In re Boileau*, 736 F.2d 503, 505-06 (9th Cir. 1984)(same); *In re Harper Industries, Inc.*, 18 B.R. at 775 (same); *In re Freedlander, Inc.*, 86 B.R. 66, 68 (Bankr. E.D. Va. 1988)(substitution of management is permissible where there is a consensus that management should be replaced).

35. See 11 U.S.C. §§ 704(1), 704(2) and 1106(a)(1); *In re Washington Group, Inc.*, 476 F.Supp. 246, 250 (M.D.N.C. 1979).

36. *Id.*

37. The phrase "ordinary course of business" is not defined in the Bankruptcy Code. Many courts have applied a two-part test to determine whether a transaction is in the ordinary course of business. First, in the "vertical dimension" or "creditor expectation" test, the court analyzes the transaction from the vantage point of a hypothetical creditor and inquires whether the transaction subjects a creditor to economic risks of a nature different from those the creditor accepted when it initially contracted with the debtor. Second, the "horizontal dimension" test determines whether, from an industry-wide perspective, the transaction is of the sort commonly undertaken by companies in that industry. For a discussion of these tests, see *In re Roth American, Inc.*, 975 F.2d 949, 953 (3d Cir. 1992); and *In re Glosser Bros.*, 124 B.R. 664, 667 (Bankr. W.D. Pa. 1991).

38. See 11 U.S.C. §§ 363(b), 363 (c)(1) and 1106(3). Sections 363(b)(1) and 363(c)(1) of the Bankruptcy Code provide that a trustee or debtor-in-possession may use, sell or lease property of the estate without prior court approval only so long as the transaction contemplated by the trustee or debtor-in-possession is "in the ordinary course of business." See 11 U.S.C. §§ 363(b)(1) and (c)(1). If the trustee's or debtor's transaction is outside the ordinary course of business, the transaction may be avoided. See 11 U.S.C. § 549. Thus, where a

### B. *Appointment, Powers, and Duties of Examiners*

All of the expansive powers reposed in a Chapter 11 trustee, along with their correlating benefits, do not come without a price. From a practical perspective, the appointment of a Chapter 11 trustee may cause business operations to be interrupted to some degree as a result of the installation of new management.<sup>39</sup> In addition, the debtor and Chapter 11 trustee lose one of the fundamental protections afforded to Chapter 11 debtors, namely the exclusive right to propose a plan and solicit support for a plan of reorganization during the first 120 days of a bankruptcy case.<sup>40</sup> As

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transaction is ordinary, as opposed to extraordinary, a trustee or debtor-in-possession may freely enter into the desired transaction without the need of affording interested parties notice or opportunity for a hearing. The purpose behind such a rule was stated succinctly by the United States District Court for the Southern District Court in the case of *In re James A. Phillips, Inc.*, 29 B.R. 391 (S.D.N.Y. 1983). The Court in the *Phillips, Inc.* case, wrote:

[T]he apparent purpose of requiring notice only where the use of property is extraordinary is to assure interested persons of an opportunity to be heard concerning transactions different from those that might be expected to take place so long as the debtor in possession is allowed to continue normal business operations under 11 U.S.C. §§ 1107(a) and 1108. The touchstone of 'ordinariness' is thus the interested parties' reasonable expectation of what transactions the debtor in possession is likely to enter in the course of business. So long as the transactions conducted are consistent with these expectations, creditors have no right to notice and hearing, because their objections to such transactions relate to the bankrupt's chapter 11 status, not the particular transactions themselves. Where the debtor in possession is merely exercising the privileges of its chapter 11 status, which include the right to operate the bankrupt business, there is no general right to notice and hearing concerning particular transactions.

*In re James A. Phillips, Inc.*, 29 B.R. at 394.

39. For example, the appointment of a bankruptcy trustee may trigger an event of default under the debtor's post-petition credit facility, which in-turn could impair the debtor-in-possession's ability to finance its operations in Chapter 11.

40. See 11 U.S.C. § 1121(c)(1). Section 1121 of the Bankruptcy Code augments the concept of a "debtor-in-possession" and provides for an initial "exclusivity" period of 120 days after the commencement of a Chapter 11 case during which a debtor has the exclusive right to file a plan of reorganization; if the debtor files a plan within such 120-day period, it has an additional 60 days thereafter to solicit acceptance of its plan, during which time no other party may file a plan. See 11 U.S.C. § 1121(b), (c). While Section 1121 of the Bankruptcy Code has only a 120 day time limitation, the Bankruptcy Code does afford debtors-in-possession with flexibility in that the Bankruptcy Code expressly authorizes the court to extend the exclusivity period for "cause," after notice and hearing. 11 U.S.C. § 1121(d). Whether cause exists to extend the exclusive periods is at the discretion of the court based upon the facts and circumstances of each particular case. See *First American Bank of New York v. Southwest Gloves & Safety Equip., Inc.*, 64 B.R. 963 (D. Del. 1986). Although the term "cause" is not defined in the Bankruptcy Code, the legislative history indicates that it is intended to be a flexible standard. See H.R. REP. NO. 95-595 at 231 (1977), reprinted in 1978 U.S.C.C.A.N. 5963; *In re AMKO Plastics, Inc.*, 197 B.R. 74, 77 (Bankr. S.D. Ohio 1996)("[T]he legislative intent . . . [is] to promote maximum flexibility."); *In re Clamp-All Corp.*, 233 B.R. 198, 207 (Bankr. D. Mass. 1999); *In re All Seasons, Inc.*, 121 B.R. 1002, 1004 (Bankr. N.D. Ind. 1990). A flexible standard is necessary "in order to allow the debtor

a result, once a Chapter 11 trustee is appointed, creditors lacking fiduciary duties to all creditors may come forward and propose their own plan and attempt to take control of the reorganization process.<sup>41</sup> Congress recognized these risks, and crafted in Section 1104 of the Bankruptcy Code an alternative to the appointment of a trustee, wherein something less than a full-fledged trustee is warranted.<sup>42</sup> In these unique circumstances, the vehicle utilized by Congress in Section 1104 of the Bankruptcy Code is called an "examiner."<sup>43</sup>

The process for the appointment of an examiner is the same for the appointment of a trustee,<sup>44</sup> with one notable exception.<sup>45</sup> In

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to reach an agreement." H.R. REP. No. 95-595, 95<sup>th</sup> Cong., 1<sup>st</sup> Sess. 231-32 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6191. A flexible standard thus provides the debtor with reasonable opportunity to stabilize its business operations at the outset of the case, to negotiate with creditors an effective plan of reorganization, and to prepare the necessary financial and non-financial information that must be disclosed to creditors. See *In re Newark Airport/Hotel*, 156 B.R. 444, 451 (Bankr. D.N.J. 1993); *In re McLean Indus.*, 87 B.R. 830, 833-34 (Bankr. S.D.N.Y. 1987). In determining whether to extend a debtor's exclusive periods, courts assess the totality of circumstances and consider a variety of factors. See, e.g., *In re Dow Corning Corp.*, 208 B.R. 661, 664 (Bankr. E.D. Mich. 1997); *In re Express One Int'l Inc.*, 194 B.R. 98, 100 (Bankr. E.D. Tex. 1996); *McLean*, 87 B.R. at 834. The following factors are relevant to a court's decision to extend a debtor-in-possession's exclusive periods: whether (a) the debtor's case is sizeable and complex; (b) there is good faith progress towards rehabilitation and development of a consensual plan of reorganization; (c) the debtor is not seeking to use its exclusivity to pressure creditors into accepting a plan they find unacceptable; and (d) the debtor is generally making required post petition payments as they come due and is effectively managing its business and preserving the value of its assets. See *id.* *In re Express One*, 194 B.R. at 100; *In the Matter of Interco, Inc.*, 137 B.R. 999, 1001 (Bankr. E.D. Mo. 1992). The Bankruptcy Code also contains provisions that protect creditors from a debtor-in-possession's abuse of the exclusivity afforded to it. Specifically, Section 1121(d) of the Bankruptcy Code provides that "after notice and a hearing, the court may for cause reduce or increase the 120-day" exclusivity period. 11 U.S.C. § 1121(d). The leading case in this area is the case of *In re Texaco, Inc.*, 81 B.R. 806 (Bankr. S.D.N.Y. 1988). In *Texaco*, the United States Bankruptcy Court held that the party seeking to reduce or extend the exclusivity period carries the burden of proving that "cause" exists to do so. One court has even described that burden as being "heavy." See *Interco Inc.*, *supra*. In those cases where the exclusivity period was reduced, factors such as gross mismanagement of the debtor's operations or acrimonious feuding between the debtor's principals serving as a major obstacle to a successful reorganization were regarded as "cause" for the reduction of the exclusivity period. See e.g., *In re Texas Extrusion Corp.*, 68 B.R. 712 (Bankr. N.D. Tex. 1986). Courts have also held that plan exclusivity provisions should not be employed as a tactical device to put pressure on parties to yield to a plan the movant considers to be unsatisfactory. *Texaco*, 81 B.R. at 812. In a reorganization context, it has been held that the mere fact that a party would like to take part in the plan formulation and negotiation process is insufficient to constitute "cause" for terminating exclusivity. See *In re Eagle-Picher Indus., Inc.*, 176 B.R. 143 (Bankr. S.D. Ohio 1994). It has also been held that "cause" is not shown merely where the movant desires to file its own plan. *Id.*

41. See, e.g., *In re Allegheny Int'l, Inc.*, 118 B.R. 282 (Bankr. W.D. Pa. 1990), as a textbook case in which the plan process in bankruptcy was, albeit unsuccessfully, used as a tool to undertake a hostile takeover of a debtor-in-possession.

42. 11 U.S.C. § 1104(c).

43. *Id.*

44. The process is that a party in interest, or the court on its own motion, must move for the appointment of an examiner and demonstrate that (a) "cause" exists for the ap-

looking at the plain language of Section 1104(c) of the Bankruptcy Code, it appears that Congress intended the automatic appointment of an examiner in instances where (a) the debtor's obligations to an insider exceed \$5,000,000; and (b) creditors desire the appointment of an examiner to investigate the conduct, assets, and liabilities of the debtor.<sup>46</sup>

Hence, the frequently asked question is: "Is Section 1104(c)(2) relief automatic or does the bankruptcy court have some discretion in fashioning relief?" Courts are split on how Section 1104(c)(2) operates.<sup>47</sup> The Sixth Circuit Court of Appeals, following the majority rule, concluded that when the statutory requirements of 11 U.S.C. § 1104(c)(2) are met, the court has no discretion and must order the appointment of an examiner because the statute is clear on its face.<sup>48</sup> The United States Bankruptcy Court for the Middle District of Florida, however, reached a different result and concluded that the appointment of an examiner is nonetheless discretionary even if the movant demonstrates that insider claims exceed \$5 million.<sup>49</sup>

Once appointed, the question often posed by parties-in-interest to examiners is, "What are your powers and duties?" While the

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pointment; and (b) the appointment is in the best interest of creditors and other parties in interest. See 11 U.S.C. § 1104(c).

45. Under the Bankruptcy Act, an examiner could only be appointed in cases where no bankruptcy trustee was appointed, as Chapter X did not contemplate the appointment of both a trustee and an examiner. See KING, *supra* note 5, at ¶ 1104.LH[2][a]; see also *Gochenour v. Cleveland Terminals Bldg. Cor.*, 118 F.2d 89 (6th Cir. 1941), for a description of the use of examiners in bankruptcy under the Bankruptcy Act.

46. See 11 U.S.C. § 1104(c)(2). The term "insider" is defined in Section 101(31) of the Bankruptcy Code, and such term includes, but is not limited to, any relative of an individual debtor and any officer, director or person in control of a corporate debtor. See 11 U.S.C. § 101(31).

47. Compare *In re Revco D.S., Inc.*, 898 F.2d 498 (6th Cir. 1990)(appointment of examiner mandatory where provisions of Section 1104(c)(2) are met); *In re Mechem Fin. of Ohio, Inc.*, 92 B.R. 760 (Bankr. N.D. Ohio 1988)(same); *In re the Bible Speaks*, 74 B.R. 511 (Bankr. D. Mass. 1987); *In re 1243 20<sup>th</sup> Street, Inc.*, 6 B.R. 683 (Bankr. D. D.C. 1980)(same); *In re Lenihan*, 4 B.R. 209 (Bankr. D. R.I. 1980)(same); with *In re Rutenberg*, 158 B.R. 230 (M.D. Fla. 1993)(appointment not mandatory even if requirements of Section 1104(c)(2) met); *In re Shelter Res. Corp.*, 35 B.R. 304 (N.D. Ohio 1983)(same). In any event, even if the applications of Section 1104(c)(2) are met, a party-in-interest may waive his or her right to seek the appointment of an examiner by sheer delay in submitting such a request to the court. *In re Bradlees Stores, Inc.*, 209 B.R. 36, 39 (Bankr. S.D.N.Y. 1997); see also *In re Schepps Food Stores, Inc.* 148 B.R. 27, 30-31 (S.D. Tex. 1992)(holding that creditor waived right to examiner where request was made just before plan confirmation hearing and would disrupt proceedings).

48. *Revco*, 898 F.2d at 500.

49. *Rutenberg*, 158 B.R. at 233 (although the case in question met the statutory provisions of 11 U.S.C. § 1104(c)(2), the appointment of an examiner was rejected on the basis that such appointment would delay the administration of the case).

powers and duties of a Chapter 11 trustee are generally broad, the powers and duties of an examiner may be subject to some restrictions, thereby affording a Chapter 11 debtor some autonomy in its restructuring.<sup>50</sup>

The limited operational impact of an examiner in bankruptcy is consistent with the limited purpose of the appointment of an examiner in the first instance. In *In re Gilman Servs., Inc.*, the Bankruptcy Court for the District of Massachusetts held,

The primary function of an examiner is to investigate the debtor's actions, financial condition, as is appropriate under the particular circumstances of the case including any allegations of fraud, dishonesty or gross mismanagement of the debtor by current or former management. . . .

Even though § 1104 provides for the appointment of an examiner to investigate allegations of fraud, dishonesty, and gross mismanagement, mere allegations of misconduct will not suffice; there must be a factual basis supporting the need for an independent investigation.<sup>51</sup>

The *Gilman* Court's description of the purpose of an examiner in bankruptcy is consistent with conclusions reached by other bankruptcy courts throughout the country. For instance, the United States Bankruptcy Court for the Southern District of Ohio observed in *In the Matter of Baldwin United Corp.*,

An Examiner's legal status is unlike that of any other court-appointed officer which comes to mind. He is first and foremost disinterested and non adversarial. The benefits of his investigative efforts flow solely to the debtor and to its creditors and shareholders, but he answers solely to the Court. [A]n examiner constitutes a Court fiduciary and is amendable to no other purpose or interested party.<sup>52</sup>

Similarly, in *In re Ionosphere Clubs, Inc.*, the United States Bankruptcy Court for the Southern District of New York held,

The purpose of an examiner's investigation in bankruptcy is to discover whatever assets may exist for the estate of the

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50. See KING, *supra* note 5 at ¶ 1104.03.

51. 46 B.R. 322, 327 (Bankr. D. Mass. 1985).

52. 46 B.R. 314, 316 (Bankr. S.D. Ohio 1985).

bankrupt, just as one purpose for the appointment of a trustee is so that a trustee may use statutory powers conferred by the Bankruptcy Code to collect all property belonging to the debtor for the benefit of the debtor's creditors. The bankruptcy code gives a trustee more power than a solvent debtor to collect property belonging to the estate. Bankruptcy Rule 2004 likewise gives the Examiner scope to investigate which is broader than that of civil discovery under Rule 26. . .

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 . . . .<sup>53</sup>

The limited nature<sup>54</sup> of an examiner's role is highlighted by the plain language of Section 1106 of the Bankruptcy Code.<sup>55</sup> Under Section 1106(b), and unless the bankruptcy court orders otherwise, a bankruptcy examiner is a fiduciary charged with the duty of investigating<sup>56</sup> the "acts, conduct, assets, liabilities, and finan-

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53. 156 B.R. 414, 432 (S.D.N.Y. 1993).

54. See *In re American Bulk Transp., Inc.*, 8 B.R. 337, 340 (Bankr. D. Kan. 1980).

55. See 11 U.S.C. § 1106(b)(setting forth the duties of trustees and examiners).

56. As set forth above, the primary function of an examiner appointed pursuant to 11 U.S.C. § 1104(c) is to investigate the debtor's actions, financial condition, and, as is appropriate under the particular circumstances of the case, any allegations of fraud, dishonesty, or gross mismanagement of the debtor. *Gilman Servs., Inc.*, 46 B.R. at 327. An examiner acts as an independent party to review, without monetary interest, transactions and documents. An examiner is first and foremost a disinterested party and is nonadversarial. The benefits of an examiner's investigative efforts therefore flow solely to the debtor and the debtor's creditors and equity holders. *Baldwin United Corp.*, 46 B.R. at 316. Once an examiner collects the requisite information, he or she then disseminates the information to the creditors of the bankruptcy estate in a nonadversarial context by filing a report with the bankruptcy court. Towards this end, the examiner is:

[A] fact-finder in the colloquial sense of the term. The Examiner discovers facts for the benefit of the creditors as directed by the Court. He does not, however, issue judicial "findings of fact" as a court does under F.R.B.P. 7052. It follows then, that while the Examiner may be appointed by the Court, he is so appointed to assist the parties other than the Court. He is not an extension of the Court.

*In re Apex Oil Co.*, 101 B.R. 92, 99 (Bankr. E.D. Mo. 1989). The conclusions of an examiner, therefore, "do not have the binding effect on the Court or parties of those of a special master, arbitrator or magistrate." *Ionosphere Clubs, Inc.*, 156 B.R. at 432 (quoting *Baldwin United Corp.*, 46 B.R. at 316). Accordingly, because an examiner does not make an "adjudicatory determination of substantive rights," an examiner's findings have no binding effect on the debtor or its creditors in the absence of a bankruptcy court expressly adopting the examiner's conclusions. As a practical matter, however, a bankruptcy court will probably give great deference to the conclusions drawn by any examiner that it appoints. FED. R. EVID. 702 might also apply to permit the introduction of an examiner's report into evidence as an "expert opinion" to the extent the appropriate legal foundation is made by the party proffering the evidence.

cial 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."<sup>57</sup>

While Section 1106(b) generally provides for a limited role of an examiner in Chapter 11, Section 1106(b) does not contain an absolute express prohibition to the bankruptcy court expanding an examiner's duties beyond conducting a mere investigation. The plain language of Section 1106(b) even contemplates that an examiner appointed by the Court "shall perform . . . any other duties of the trustee that the court orders the debtor in possession not to perform."<sup>58</sup> The issue raised by this catch-all provision therefore is

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57. See 11 U.S.C. § 1106(b). Because an examiner must also, "as soon as practicable, file a 'statement of any investigation' and '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," see 11 U.S.C. § 1106(a)(4), (as adopted and incorporated by 11 U.S.C. § 1106(b)), an issue exists as to whether a court-appointed examiner is protected from discovery by some sort of quasi-immunity. This issue comes up from time to time, as the investigation that an examiner does in the course of a bankruptcy proceeding usually uncovers an abundance of information which third party litigants would like to use to their own benefit. The *Enron* case is a good example of a situation wherein various parties-in-interest had litigation claims and contended that the examiner possessed documents and information relevant to the prosecution or defense of such actions. The examiner in *Enron*, however, obtained limited immunity from third-party discovery before any discovery was propounded upon the examiner in that case. Why? There are compelling interests in allowing an examiner to be immune from discovery in connection with his or her work. From a practical perspective, finding individuals to work as examiners in complex cases like *Enron* might become increasingly difficult if the examiner would be subject to a barrage of discovery requests at the conclusion of the examiner's tenure. Essentially, no one would want to be placed in involuntary servitude to the bankruptcy estate. Providing an examiner with limited immunity from discovery is consistent with the notion that an examiner is a disinterested third party and an officer of the court. *Big Rivers Elec. Corp.*, 213 B.R. at 977 (recognizing that an examiner is an independent third party and an officer of the court); *Interco Inc.*, 127 B.R. at 638 (the examiner's role is by its nature disinterested and non-adversarial). Third party litigants and those involved in the underlying bankruptcy, however, do have compelling arguments for requesting information from the examiner to be used in subsequent litigation. In fact, such parties' due process rights are paramount to an examiner's convenience so long as the examiner suffers no undue harm or burden for its efforts in responding to discovery requests. Accordingly, access to the examiner's documents and information appears to be appropriate when the proponent of discovery has no other available means of obtaining relevant documents and information from other known sources. This conclusion appears to be consistent with the traditional view that an examiner is independent and should not be used by third party litigants to fuel their litigation. *Baldwin United Corp.*, 46 B.R. at 316.

58. 11 U.S.C. § 1106(b). Section 1106(a)(3) and (a)(4) of the Bankruptcy Code requires the trustee to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business, the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan." The "other duties" referred in Section 1106(a) of the Bankruptcy Code include the duty to account for estate property, 11 U.S.C. § 704(2); the duty to examine and object to claims, 11 U.S.C. § 704(5); the duty to furnish information to parties-in-interest, 11 U.S.C. § 704(7); the duty to file financial reports and tax returns, 11 U.S.C. § 704(8); the duty to make a

whether an examiner may be morphed into a quasi-trustee, without implicating some of the adverse consequences triggered by the appointment of a trustee. The answer to this question is somewhat mixed.

From the outset, it should be recognized that an examiner's duties cannot be morphed if a bankruptcy trustee has been appointed. Section 1104(b) of the Bankruptcy Code appears to contemplate that an examiner cannot be appointed if a trustee is already in place.<sup>59</sup> This "don't tread on me" approach is consistent with the prudential concern of not limiting a trustee's powers and duties, as the appointment of a bankruptcy trustee under the Bankruptcy Code completely ousts the debtor's officers and directors.<sup>60</sup>

The expansion of an examiner's duties under the Bankruptcy Code is not to be inferred or taken lightly. Expansion of an examiner's duties may be accomplished only by an express order of the bankruptcy court, and such order must plainly set forth both the duties that the examiner is to perform and the duties that the debtor is to abstain from performing.<sup>61</sup>

In instances where an examiner's duties have been expanded, the majority of the case law appears to indicate that the inflation of the duty balloon occurs in the context of liquidating assets of the bankruptcy estate, including pursuing causes of action identified in an examiner's report and soliciting bids for the sale of assets under circumstances wherein the debtor did not aggressively pursue the liquidation of such asserts.<sup>62</sup> Alternatively, courts have also cloaked examiners with the duty of facilitating the plan confirmation process in instances where the reorganization process

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final report with respect to the administration of the estate, 11 U.S.C. § 704(9); the duty to file schedules of assets and liabilities and statements of financial affairs, 11 U.S.C. 1106(a)(2); the duty to file a plan or recommend conversion or dismissal of the case, 11 U.S.C. § 1106(a)(5); the duty to furnish information to governmental taxing bodies, 11 U.S.C. § 1106(a)(6); and the duty to file post-confirmation reports, 11 U.S.C. § 1106(a)(7).

59. See 11 U.S.C. § 1104(c)(providing that the appointment of an examiner can only occur where cause is shown and where "the court does not order the appointment of a trustee").

60. See KING, *supra* note 5 at ¶ 1106.05[1](noting that Section 1106(b) of the Bankruptcy Code should "not be viewed as a means by which the court can essentially remove the debtor in possession from control of the estate without appointing a trustee").

61. See 11 U.S.C. § 1106(b).

62. *In re Patton's Busy Bee Disposal Serv., Inc.*, 182 B.R. 681 (Bankr. W.D.N.Y. 1995); see also *In re John Peterson Motors, Inc.*, 47 B.R. 551 (Bankr. D. Minn. 1985); *In re Carnegie Int'l Corp.*, 51 B.R. 252 (Bankr. S.D. Ind. 1984).



has broken down.<sup>63</sup> By way of illustration, the court in *In re Public Serv. Co. of New Hampshire* appointed an examiner to mediate and break a deadlock in plan negotiations and to assist the court at disclosure statement hearings relating to competing plans.<sup>64</sup>

### III. THE EXAMINER AND THE ATTORNEY-CLIENT PRIVILEGE

The ability of a court to grant an examiner quasi-trustee powers and duties under Section 1106 of the Bankruptcy Code has allowed courts to expand the scope of an examiner's role in Chapter 11 beyond that of a mere investigator in order to meet the individual needs of each case.<sup>65</sup> The ability to inflate the role of an examiner appears to have practical utility in the bankruptcy context, particularly due to the fact that Chapter 11 cases have grown in size, complexity, and volume.<sup>66</sup> The growing number of accounting scandals and cases of executive misconduct will lead to examiners continuing to play a pivotal role in complex Chapter 11 cases.<sup>67</sup>

However, an examiner's inflated power and duty balloon may be popped in certain circumstances.<sup>68</sup> The outer-limits of an examiner's powers and duties can be illustrated through an examination of whether the examiner has the power to waive a debtor's attorney-client privilege. Perhaps one of the most publicized Chapter 11 cases involving the scope of an examiner is *In re Enron Corporation*,<sup>69</sup> in which the United States Bankruptcy Court for the Southern District of New York authorized the appointment of

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63. See, e.g., *In re Enron Corp.*, 279 B.R. 671, 678-82 (Bankr. S.D.N.Y. 2002)(examiner's role expanded to facilitate reorganization plan); *In re Keene Corp.*, 205 B.R. 690, 694 (Bankr. S.D.N.Y. 1997)(examiner appointed with power to mediate and supervise reorganization negotiations); *In re UNR Indus.*, 72 B.R. 789, 795-96 (Bankr. N.D. Ill. 1987)(examiner appointed to mediate and facilitate impasses in negotiating a reorganization plan).

64. 99 B.R. 177, 182-83 (Bankr. D. N.H. 1989); see also *In re Great Barrington Fair & Amusement, Inc.*, 53 B.R. 241, 244 (Bankr. D. Mass. 1985).

65. See, e.g., *Enron Corp.*, 279 B.R. at 678-82 (appointing examiner with expanded powers to facilitate plan of reorganization); *Apex Oil Co.*, 111 B.R. at 240 (examiner appointed with expanded power to resolve claims); *Williamson v. Roppollo*, 114 B.R. 127 (W.D. La. 1990)(examiner with expanded powers to pursue avoidance actions); *In re World Indus. Ctrs., Ltd.*, 992 F.2d 1220 (9th Cir. 1993)(unpublished decision)(examiner appointed with expanded power to sell estate property); *Balser v. Dep't of Justice*, 327 F.3d 903, 905-06 (9th Cir. 2003)(examiner appointed with expanded power to manage rental properties and sell assets).

66. Kaplan, *The Role of the Examiner: Some Observations*, 4 BANKR. DEV. J. 439 (1987).

67. See Loomis, *supra* note 2.

68. *In re Int'l Distrib. Ctrs., Inc.*, 74 B.R. 221 (S.D.N.Y. 1987)(rejecting powerful examiner as a "pseudo-trustee").

69. No. 01-16034, 2002 WL 32151530 (Bankr. S.D.N.Y. 2002).

an examiner to investigate various questionable balance sheet transactions between the debtor and its affiliates.<sup>70</sup> The order appointing an examiner in *Enron* (hereinafter “the Enron Order”) was fairly broad in terms of the investigative duties reposed in the examiner appointed in that case.<sup>71</sup> To facilitate the examiner’s investigation, and to aid the examiner in uncovering claims and causes of action against various parties (including, without limitation, the debtor’s present and former officers, attorneys, and accountants), the Enron Order also went so far as to grant the examiner the power to waive the debtor’s attorney-client privilege.<sup>72</sup>

The power granted in the Enron Order that permitted the examiner to exercise control over and to waive the attorney-client privilege is controversial and raises many questions, including: “Does an examiner have an interest in the attorney-client privilege in order to waive it?”

There is no specific provision in the Bankruptcy Code that grants an examiner an interest in the debtor’s privileges, let alone conferring upon an examiner the ability to waive those privileges. Indeed, examiners are not even mentioned as being parties-in-interest under the Bankruptcy Code.<sup>73</sup>

Proponents of granting an examiner the power to waive the debtor’s privileges point to Section 1106(b) of the Bankruptcy Code as a source of this power.<sup>74</sup> Section 1106(b) of the Bankruptcy Code, however, may not be as expansionist as the proponents contend.<sup>75</sup>

The United States Supreme Court held in *CFTC v. Weintraub* that a trustee in bankruptcy has the power to waive a corporate

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70. *Id.* at \*1.

71. *Id.*

72. See Enron Order at 3. The waiver provisions of the Enron Order provided that the examiner “shall have the power to waive” the attorney-client privilege on an “issue-by-issue basis” with respect to pre-petition communications relating to matters that the examiner was to investigate. In the Enron Order, the court further instructed that the examiner was to act “in the best interest of the debtor’s estates” in connection with any decision to waive the attorney-client privilege, and that the debtors’ and creditors’ committees could make objections to such a waiver.

73. See 11 U.S.C. § 1109(b). The notion that an examiner is not a party-in-interest is consistent with the fact that an examiner’s role in bankruptcy is generally limited to being a neutral and independent investigator.

74. *Cf., Baldwin United Corp.*, 46 B.R. at 315 (holding that examiner shall have the same privilege rights as trustee so that examiner may perform its statutorily mandated duties).

75. In *Norwest Bank Worthington v. Ahlers*, the United States Supreme Court concluded that “whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.” 485 U.S. 197, 206 (1988).

debtor's attorney-client privilege with respect to pre-bankruptcy communications.<sup>76</sup> The *CFTC v. Weintraub* case appears to provide practical support for conferring upon an examiner the power to waive the attorney-client privilege.<sup>77</sup>

In *Weintraub*, the United States Supreme Court noted the proposition that the trustee in bankruptcy plays the role most closely analogous to that of a solvent corporation's management.<sup>78</sup> The Supreme Court reasoned that conferring upon a trustee the power to waive the privilege is consistent with the fact "that the debtor's directors retain virtually no management powers, [and, as a result,] they should not exercise the traditional management function of controlling the corporation's attorney-client privilege."<sup>79</sup> The Supreme Court went on to explain,

It would be extremely difficult for the trustee to investigate the conduct of prior management if the former management were allowed to control the attorney-client privilege and therefore control access to the corporation's legal files.<sup>80</sup>

The *Weintraub* Court therefore held that vesting control of the debtor corporation's attorney-client privilege in the trustee was appropriate<sup>81</sup> and did not in any way conflict with the careful design of the Bankruptcy Code.<sup>82</sup>

The Supreme Court's second line of reasoning in *Weintraub* asserted that trustees need to be able to control the attorney-client privilege in order to conduct a thorough investigation and thereby discover "hidden assets" or "looting schemes."<sup>83</sup> Essentially, the Supreme Court appears to have held in this instance that wresting control of the privilege away from persons who may have engaged in, or have knowledge of, tortious conduct is in the best interest of creditors. In fact, some cases have suggested that the

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76. *Weintraub*, 471 U.S. at 358.

77. *Id.*

78. *Id.* at 353.

79. *Id.*

80. *Id.*

81. *Weintraub*, 471 U.S. at 355. Wrestling control of the attorney-client privilege does not translate into a trustee's unfettered right to waive it. As the Supreme Court in *Weintraub* noted, "The propriety of the trustee's waiver of the attorney-client privilege in a particular case can, of course, be challenged in the bankruptcy court on the ground that it violates the trustee's fiduciary duties." *Id.* at n.7.

82. *Id.* at 354.

83. *Id.*

debtor or trustee has the fiduciary duty to waive the privilege in these circumstances.<sup>84</sup>

#### IV. DOES AN EXAMINER REALLY HAVE STANDING TO WAIVE THE DEBTOR'S ATTORNEY-CLIENT PRIVILEGE?

The fiduciary duty argument conferring standing upon an examiner to waive an attorney-client privilege does have some curb appeal, and perhaps some basis in Sections 105 and 1106(b) of the Bankruptcy Code.<sup>85</sup> This argument, however, is also prone to attack.

Challenges to an examiner's power to waive the debtor's attorney-client privilege may cite to the plain language of the Bankruptcy Code as support for the proposition that an examiner's power to waive privileges is illusory. Specifically, a fair reading of the fundamental premise of the Supreme Court's decision in *Weintraub* is that the attorney-client privilege is property of the estate,<sup>86</sup> which a bankruptcy trustee owns and controls as a matter

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84. See *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970). *Garner* is the seminal case reflecting the fiduciary exception to retaining the attorney-client privilege. In *Garner*, a number of shareholders brought a derivative suit against a corporation alleging various counts of fraud and corporate misconduct. When the shareholders sought information and documentation from the company's former counsel, who later became an officer of the company, both the counsel and the company claimed that the information and documentation were protected by the privilege. The Fifth Circuit Court of Appeals held that the privilege did not apply because the corporation owed a fiduciary duty to the shareholders and the privilege should not deny the beneficiary access to information or documentation created or obtained, at least in part, for the shareholders' benefit. According to the Court in *Garner*, courts are to consider the applicability of the attorney-client privilege in a particularized context. In instances wherein the client asserting the privilege is an entity that in the performance of its functions acts wholly or partly in the interests of others, and those others or some of them seek access to the subject matter of the communications, courts are to conclude:

The representative and the represented have a mutuality of interest in the representative's freely seeking advice when needed and putting it to use when received. This is not to say that management does not have allowable judgment in putting advice to use. But management judgment must stand on its merits, not behind an ironclad veil of secrecy which under all circumstances preserves it from being questioned by those for whom it is, at least in part, exercised.

*Garner*, 430 F.2d at 1101.

85. See generally 11 U.S.C. §§ 105, 1106(b). Section 105 of the Bankruptcy Code authorizes the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." See 11 U.S.C. § 105(a). Certainly, the entry of an order providing an examiner with access to privileged materials, and to waive applicable privileges, is consistent with an examiner's duty to investigate the acts, conduct, assets, liabilities, and financial condition of the debtor and the operation of the debtor's business.

86. The phrase "property of the estate" is defined in section 541 of the Bankruptcy Code, and includes "all legal or equitable interests of the debtor in property as of the com-

of law once he or she is appointed.<sup>87</sup> According to *Weintraub*, management of the debtor is "ousted" by the appointment of a trustee, and all such property of the estate then passes to the trustee duly appointed by the court.<sup>88</sup> Towards this end, *Weintraub* may be construed narrowly and be applicable only in contexts of bankruptcy trustees (who have vast powers) as opposed to bankruptcy examiners (whose powers are limited).

The Bankruptcy Code is consistent with a narrow application of *Weintraub*. Section 363 of the Bankruptcy Code authorizes a bankruptcy trustee to sell, use or lease property of the bankruptcy estate both in the ordinary course of business, and (subject to prior order of the court) outside the ordinary course of business.<sup>89</sup> Arguably, the waiver of the attorney-client privilege is a "use" of property of the estate as contemplated in Section 363(b) of the Bankruptcy Code.<sup>90</sup> As a result, it is important to note that Section 363 of the Bankruptcy Code permits no one, other than the debtor or trustee, to use, sell, or lease property of the estate.<sup>91</sup> Consequently, to the extent that the waiver of the attorney-client privilege constitutes a "use" of "property of the estate," the Bankruptcy Code does not appear to authorize or empower an examiner to waive the privilege.<sup>92</sup>

The legal concept of "property of the bankruptcy estate" is quite broad, and, pursuant to Section 541 of the Bankruptcy Code, includes all legal and equitable interests of the debtor as of the commencement of the bankruptcy case.<sup>93</sup> The question of whether the debtor's attorney-client privilege constitutes property of the debtor's bankruptcy estate is an issue that has been confounding

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mencement of the case" and any such interest acquired "after the commencement of the case." 11 U.S.C. § 541(a).

87. See *Weintraub*, 471 U.S. at 349-353.

88. *Id.* at 352-353 (citing Bankruptcy Code Sections 323, 541, 363, 704 and 1106).

89. See 11 U.S.C. § 363(b).

90. The *Weintraub* opinion suggests that creditors may object to the waiver of any estate privileges. See *supra* note 81. Implicit in such a conclusion is that the waiver is a non-ordinary course transaction for which creditors and other parties in interest are entitled to notice and an opportunity to be heard.

91. *Id.* The United States Supreme Court has held that when the "statute's language is plain, the sole function of courts is to enforce it according to its terms." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989) (citing *Caminetti v. United States*, 242 U.S. 470, 485 (1917)).

92. See *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000) (holding that only the trustee or debtor-in-possession may assert Section 506(c) surcharge claims because Section 506(c) of the Bankruptcy Code does not repose the authority of prosecuting such claims in third-parties).

93. See 11 U.S.C. Section 541.

legal scholars for many years.<sup>94</sup> Some commentators suggest that characterizing the attorney-client privilege as alienable property is “morally repugnant” since the privilege is personal in nature.<sup>95</sup>

Authority exists in support of the proposition that the right to invoke the attorney-client privilege is both transferable and has some indicia of property. For example, in *Swidler & Berlin and James Hamilton v. United States*,<sup>96</sup> the United States Supreme Court held that as a matter of federal common law the attorney-client privilege survives the death of its holder for the benefit of the holder’s estate.<sup>97</sup> Similarly, in the commercial context, some courts have acknowledged that the attorney-client privilege can be transferred along with the debtor’s personal property.<sup>98</sup> In the corporate context, the United States Supreme Court in *Weintraub* even appears to implicitly embrace the concept that the attorney-client privilege constitutes a legal and/or equitable property interest of a debtor in bankruptcy.<sup>99</sup>

Critics of the “privilege as property” theory contend that construing the attorney-client privilege as a legal or equitable interest of the debtor falling within the ambit of Section 541 of the Bankruptcy Code is “unsound.”<sup>100</sup> Undoubtedly, the purpose of the attorney-client privilege “is to encourage full and frank communication between attorneys and their clients and thereby promote

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94. For an outstanding discussion of the issue, see Laura B. Bartell, *The Implied Waiver Solution to the Problem of Privileges in the Individual Bankruptcy Case*, 20 BANKR. DEV. J. 25 (2003) and Neil E. Herman, *Who Controls the Attorney-Client Privilege in Bankruptcy*, 13 HOFSTRA L. REV. 549 (1985).

95. Bartell, *The Implied Waiver Solution to the Problem of Privileges in the Individual Bankruptcy Case*, 20 BANKR. DEV. J. at 42 n 97.

96. 524 U.S. 399 (1998).

97. *Swidler & Berlin*, 524 U.S. at 404-405.

98. See, e.g., *American Metrocomm Corp. et al. v. Duane Morris & Heckscher (In re American Metrocomm Corp.)*, 274 B.R. 641, 654 n.10 (Bankr. D. Del. 2002)(where assignee of litigation claims also acquired shared privilege rights); *Grace Children’s Prods, Inc. v. Regalo Int’l LLC*, Civ. A. 97-6885, 1999 WL 553478 at \*3, 4 (E.D. Pa. July 29, 1999)(holding that the right to assert or waive the attorney-client privilege also passes with the majority of a corporation’s assets in an asset sale); *Rhode Island Depositors Economic Protection Corp. v. Mapleroot Dev. Corp.*, 710 A.2d 167 (R.I. 1998)(stating that “DEPCO expressly purchased all of the receiver’s personal and intangible rights with respect to this borrower. Such rights would include the receiver’s right to assert any attorney client privilege that formerly belonged to [the borrower]”); *In re Amjoe*, Bankr. L.Rep. (CCH) P 66, 131 (M.D. Fla. 1976)(suggesting that the attorney-client privilege is connected to other property of the estate, and if that other property passes to the trustee, the attorney-client privilege should pass with it); *contra In re Grand Jury Subpoenas 89-3 & 89-4*, 734 F.Supp. 1207, 1211 n.3 (E.D. Va.), *aff’d in part, vacated in part*, 902 F.2d 244 (4<sup>th</sup> Cir. 1990).

99. *Weintraub*, 471 U.S. at 348-351.

100. See, e.g. Herman, *Who Controls the Attorney-Client Privilege in Bankruptcy*, 13 HOFSTRA L. REV. at 583.

broader public interests in the observance of law and administration of justice."<sup>101</sup> Critics contend that if the attorney-client privilege is construed as a property interest passing to a bankruptcy trustee automatically upon the commencement of a Chapter 7 bankruptcy case or upon the appointment of a trustee in a Chapter 11 case, such a construction will have a chilling effect upon the attorney-client relationship.<sup>102</sup> According to such critics, the chilling effect is predictable because any "rational individual would not divulge sensitive information to an attorney who might be forced to reveal the information if the individual suffers a financial reversal."<sup>103</sup>

The arguments of the critics of the "privilege as property" theory appear to be misplaced to a certain degree. With respect to the corporate context, the *Weintraub* decision (which indirectly adopted the "privilege as property" theory) is nearly twenty years old, and corporate entities still seek out and obtain corporate counsel just as they did prior to that decision. Irrespective of the *Weintraub* decision, corporate decision makers outside of a bankruptcy context have always been subject to the risk that successor managers of the corporation's affairs would waive the attorney-client privilege to the extent that such a waiver is either in the corporation's best interest or is consistent with the fiduciary duties of the corporation's officers and directors. Under these circumstances, the *Weintraub* decision and the concept of "privilege as property" has no chilling effect on the attorney-client privilege in the corporate context. As a matter of fact, the *Weintraub* decision and the privilege as property theory merely restate the obvious (i.e. -- that corporate entities are inanimate objects whose then current managers control the invocation and waiver of the attorney-client privilege).

With respect to the individual debtor context, critics of the "privilege as property" approach contend that characterizing the attorney-client privilege as a property interest has "untoward consequences."<sup>104</sup> Citing to the fact that the fiduciary duties of a bankruptcy trustee flow to creditors, and not to the interests of the individual debtor,<sup>105</sup> critics argue that a bankruptcy trustee "will

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101. *Upjohn Co. v. United States*, 449 U.S., 389 (1981).

102. *Id.*

103. *Id.*

104. Bartell, *The Implied Waiver Solution to the Problem of Privilege in the Individual Bankruptcy Case*, 20 BANKR. DEV. J. at 43-45.

105. *Id.*

not, and should not act in the best interests of the debtor in deciding whether to waive the privilege, but will pursue his [or her] statutory obligations to collect property of the estate and investigate the financial affairs of the debtor.”<sup>106</sup> Consequently, an untoward corollary highlighted by critics of the “privilege as property” theory is the fact that individual debtors’ pre-bankruptcy communications subsequently may operate to open a Pandora’s Box of criminal and/or civil liability to the detriment of the unsuspecting debtor.<sup>107</sup>

It can be argued that the critics’ fears of the “privilege as property” theory in the individual debtor context also are somewhat misguided. As an initial matter, the attorney-client privilege is not without exception, as the law of virtually every jurisdictions will not allow clients and lawyers to communicate with impunity about future crimes or intentional torts such as fraud.<sup>108</sup> Even outside of bankruptcy, an individual consumer debtor may find his or her privilege impliedly waived if the circumstances fall within the crime/fraud exception to the attorney-client privilege.

Also, the individual debtor does have resources available to avoid the forfeiture of the privilege. To the extent that the individual debtor’s interest in retaining the privilege is paramount to all of his or her other interests, the debtor is always free not to seek bankruptcy protection in the first instance and to deal with his or her creditors in a non-bankruptcy context. To the extent that the individual debtor is in need of a fresh start and has no choice but to seek bankruptcy protection (or, alternatively, if the individual debtor finds himself or herself subject to an involuntary bankruptcy proceeding), the debtor can attempt to shield the privilege, and augment his or her “fresh start” in bankruptcy, by declaring his or her interest in the attorney-client privilege as being exempt from property of the estate pursuant to Section 522 of the Bankruptcy Code.<sup>109</sup>

Exempting the attorney-client privilege under Section 522 of the Bankruptcy Code from property of the estate does have practical

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106. *Id.*

107. *Id.* at 49.

108. See § 82 at 613-14 RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS (1998); see e.g. *In re Grand Jury Subpenas*, 144 F.3d 653, 660 (10th Cir.), cert. denied, 525 U.S. 966 (1998).

109. See 11 U.S.C. § 522(d)(5) (2004) (providing an individual debtor with a “wild-card” exemption to the extent of \$8,725 of an unused homestead exemption in bankruptcy); see also 11 U.S.C. § 542(a) (2004) (providing that an entity holding exempt property does not have to turnover such exempt property to the bankruptcy trustee).



concerns. For example, how does one value the exemption to insure that the statutory amount of exemptions are met? If the content of the privileged communication is not disclosed, can a court ever determine whether the "asset" has been appropriately exempted by the debtor? Surely, this result is unworkable and is something that Congress did not contemplate when it drafted the property of the estate provisions of the Bankruptcy Code.

Despite a debtor's ability to claim exemptions under Section 522 of the Bankruptcy Code, the statutory framework of the Bankruptcy Code is such that debtors do not enjoy an expectation of confidentiality where the attorney-client privilege implicates tangible assets and choses of action which could be liquidated for the benefit of creditors.<sup>110</sup> The provisions of Section 521 of the Bankruptcy Code impose upon the debtor the absolute duty to "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties" under the Bankruptcy Code.<sup>111</sup> Such duties of a debtor to cooperate include surrendering to the bankruptcy trustee "any recorded information, including books, documents, records, and papers, relating to property of the estate."<sup>112</sup> Based on Section 521 of the Bankruptcy Code and the broad concept of "property of the estate" utilized in Section 541 of the Bankruptcy Code, it is conceivable to conclude that Congress envisioned a scheme whereby the attorney-client privilege of an individual debtor would submit, in appropriate situations, to the needs of the bankruptcy trustee, so that the trustee may carry through with his or her duties under the Bankruptcy Code.<sup>113</sup> In addition, the "as necessary" language utilized in Section 521 of the Bankruptcy Code also suggests that the bankruptcy trustee's claim to privileged materials is tempered by necessity. Courts therefore should balance the interests of the bankruptcy estate in general against the harm caused to the individual debtor when framing an order directing the turnover of privileged materials.<sup>114</sup>

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110. It should also be recognized that the mere fact that a trustee may succeed to the debtor's interest in the attorney-client privilege does not necessarily mean that the privilege is waived. In fact, Section 542 of the Bankruptcy Code appears to preserve the privilege unless expressly waived by the trustee as the Bankruptcy Code provides that the transfer of documents and information by attorneys to the trustee is "[s]ubject to applicable privileges. . . ." 11 U.S.C. § 542(e).

111. See 11 U.S.C. § 521(3).

112. See 11 U.S.C. § 521(4).

113. *In re Miller*, 247 B.R. 704, 710 (Bankr. N.D. Ohio 2000).

114. *Id.* The analysis pursuant to Section 521 of the Bankruptcy Code is consistent with Rule 501 of the Federal Rules of Evidence. Federal Rule of Evidence. 501 provides that the attorney-client privilege "shall be governed by the principles of the common law as they

No matter how the attorney-client privilege is viewed from a bankruptcy perspective, it is important to recognize that the right to assert or to waive privileges in and of itself is either property of the bankruptcy estate or it is not. Authority certainly exists (most notably the *Weintraub* decision) in support of the theory that a debtor's attorney-client privilege should be construed as property of the bankruptcy estate.<sup>115</sup> If the privilege constitutes property of the bankruptcy estate, Section 363 of the Bankruptcy Code authorizes only the debtor or trustee to sell, use, or lease such property, and no-one else (including an examiner in bankruptcy) is authorized to do so. Conversely, if the debtor's attorney-client privilege does not constitute property of the bankruptcy estate, there is absolutely nothing in the Bankruptcy Code that empowers anyone other than the debtor to waive the privilege. Moreover, a debtor's obligation to cooperate and turn over records flows only to a bankruptcy trustee under Section 521 of the Bankruptcy Code. Under these circumstances, waivers in favor of examiners, like the one procured in *Enron*, appear to be suspect.

Additional statutory prohibitions on an examiner's power to waive an attorney-client privilege can be found in Sections 321(b) and 1106 of the Bankruptcy Code.<sup>116</sup> As to the former, Section 321(b) of the Bankruptcy Code prohibits an examiner from serving as a trustee in the same bankruptcy case.<sup>117</sup> Bankruptcy courts have relied upon this statute to prohibit examiners from being morphed into quasi-trustees.<sup>118</sup>

For example, in *In re International Distributions Centers, Inc.*, the United States District Court for the Southern District of New York vacated an order of the bankruptcy court delegating the powers and duties of a trustee to an examiner.<sup>119</sup> The District Court, looking at the substantive powers afforded to the examiner in that case (as opposed to mere titles bestowed upon officers of the court), concluded that the powers granted to the examiner at

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may be interpreted by the courts of the United States in the light of reason and experience." This analysis also is consistent with Section 542 of the Bankruptcy Code. 11 U.S.C. § 542. Section 542(a) provides that property of "inconsequential value or benefit" to the bankruptcy estate need not be turned over to the bankruptcy trustee. See 11 U.S.C. § 542(a).

115. See also *Citibank, N.A. v. Andros*, 666 F.2d 1192, 1194-1196 (8<sup>th</sup> Cir. 1981).

116. See 11 U.S.C. §§ 321(b) and 1106(b).

117. 11 U.S.C. § 321(b).

118. See *In re Int'l Distributions Centers, Inc.*, 74 B.R. 221 (1977).

119. *Id.*

issue intruded upon the powers conferred upon a trustee.<sup>120</sup> In vacating the bankruptcy court's order, the Court in *International Distributions Centers, Inc.* held that it is an abuse of discretion to appoint pseudo-trustees cloaked with powers of a trustee when Section 321 of the Bankruptcy Code prohibits an examiner from being both trustee and examiner in the same bankruptcy case.<sup>121</sup>

The conclusion reached in the *In re International Distributions Centers, Inc.* case is supported by Section 1106 of the Bankruptcy Code and case-law interpreting this statute. In looking at Section 1106 of the Bankruptcy Code, this section describes the powers and duties of trustees and examiners.<sup>122</sup> As it relates to trustees, Section 1106(b) sets forth both the "powers" and the "duties" of trustees in bankruptcy. Conversely, when Section 1106 addresses examiners, Section 1106 only imposes "duties" upon examiners and bestows no "powers" whatsoever.<sup>123</sup> This distinction between "powers" and duties" in Section 1106 of the Bankruptcy Code served to deflate an examiner's efforts to prosecute certain adversary proceedings in the case of *In re Patton's Busy Bee Disposal Service, Inc.* In *Patton's Busy Bee*, the Bankruptcy Court for the Western District of New York wrote:

. . . [T]he parties fail to distinguish the concepts of duty and responsibility from the concepts of power and authority. The existence of an obligation does not necessarily command the use of any particular means to fulfill that obligation. For example, the duty to safeguard an interest does not necessarily empower the obligor to commence an action. Rather, a plaintiff must possess authority to employ litigation as an appropriate exercise of responsibility. For such creatures of this Court as examiners and trustees, this authority must derive from the Bankruptcy Code itself or from an order of this Court.

The Bankruptcy Code carefully defines the responsibilities and powers of a trustee. Section 1106(a) sets forth seven duties of a trustee. Apart from this provision are grants of authority contained in section 323. . . . In contrast, the Code assigns far more limited responsibility to an examiner and con-

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120. *Id.* at 223.

121. *Id.* at 224.

122. 11 U.S.C. § 1106 (2004).

123. Compare 11 U.S.C. § 1106(a) with 11 U.S.C. § 1106(b).

tains no clear authorization for the examiner's commencement of an adversary proceeding.<sup>124</sup>

The Bankruptcy Code and case law set forth above suggests that the ability of an examiner to have its powers morphed to include powers traditionally vested solely with a bankruptcy trustee (such as waiver of the attorney-client privilege) is far from certain.<sup>125</sup> Precedent and statutory provisions under the Bankruptcy Code both support and work against affording an examiner the power to waive the attorney-client privilege.<sup>126</sup> While the practical and prudential reasons for permitting an examiner to waive the attorney-client privilege are frequently present in most cases (such as the trustee case in *Weintraub*), Congress has not yet specifically empowered examiners to waive attorney-client privileges that constitute either property of the bankruptcy estate under Section 541 of the Bankruptcy Code or records turned over to bankruptcy trustees pursuant to Section 521 of the Bankruptcy Code. This legal issue has been further complicated by the United States Supreme Court's decision in *Hartford Underwriters Insurance Company v. Union Planters Bank, N.A.*, which contains a narrow view of which persons may exercise powers traditionally held by the debtor or trustee.<sup>127</sup>

In *Hartford Underwriters*, a unanimous United States Supreme Court reaffirmed the well-established precept of statutory construction that provides that where the language of a statute is clear and unambiguous, "the sole function of the courts . . . is to enforce [the statute] according to its terms."<sup>128</sup> In *Hartford Underwriters*, the United States Supreme Court followed this precept of statutory construction in the context of a case in which an administrative creditor, in its own right, sought to recover its post-petition claim against the debtor's secured lender pursuant to the "surcharge" provisions of Section 506(c) of the Bankruptcy Code.<sup>129</sup>

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124. *In re Patton's Busy Bee*, 182 B.R. at 685-86.

125. Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 578 (3d Cir. 2003).

126. *Id.* at 577-78 (noting that language of Section 1106 of the Bankruptcy Code has been interpreted to afford courts with the authority to expand an examiner's power to sue, and also noting that such a construction is suspect).

127. See *Hartford Underwriters*, 530 U.S. at 2.

128. *Id.*

129. *Id.* Section 506(c) of the Bankruptcy Code states, "The Trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holders of such claim." 11 U.S.C. § 506(c) (2004).

Because the administrative creditor in *Hartford Underwriters* pursued the surcharge claim in its own right without express consent of the court, and because Section 506(c) of the Bankruptcy Code unambiguously provides that “[t]he trustee may” pursue such surcharge claims, the United States Supreme Court rejected the unilateral right of an unpaid administrative creditor to prosecute a surcharge claim under Section 506(c) of the Bankruptcy Code.<sup>130</sup>

*Hartford Underwriters’* narrow view of which persons may exercise powers traditionally owned by the debtor or trustee arguably restricts the ability of a bankruptcy examiner to waive the attorney-client privilege of a debtor-in-possession. It is difficult to harmonize this narrow view espoused by *Hartford Underwriters* with the fundamental purpose of the Bankruptcy Code (i.e., maximizing the estate and distributions to creditors) in the absence of some statutory enactment by Congress or Supreme Court precedent that permits persons other than the debtor or trustee to waive the debtor’s attorney-client privilege in bankruptcy.<sup>131</sup>

All may not be lost, however. In *Hartford Underwriters*, the United States Supreme Court left open the issue of whether the concept of “derivative standing” is legally cognizable in a bankruptcy setting when a bankruptcy trustee or debtor-in-possession refuses to enforce legal claims or causes of action for the benefit of creditors.<sup>132</sup> While the United States Supreme Court has yet to tackle the derivative standing issue, several Federal Courts of Appeals have recently been heard on the issue and have recognized

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130. See *Hartford Underwriters*, 530 U.S. at 2.

131. In *In re Boileau*, 736 F.2d 503 (9th Cir. 1984), the Ninth Circuit Court of Appeals affirmed an order that permitted an examiner to waive the debtor’s attorney-client privilege. Under the unique facts of the case, the *Boileau* Court stated, “Our holding is not to be understood as a ruling on the authority of an examiner to waive the attorney-client privilege.” *Id.* at 506.

132. Specifically, the United States Supreme Court wrote:

We do not address whether a bankruptcy court can allow other interested parties to act in the trustee’s stead in pursuing recovery under § 506(c). Amici . . . draw our attention to the practice of some courts of allowing creditors or creditors’ committees a derivative right to bring avoidance actions when the trustee refuses to do so, even though the applicable Code provisions, see 11 U.S.C. §§ 544, 545, 547(b), 548(a), 549, mention only the trustee. See, e.g., *In re Gibson Group, Inc.*, 66 F.3d 1436, 1438 (C.A.6 1995). Whatever the validity of that practice, it has no analogous application here, since petitioner did not ask the trustee to pursue payment under § 506(c) and did not seek permission from the Bankruptcy Court to take such action in the trustee’s stead. Petitioner asserted an independent right to use § 506(c), which is what we reject today.

*Hartford Underwriters*, 530 U.S. at 13 n. 5.

the general equitable concept of “derivative standing”<sup>133</sup> in instances where a bankruptcy trustee or debtor-in-possession wrongfully fails to prosecute lawsuits for the benefit of creditors.<sup>134</sup> These cases are indeed persuasive. To the extent that they are applicable to the issue of whether an examiner’s power may, on a derivative basis, be expanded to include the ability to waive the debtor’s attorney-client privilege, these cases are also consistent with the goals and aims of Sections 1104 and 1106 of the Bankruptcy Code, namely, to eliminate the proverbial problem of the “fox guarding the henhouse.”<sup>135</sup>

Notwithstanding the apparent benefits of recognizing the concept of “derivative standing” in bankruptcy, recent case law in this area nonetheless casts some doubt on whether an examiner can have its powers morphed into the various powers normally re-

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133. Bankruptcy courts have long been recognized as courts of equity. *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934); *Pepper v. Litton*, 308 U.S. 295 (1939). The concept of derivative standing is consistent with the equitable jurisdiction of the bankruptcy courts, as derivative standing permits the beneficial owners (i.e., the creditors) of the legal claim or cause of action to exercise such rights in the name of the party who holds a mere nominal interest (i.e., the trustee or debtor-in-possession) in the legal claim or cause of action. *See e.g.*, *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 349 (2001)(noting that creditors are the beneficiary of claims prosecuted by trustee or debtor-in-possession). Because the concept of derivative standing is consistent with the equitable jurisdiction of the bankruptcy court, derivative standing has long been recognized in bankruptcy, *see e.g.*, *Glenny v. Langdon*, 98 U.S. 20, 27 (1878)(derivative standing “is founded upon the enlarged principles of equity”); *McDaniel v. Stroud*, 106 F. 486, 489 (4th Cir. 1901)(“the court would, in the first instance, have directed the trustee to allow the use of his name to conduct the appeal if it was thought necessary”); *In re Stern*, 144 F. 956, 958 (8th Cir. 1906)(“if [the trustee] refuses to oppose a claim or to move for its reconsideration when he ought to do so, he may be compelled to act or to permit the objecting creditors to act in his name”); *Ohio Valley Bank Co. v. Mack*, 163 F. 155, 156 (6th Cir. 1906)(“when the trustee refuses to appeal . . . the better practice would be to order the trustee to appeal or to allow the dissatisfied creditor to appeal in his name”); *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434, 457-58 (1940)(recognizing creditors derivative rights to challenge claims filed by other creditors in a Chapter XI proceeding). Such a mechanism was not abrogated by the Bankruptcy Code. *Midatlantic Nat’l Bank v. New Jersey Dep’t of Env’tl. Prot.*, 474 U.S. 494, 501 (1986)(“The normal rule of statutory construction is that if Congress intends for legislation to change interpretation of a judicially created concept, it makes that intent specific . . . .The Court has followed this rule with particular care in construing the scope of bankruptcy codification.”).

134. *See Cybergemics, supra.*; *see also Commodore Int’l, Ltd. v. Gould*, 262 F.3d 96 (2d Cir. 2001).

135. For example, if the debtor’s insiders and professionals are permitted to hide behind the cloud of secrecy that is attendant to the attorney-client privilege, how will an examiner be able to complete fully his or her mandate? The answer to this hypothetical suggests that if the plain language of the Bankruptcy Code prohibits an examiner from fulfilling his or her duties, the result may be deemed “absurd” and the statute should be interpreted to avoid any absurd result. *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2001)(the sole function of the court is to enforce the statute according to its terms if the statute is plain and does not lead to an absurd result).

served to a bankruptcy trustee.<sup>136</sup> Simply stated, the largest stumbling block to this endeavor is the plain language of the Bankruptcy Code itself. As a starting point, and as set forth above, a preliminary problem with giving an examiner the equal rights and powers of a trustee is the fact that the Bankruptcy Code fails to provide an examiner with "party-in-interest" status.<sup>137</sup> As a result, the ability of an examiner to appear and be heard on any issue in Chapter 11 may be in doubt.

An examiner's chameleon-like character is also thwarted by the provisions of Section 1106 of the Bankruptcy Code.<sup>138</sup> In the context of its holding that an examiner in bankruptcy lacks the power to prosecute estate causes of action on a derivative basis, the United States Court of Appeals for the Third Circuit in *Official Committee of Unsecured Creditors of Cybergenics Corporation v. Chinery* wrote,

. . . [W]e harbor doubts about [an examiner's] ability to substitute for derivative suit. One concern is that, like a trustee, an examiner would incur direct costs through its fees, so that extent of this remedy is inferior to the alternative of derivative suit by a creditors' committee.<sup>[139]</sup>

The more serious problem, however, is that it is less than obvious that Section 1106(b) actually *does* permit examiners to initiate actions on the debtor's behalf. The full text of that section states:

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

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136. *Cybergenics*, 330 F.3d at 577-78.

137. See 11 U.S.C. § 1109(b). The fact that an examiner is not a party-in-interest in bankruptcy is consistent with the concept that an examiner is a disinterested neutral. See *supra* note 57. Because an examiner is a neutral party, arguably it is improper to afford an examiner derivative standing, as such standing erodes the examiner's neutrality. *Id.*

138. See 11 U.S.C. § 1106(a) and (b) (describing the powers of trustees and only the duties of examiners).

139. Unlike an examiner, a creditors' committee is a party-in-interest under 11 U.S.C. § 1109 of the Bankruptcy Code. See 11 U.S.C. § 1109(b). Some courts have relied on this section of the Bankruptcy Code to confer standing upon creditors' committees to prosecute various lawsuits such as preference actions and fraudulent conveyance claims when a debtor-in-possession or Chapter 11 trustee fails to initiate the action and the claims are shown to be colorable. See *e.g.*, *In re STN Enterprises*, 779 F.2d 901 (2d Cir. 1985).

that the court orders the debtor in possession not to perform.<sup>140</sup>

Although this catch-all language is expansive, it is subject to the interpretive canon *ejusdem generis*, which states that “where general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar to those enumerated by the preceding specific words.” [citation omitted]. [Paragraphs] (3) and (4) [of Section 1106(a)] allow the examiner 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 [relevant] matter,” and also to “file a statement of investigation.” 11 U.S.C. §§ 1106(a)(3)-(4). Critically, these sections permit only investigating and reporting on that investigation, they stop far short of authorizing examiners to litigate based on their findings.<sup>141</sup>

As the Third Circuit’s holding in *Cybergenics* illustrates, an examiners’ ability to have its powers expanded to encompass powers normally reserved for trustees is indeed questionable under the current status of the law -- both in the attorney-client privilege waiver context and outside of it. Examiners therefore will continue to find that their powers may be legitimately questioned in any bankruptcy context until such time the outer limits of an examiner’s powers are fully and finally defined by Congress or the United States Supreme Court. The end result is that the confusion attenuated by the Bankruptcy Code and existing case law does nothing but add to the costs of administering a bankruptcy estate<sup>142</sup> and, in some instances, cloaks an examiner in a cloud of uncertainty.

## V. CONCLUSION

Bankruptcy examiners remain a useful alternative to the appointment of a trustee in some Chapter 11 cases. The utility of

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140. 11 U.S.C. § 1106(b).

141. *Cybergenics*, 330 F.3d at 578.

142. See *In re Mirant Corporation et al*, Case No. 03-46590 (Bankr. N.D. Texas 2003), in which the Bankruptcy Court appointed an examiner with expanded powers only to have various parties-in-interest litigate and file motions for reconsideration as to whether expanding the powers of an examiner is proper under the Bankruptcy Code. *Id.*



examiners includes the fact that an examiner is a disinterested officer of the court who has the unquestionable duty to investigate the acts, conduct, assets, liabilities, and financial condition of the debtor and the operation of the debtor's business. The utility of examiners in bankruptcy also includes the fact that an examiner is duty bound to submit a public report to the court for the benefit of all creditors. It is generally recognized that the court appointment of examiners with expanded powers is an inventive, efficient, and valuable method of identifying assets, promoting a reorganization under Chapter 11, and maximizing distributions to creditors. The expandable powers bestowed upon examiners, however, are far from unfettered, as some courts have expressly rejected the notion of expanding an examiner's powers to include powers normally reserved for bankruptcy trustees (such as the power to waive the debtor's attorney-client privilege). Until the outer limits of an examiner's powers are fully and finally defined by Congress or the United States Supreme Court, examiners will continue to find their powers to be illusory.