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# Trustees and Examiners in Chapter 11

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# TRUSTEES AND EXAMINERS IN CHAPTER 11

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One of the unique aspects of Chapter 11 of the Bankruptcy Code is the ability of a debtor to remain in possession of a business even after a bankruptcy filing. In most cases, the same managers who presided over the

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debtor's financial decline may remain in effective control of the debtor's day-to-day operations during the reorganization effort.[1] They also retain, for at least some period of time, an exclusive right to propose a reorganization plan.[2]

This ability of management to retain control of the business during a reorganization case is part of an effort to increase the effectiveness of the reorganization process.[3] Managers are more likely to attempt a Chapter 11 reorganization earlier, while the company is still a viable business capable of being reorganized, if the managers have some confidence that they can remain in their positions.[4] Also, permitting management to remain in possession assures that those who are familiar with the business are able to control the ongoing operations, utilizing their experience and contacts. Some

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1. 11 U.S.C. § 1107 (1988). As a practical matter, at least in larger cases, management may in fact change either just before, or sometime after, a Chapter 11 filing. *See* Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669 (1993); Stuart C. Gilson, *Bankruptcy, Boards, Banks, and Blockholders: Evidence on Changes in Corporate Ownership and Control when Firms Default*, 27 J. FIN. ECON. 355 (1990). Yet, although the managers may change, the board of directors may well remain in place during the reorganization effort. *See, e.g.*, Manville Corp. v. Equity Sec. Holders Comm. (*In re* Johns-Manville Corp.), 801 F.2d 60 (2d Cir. 1986); Lionel Corp. v. Committee of Equity Sec. Holders (*In re* Lionel Corp.), 30 B.R. 327 (Bankr. S.D.N.Y. 1983). *See generally* Anna Y. Chou, *Corporate Governance in Chapter 11: Electing a New Board*, 65 AM. BANKR. L.J. 559 (1991); Mark E. Budnitz, *Chapter 11 Business Reorganizations and Shareholder Meetings: Will the Meeting Please Come to Order, or Should the Meeting be Cancelled Altogether?*, 58 GEO. WASH. L. REV. 1214 (1990); Michael A. Gerber, *The Election of Directors and Chapter 11—The Second Circuit Tells Stockholders to Walk Softly and Carry a Big Lever*, 53 BROOK. L. REV. 295 (1987). For purposes of this Article, I consider both the officers and the directors to be part of the management of the debtor. *Cf.* Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKR. DEV. J. 1, 21 (1989) (describing management as "the officers, directors, retained professionals and business managers"); FED. R. BANKR. P. 9001(5) (defining "debtor" as including "any or all of its officers, members of its board of directors or trustees or of a similar controlling body, a controlling stockholder or member, or any other person in control"). Thus, even if the chief executive officer is changed, management in the hands of the board remains in place.

2. 11 U.S.C. § 1121(b).

3. *See, e.g.*, ELIZABETH E. WARREN & JAY L. WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 190 (2d ed. 1991) ("The principal benefit [of revised Chapter 11] might be that companies will enter Chapter 11 earlier and therefore will be healthier and more likely to survive when they do. . . . [T]here may be an important benefit in jobs saved and investments protected.").

4. *See, e.g.*, H.R. REP. NO. 595, 95th Cong., 1st Sess. 231 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6191.

commentators have suggested that even the creditors will often prefer to deal with managers with whom they are familiar than to suffer the time and expense of educating a trustee or other third party about the business and its problems.[5]

However, the debtor-in-possession concept is not without its costs. Managers whose conduct likely contributed to or precipitated the debtor's financial difficulty continue to manage the debtor in bankruptcy. Moreover, the debtor-in-possession construct involves difficult corporate governance issues as a result of the continued control of prebankruptcy managers.[6] In addition, one of the effects of the debtor-in-possession construct is a relatively unstructured Chapter 11 process in which no independent party is responsible for moving the case along. In general, the debtor-in-possession construct has provided a basis for questioning the credibility of the Chapter 11 process.

The Bankruptcy Code addresses these problems in several ways. Often, problems with the debtor-in-possession construct can be addressed by active committees, such as creditors' or equity security holders' committees.[7] A committee may consult with the debtor concerning the administration of the case and investigate the debtor's financial condition, conduct, and viability, as well as other matters relevant to the case or the development of a

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5. *See* Peter F. Coogan et al., *Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills*, 30 BUS. LAW. 1149, 1156 (1974).

6. When the debtor is insolvent, creditors are often residual owners of the business. During the reorganization, however, these "owners" are, to some extent, disenfranchised by the debtor-in-possession construct. Although they can have input with respect to various business decisions, they cannot elect a new board or control the decision process.

Some commentators have maintained that the managers are more concerned with their own profit and well-being than with the concerns of creditors and shareholders. *See, e.g.*, Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1992). Others have observed that the debtor-in-possession concept creates difficult issues concerning the managers' fiduciary obligations. *See, e.g.* Thomas G. Kelch, *The Phantom Fiduciary: The Debtor in Possession in Chapter 11*, 38 WAYNE L. REV. 1323 (1992); Christopher W. Frost, *Running the Asylum: Corporate Governance Problems in Bankruptcy Reorganizations*, 34 ARIZ. L. REV. 89 (1992); Nimmer & Feinberg, *supra* note 1. For an excellent recent discussion of the various issues concerning corporate governance in Chapter 11, see LoPucki & Whitford, *supra* note 1.

In some jurisdictions, management's fiduciary duties may be altered even prior to a Chapter 11 filing, particularly if the debtor is insolvent. *See, e.g.*, CONN. GEN. STAT. § 33-313 (1990); ARIZ. REV. STAT. ANN. § 10-1202 (1991); IDAHO CODE § 30-1602 (1992); *see also* Geyer v. Ingersoll Publications Co., 621 A.2d 784 (Del. Ch. 1992); Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).

7. *See* 11 U.S.C. §§ 1102, 1103 (1988). Creditors' committees are the subject of another article in this symposium. *See* Kenneth N. Klee & K. John Shaffer, *Creditors' Committees Under Chapter 11 of the Bankruptcy Code*, 44 S.C. L. REV. 995 (1993).

reorganization plan. A committee may also participate in plan negotiations as a representative of its constituency and perform other acts in the interest of those represented.[8] In general, committees can oversee the debtor's conduct during the case and can often effectively address problems that flow from the debtor-in-possession construct.

When the protection provided by the committees is insufficient to address issues inherent in the debtor-in-possession construct, the Bankruptcy Code provides for the appointment of an independent third party—a trustee or an examiner—to protect the interests of various constituencies.[9] These independent third parties represent the estate, as opposed to any particular constituency, and can often investigate and act more credibly than the debtor or committees.[10] They can also be instrumental in assuring that the case moves expeditiously towards resolution and can enhance the credibility of the Chapter 11 process.

Although examiners and trustees can ameliorate many of the management difficulties, corporate governance issues, and process issues that may arise in a Chapter 11 case, courts and parties to Chapter 11 proceedings have generally been reluctant to utilize these third parties absent compelling circumstances that strongly suggest a general need for third-party intervention. Both courts and parties to the proceedings have sometimes failed to recognize that the Bankruptcy Code offers considerable flexibility with respect to the use of trustees and examiners in Chapter 11 cases and that an independent third party may effectively and efficiently assist in the reorganization effort.

This Article suggests that recognition of a broad, flexible standard for the appointment of trustees and examiners in Chapter 11 and imaginative use of these independent third parties can facilitate resolution of many Chapter 11 cases. Although many Chapter 11 cases can be resolved adequately by the debtor-in-possession and committee representatives without third-party intervention, the ready availability of an independent third party can, in other cases, address issues that arise under the debtor-in-possession construct

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8. 11 U.S.C. § 1103(c).

9. *Id.* § 1104.

10. The Bankruptcy Code also contains provisions for United States trustees who, *inter alia*, are to "supervise the administration of cases and trustees in cases under chapters 7, 11, or 13." 28 U.S.C. § 586(a)(3) (1988). The duties of the United States trustee include monitoring the following: applications for compensation, plans and disclosure statements, timely filing of schedules and reports, creditors' committees, and progress of cases. *Id.* The United States trustee does not, however, manage debtors' estates or generally investigate allegations of wrongdoing by the debtor. Consequently, the United States trustee, as presently constituted and financed, cannot adequately fulfill the role that can be served by an independent third party appointed to investigate, manage, or mediate in a Chapter 11 case.

while assuring that the business can continue to operate and meaningfully attempt to reorganize. In addition, particularly in larger cases, the protection of an independent investigation of relevant issues, or, in appropriate cases, monitoring or operation by an independent third party, can add credibility to the Chapter 11 process when any significant party in interest has reason to be uncomfortable with the protection provided by the debtor-in-possession and the committee structure.

This Article first describes briefly the issues that are presented by the debtor-in-possession construct and discusses why input by an independent third party may sometimes be useful. The Article then reviews the statutory provisions and the legislative history concerning the use of trustees and examiners and concludes that, although Chapter 11 affords a court considerable flexibility in deciding whether to order the appointment of a trustee or examiner, Congress intended that, at least in larger cases, the input of an independent third party would be available at the request of any party in interest. Finally, the Article illustrates the considerable flexibility accorded to courts in assigning duties to a trustee or examiner, reviewing some of the circumstances under which trustees or examiners have been employed in Chapter 11 cases. In this regard, the Article suggests that broad and flexible use of trustees and examiners can assist in validating the Chapter 11 process and in providing creditors and other constituencies with confidence that their rights will be protected.

## I. THE DEBTOR-IN-POSSESSION CONSTRUCT

In most Chapter 11 cases, the debtor remains in possession of the business and continues to oversee operation of the business.[11] Indeed, courts have recognized a strong presumption that the debtor is entitled to remain in possession of the estate.[12] The debtor also retains, for at least some period, the exclusive right to propose a reorganization plan.[13] Thus, the debtor retains significant control over both the business and the reorganization.

Early in a Chapter 11 case the debtor-in-possession makes various business decisions, albeit often subject to court approval, that may affect the rights of different parties as well as the viability of the business. In general, these decisions are part of an early evaluation of whether the business should be continued or liquidated.

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11. 11 U.S.C. § 1107 (1988).

12. *See, e.g.*, Committee of Dalkon Shield Claimants v. A.H. Robins Co., 828 F.2d 239 (4th Cir. 1987); *In re* Ionosphere Clubs, Inc., 113 B.R. 164 (Bankr. S.D.N.Y. 1990).

13. 11 U.S.C. § 1121(b).

For example, if the business is to be continued, even temporarily, the debtor will typically have to arrange quickly postpetition financing.[14] This may involve offering priority or liens to a new lender at the expense of prepetition creditors.[15] The debtor may also have to determine whether to assume or reject leases of nonresidential real property in the early stages of the case.[16] In general, the debtor may need to make commitments to suppliers, employees, and others dependent on the debtor, in order to maintain the ongoing business. These commitments will often create first-priority administrative expenses that will have to be paid prior to any recovery by prepetition general creditors.

As the case continues, the debtor is an integral part of the process of evaluating the continued viability of the business. The debtor will often seek to improve its operations by restructuring or streamlining them, disposing of inefficient assets and, perhaps, certain business lines.[17] Naturally, current managers may tend towards optimism about the debtor's prospects, particularly if their positions depend on the continued existence of the debtor. Therefore, the debtor's restructuring plans and projections for the success of future operations must be carefully evaluated. Yet the debtor maintains significant control over the information available to creditors seeking to analyze those plans and projections. Moreover, because the debtor determines what actions it will take, albeit subject to court approval, the debtor's business plan is ultimately dependent on management's willingness and ability to move in a particular direction.[18]

Through the debtor's exclusive right to propose a plan, the debtor-in-possession also maintains significant control over the plan process. Although the debtor negotiates with the various constituencies to attempt to reach agreement on a reorganization plan, the debtor's exclusivity represents a lever that enables the debtor to exert pressure on the various constituencies. The debtor's exclusivity also provides some structure for the negotiations, with the debtor often taking the lead in bringing together various creditor constituencies.

The debtor-in-possession construct may change the nature of management's obligations.[19] In Chapter 11, managers who previously may have been obligated primarily to shareholders owe obligations to creditors and,

14. *See id.* § 364.

15. *See id.*

16. *See id.* § 365(d)(3), (4) (requiring trustee or debtor-in-possession to perform under nonresidential leases of real property and, unless court extends time, to assume or reject within 60 days after the order for relief).

17. *See generally* Frost, *supra* note 6, at 93.

18. *See* LoPucki & Whitford, *supra* note 1, at 692-93.

19. *See generally* Kelch, *supra* note 6; Frost, *supra* note 6; Nimmer & Feinberg, *supra* note 1.

some would argue, a broad range of other constituencies who may be interested in the reorganization and survival of the enterprise.[20]

Yet these various constituencies have relatively little control over the debtor-in-possession, notwithstanding their interest in the debtor's efforts to alleviate its financial difficulty. The debtor's prebankruptcy board of directors typically remains in place during the reorganization effort and continues to oversee the operation of the business. The prebankruptcy managers may also be able to remain in their positions during the case, even if creditors might prefer different managers.[21] Thus, members of these constituencies may develop the perception that the debtor-in-possession is not operated primarily for their benefit, notwithstanding any change in management's fiduciary duty.

Moreover, the various constituencies may have inconsistent interests that cannot all be satisfied by the debtor-in-possession in any event.[22] The debtor-in-possession must rationalize its obligations to a broad range of constituencies and sail through the shoals of competing interests. These competing interests may exist among constituencies, such as in disputes between senior and junior creditors; or they may exist within constituencies, such as when some creditors might be subject to avoidance actions while others would benefit from the actions. Because the debtor-in-possession has its own interest in the reorganization, its attempts to rationalize competing concerns may be suspect even when it is in fact acting with the highest motives.

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20. *See, e.g.*, Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) ("If a debtor remains in possession, the debtor's directors have essentially the same fiduciary obligations to creditors and shareholders as would the trustee for a debtor out of possession. The willingness to leave the debtors in possession 'is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibility of a trustee.'"). Among the other constituencies are employees, suppliers, communities, governments, customers and others. *See generally* Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717 (1991); Elizabeth E. Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987).

21. Evidence exists that management turnover may be significant, particularly in larger cases. *See, e.g.*, LoPucki & Whitford, *supra* note 1, at 723; Gilson, *supra* note 1.

22. For example, if the liquidation value of the debtor is sufficient to satisfy senior creditors, those creditors may want the debtor liquidated so that they can be paid in full even if junior creditors (or equity holders) would suffer in a liquidation. Similarly, junior creditors, who might receive little or nothing in a liquidation, may want the debtor to continue the business and take risks that might yield large rewards, because the junior creditors would have little to lose. Such losses would fall on the senior creditors, who might have been satisfied out of the proceeds of an early liquidation. *See* LoPucki & Whitford, *supra* note 1, at 683-88.

Under the prior Bankruptcy Act, the court took an active role in the management and monitoring of a debtor-in-possession and could protect and rationalize the interests of various constituencies.[23] The 1978 bankruptcy revision narrowed the court's role and largely removed judges from administrative matters in order to retain their impartiality in deciding matters brought before them. Thus, under the Bankruptcy Code judges are generally limited to deciding disputes brought before them and are not expected to become actively involved in the administration or investigation of debtors-in-possession.[24]

Although the Code requires that a court approve various business decisions made by the debtor-in-possession, the debtor maintains the ability to determine, to a considerable extent, which issues are placed before the court. For example, the court will not be asked to approve an agreement unless the debtor or some other party reaches an agreement that needs court approval. Thus, the court will generally be less able to induce affirmative actions by the debtor than to react to courses of action proposed by the debtor. Moreover, the court's limited involvement with the administration of the debtor may prevent the court from obtaining all of the information necessary to enable it to protect the rights and interests of the various parties in the case. Consequently, one effect of removing the court from the management of the debtor is that the court's ability to protect the interests of the various constituencies is reduced.[25]

One protection provided to creditors, and at times to equity holders, is the availability of a committee to represent the constituency.[26] A committee

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23. *See* Bankruptcy Act § 39, 11 U.S.C. § 67 (1976) (repealed 1978). *See generally* H.R. REP. NO. 595, *supra* note 4, at 88-91, *reprinted in* 1978 U.S.C.C.A.N. at 6049-53.

24. H.R. REP. NO. 595, *supra* note 4, at 107-09, *reprinted in* 1978 U.S.C.C.A.N. at 6068-70.

25. Courts have recognized that removal of the court from active management of the debtor does not mean that the court has no role in assuring that cases move along promptly and fairly. In United Sav. Ass'n v. Timbers of Inwood Forest Assocs. (*In re* Timbers of Inwood Forest Assocs.), 808 F.2d 363 (5th Cir. 1987), *aff'd*, 484 U.S. 365 (1988), the court observed:

> We do not believe . . . that Congress . . . intended to relieve the bankruptcy judge of the responsibility of managing the cases before him in such a way as to promote the objectives and goals of the Bankruptcy Code. . . . [W]e think that each bankruptcy judge is called upon to manage the cases in front of him, fairly and impartially, in such a way as to promote their orderly and prompt disposition.

*Id.* at 373-74.

26. In some cases, additional committees may also be appointed. 11 U.S.C. § 1102(a)(1988). The United States trustee also monitors certain aspects of the reorganization effort. *See supra* note 10.

can, and usually does, protect the interests of its constituency generally. It can monitor the debtor, reviewing the debtor's ongoing operations as well as the debtor's future business plan. It negotiates with the debtor in an attempt to devise a consensual reorganization plan. In general, the committees are intended not only to provide oversight of the debtor-in-possession, but also to represent the constituency.

However, although a committee has the power to "consult with the . . . debtor-in-possession concerning the administration of the case"[27] and to investigate virtually any matter "relevant to the case or to the formulation of a plan,"[28] the debtor-in-possession typically retains significant informational and practical advantages that enable it to maintain considerable control over its operations. Also, a committee is not involved in the day-to-day operations of the debtor and is often in the position of responding to initiatives generated by the debtor. Its information comes primarily from the debtor and may reflect the debtor's sometimes unduly optimistic assessments. Accordingly, a committee usually cannot set the direction of the business or the tone of the operations.

Moreover, even when a committee can overcome the informational and practical advantages of the debtor-in-possession, it may not be able adequately to serve the interests of various members of its constituency. Members of a constituency do not necessarily have a unity of interest; actions seen as beneficial by one member may be viewed as detrimental by another.[29] In the absence of an effective means of resolving disputes among the constituents, a committee may not be able adequately to insist on actions that are in the best interest of the *estate*, as opposed to a dominant constituent.[30]

Also, particularly in smaller cases, the available resources may be insufficient to support the active participation of a committee. This situation may leave management effectively in complete control of the operation.[31]

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27. 11 U.S.C. § 1103(c)(1).

28. *Id.* § 1103(c)(2).

29. For example, creditors who are the recipients of voidable preferences will prefer that the debtor not pursue those claims, while other creditors would of course benefit from successful pursuit. If the preferred creditors dominate a creditors' committee, the committee may be less likely to vigorously seek pursuit of the preference claims.

30. *See* David A. Skeel, Jr., *The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases*, 78 VA. L. REV. 461 (1992) (arguing that voting power over significant decisions by the debtor-in-possession may not be properly allocated under the current version of Chapter 11).

31. *See, e.g.*, Jerome R. Kerkman, *The Debtor in Full Control: A Case for Adoption of the Trustee System*, 70 MARQ. L. REV. 159, 183 (1987) (creditors' committees active in less than half of Chapter 11 cases studied); Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and Analysis of the Law*, 97

Unless the management of the debtor-in-possession can effectively and convincingly make the transition from shareholder representatives to representatives of a broader constituency, and unless management is capable of managing and effecting the reorganization of the business, the real parties in interest in the Chapter 11 case may in fact not be well served (or may at least believe that they are not being well served) by the debtor-in-possession construct. In those instances in which management is unable satisfactorily to convince the various constituencies that it has made the necessary transition, or in which management is incapable of properly managing and reorganizing the business, there is a need to protect the interests of the affected constituencies while preserving the reorganization effort.

When a committee cannot adequately provide that protection, Chapter 11 offers protection through the use of an independent third party who can investigate, monitor, assist, and, in appropriate cases, manage the debtor. The Bankruptcy Code provides two methods of introducing an independent third party to protect the various constituencies when it appears that neither current management nor the committee structure will adequately represent the various interests. First, the court may, under certain circumstances, order the appointment of a trustee to manage the debtor and conduct its reorganization.[32] Second, the court may order the appointment of an examiner to investigate matters of concern to parties and, perhaps, to serve other appropriate roles in the administration of the case.[33] Although trustees or examiners have been appointed in a wide variety of bankruptcy cases, the appropriate use of these independent third parties remains the subject of some dispute and uncertainty.[34]

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COM. L.J. 297, 326 (1992) (survey of Chapter 11 cases in Poughkeepsie, N.Y. found that creditors' committees were appointed in only 49% of cases in sample in which Chapter 11 plan was confirmed).

32. 11 U.S.C. § 1104(a) (1988).

33. *Id.* § 1104(b).

34. Some courts have recognized a third possible replacement for the debtor-in-possession in the form of a "responsible person." *See, e.g.*, *In re* FSC Corp., 38 B.R. 346 (Bankr. W.D. Pa. 1983); *In re* Lifeguard Indus., 37 B.R. 3 (Bankr. S.D. Ohio 1983); *In re* UNR Indus., 30 B.R. 609 (Bankr. N.D. Ill. 1983). Appointment of a "responsible person" may enable a court (1) to avoid the disinterestedness requirements for trustees and examiners, (2) to permit the debtor to retain its exclusive period to file a plan, and (3) to avoid the U.S. trustee's appointment of the person to run the business. *See generally* Kelch, *supra* note 6, at 1328.

Some courts have appointed independent third parties, who were not trustees or examiners, to serve more limited roles in the case. For example, in the *Integrated Resources* bankruptcy, the court appointed Professor Karen Gross as "Special Representative" to review notices and orders in the case and "to inform the Court when in [her] judgment a proposed order or any other proposed judicial act of the Court would constitute an improper exercise of jurisdiction over [non-debtor limited partners]." *In re*

## II. BACKGROUND OF TRUSTEE AND EXAMINER PROVISIONS OF CHAPTER 11

A review of the history of the trustee and examiner provisions of Chapter 11 may assist in determining their scope and in analyzing the roles for trustees and examiners. This review illustrates that the importance of an independent third party to operate, oversee, or investigate the debtor-in-possession was recognized throughout the deliberations over the Bankruptcy Code. The history of the Code provisions suggests an intention to authorize the use of trustees and examiners under a broad range of circumstances in which the intervention of an independent third party could protect the interests of the various constituencies in the case.

### *A. Prior Bankruptcy Act*

Under the prior Bankruptcy Act, business reorganizations were governed by two separate chapters—Chapters X and XI. Chapter X was intended to deal with larger, public company reorganizations, while Chapter XI was intended to deal with more limited reorganizations of, in many instances, smaller companies.

Because Chapter X dealt primarily with larger, public companies and more complicated debt and equity structures, there was considerable concern with protecting the investing public in the reorganization process. Thus, Chapter X provided for the exercise of independent control over a reorganizing debtor and also provided broader remedies for the debtor.

As part of the effort to increase control over the debtor and to protect public investors, Chapter X required the appointment of a trustee in most cases.[35] Under the mandatory trustee provision, the trustee became "the

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Integrated Resources, Inc., No. 90B-10411 (Bankr. S.D.N.Y. Apr. 19, 1990 and May 10, 1990). In the *Zale* bankruptcy, a "mediator" was appointed to assist in the negotiations. *In re* Zale Corp., No. 392-30001-SAF-11 (Bankr. N.D. Tex. Nov. 4, 1992). Similarly, in the *El Paso Electric* bankruptcy, a "mediator" was appointed to assist in "mov[ing] this case to a successful conclusion." DAILY BANKR. REV., Jan. 27, 1993, at 1.

35. Bankruptcy Act § 156, 11 U.S.C. § 556 (1976) (repealed 1978). The full text of § 156 provided as follows:

> Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed the judge may, for the

> purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor.

*Id.*

Bankruptcy Rule 10-202 required the court promptly to appoint, *sua sponte*, one or more trustees if the debtor's indebtedness, as described in § 156, was $250,000 or more. If the indebtedness was less than $250,000, the court could either appoint a trustee(s) or continue the debtor in possession. Bankr. R. 10-202(a).

Congress enacted the provision for a mandatory trustee in response to perceived abuses under the equity receiverships that were used to reorganize business enterprises prior to enactment of Chapters X and XI. The Bankruptcy Commission, referring to an SEC study of the issue, described the basic problem as follows:

> [O]nly the sense of loyalty which a representative feels for those for whom he acts can assure adherence to high standards of fiduciary responsibility. Such loyalty in turn requires a disinterested passion for the interests he guards.
>
> The Protective Committee [SEC] Study found that too frequently the greatest flaw in the reorganization techniques of the day was lack of this disinterested spirit:
>
>> Reorganizers have at times had objectives not only different from but incompatible with those of investors. Reorganizers have frequently been interested in expeditious reorganizations not primarily to avoid expense, not necessarily because of the desire to have dividend and interest payments quickly resumed, but largely because of their desire to consummate a reorganization of their own liking. Reorganizers frequently have not been concerned, in the manner of investors, with economy in reorganization, as economy would interfere with their profits. Reorganizers at times have not been interested in fair reorganizations, since fairness might seriously intrude into their own plans and affairs. Reorganizers at times have not desired honest reorganizations, in the investors' sense of the word, because such reorganizations would be costly to them. They have been motivated by other factors. And they have endeavored—in large measure with success—to mould the reorganization processes so as to serve their own objectives.

H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. 1, at 251 (1973).

Interestingly, even mandatory appointment of a trustee did not mean that management was necessarily displaced for all purposes. Section 156 went on to state, "In any case where a trustee is appointed the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor." Bankruptcy Act § 156, 11 U.S.C. § 556 (1976) (repealed 1978).

It appears that the provision for the appointment of more than one trustee, including a director, officer, or employee, was intended to permit a bankruptcy court to appoint an independent trustee and then to appoint a current manager as a "co-trustee." By retaining current management even after the appointment of a trustee, the court could reduce the interference with normal business operations that would arise if a new management team were imposed on the debtor immediately after the filing of the Chapter X petition.

key figure in the reorganization process."[36] The trustee was generally authorized to operate the debtor's business, to investigate the debtor's affairs, to pursue causes of action on behalf of the estate, and to provide information to creditors and stockholders. The trustee was also responsible for developing, in consultation with creditors and stockholders, a reorganization plan. In this respect, the trustee provided structure to the case by serving as "the focal point about which formulation of the plan revolve[d]."[37]

Chapter XI was intended to address those situations in which debt and equity structures were less complicated and public investors were not likely to be seriously affected. Thus, Chapter XI provided less control over the debtor and more limited remedies. Appointment of a trustee was unavailable

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However, § 156 contained an inherent conflict that troubled some courts faced with the appointment of current managers as trustees. The section provided that "[a]ny trustee appointed under this chapter shall be disinterested." *Id.* Section 158 provided that a person was not disinterested if, *inter alia*, "he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor." Bankruptcy Act § 158(3), 11 U.S.C. § 558(3) (1976) (repealed 1978). Thus, although § 156 expressly provided for the appointment of officers, employees, or directors, the disinterestedness requirement seemed to preclude their appointment.

Some courts resolved the conflict by authorizing an officer, employee, or director (those parties explicitly described in § 156) to serve as an additional trustee notwithstanding the disinterestedness requirement. *See, e.g.*, *In re* Ocean City Auto. Bridge Co., 184 F.2d 726 (3d Cir. 1950); Meredith v. Thralls, 144 F.2d 473 (2d Cir. 1944). Nevertheless, even those courts subjected officers, employees, or directors to the remaining requirements of disinterestedness (other than officer, employee, or director status) so that an officer, employee, or director that held any interest materially adverse to any class of creditors or stockholders might be precluded from becoming a trustee. Interestingly, Bankruptcy Rule 10-202(a), which provided for the appointment of a trustee or trustees, omitted the language authorizing the appointment of officers, employees, and directors. In any event, it seems clear that the trustee could employ officers of the debtor, although their compensation was subject to approval of the court. Bankruptcy Act § 191, 11 U.S.C. § 591 (1976) (repealed 1978). *See generally* 6 COLLIER ON BANKRUPTCY, ¶¶ 7.04, 8.14 (14th ed. 1978).

36. 6 COLLIER ON BANKRUPTCY, *supra* note 35, ¶ 0.09, at 105.

37. *Id.* at 106. Chapter X also contained a provision for the appointment of an examiner. Bankruptcy Act § 168, 11 U.S.C. § 568 (1976) (repealed 1978). Appointment of an examiner was authorized in any case in which a trustee was not appointed. In general, an examiner under Chapter X was required to investigate and report on the affairs of the debtor. Under the Bankruptcy Rules the court could also require an examiner to prepare and file a plan. Because appointment of a trustee was mandatory in most cases, examiners served a minor role under Chapter X. Nevertheless, the examiner provision represented a recognition of the value of an independent third party in a reorganization case, even in a case that was too small to justify the appointment of a trustee. *See generally* ALEXANDER L. PASKAY, HANDBOOK FOR TRUSTEES AND RECEIVERS IN BANKRUPTCY § 1.003 (1978).

in Chapter XI. Instead, the debtor generally remained in possession, managing the business and pursuing the reorganization effort.[38] Although Chapter XI contained provision for the appointment of a receiver,[39] the debtor generally remained in possession unless a particular reason existed to divest the debtor of possession and to appoint a receiver.[40]

Although Chapter X may have authorized the retention of current management even after the appointment of a trustee,[41] in most cases management was displaced by the trustee. The perception that management would be displaced in Chapter X induced reorganizing debtors at least to attempt to reorganize under Chapter XI, where they could remain in possession and control of the business.[42] This practice supported the view that if appointment of a trustee was mandatory, debtors would not com-

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38. *See* 8 COLLIER ON BANKRUPTCY, *supra* note 35, ¶ 5.08. Bankruptcy Rule 11-18(b) provided that "if no trustee in bankruptcy has previously qualified, the debtor shall continue in possession." Bankr. R. 11-18(b).

39. Bankruptcy Act § 332, 11 U.S.C. § 732 (1976) (repealed 1978); *see also* Bankr. R. 11-18(b) ("On application of any party in interest, the court may, for cause shown, appoint a receiver to take charge of the property and operate the business of the debtor.").

40. 8 COLLIER ON BANKRUPTCY, *supra* note 35, ¶ 5.08.

41. *See supra* note 35.

42. *See, e.g.*, SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965); General Stores Corp. v. Shlensky, 350 U.S. 462 (1956); SEC v. United States Realty & Improvement Co., 310 U.S. 434 (1940).

The Bankruptcy Commission described the preference for Chapter XI as follows:

> The reason underlying the preference of lawyers for Chapter XI is obvious, although not often stated. A debtor initiates a Chapter XI proceeding, and only the debtor can propose a plan under Chapter XI. The debtor is normally allowed to operate the business. A concomitant of continued management is the continuation of the employment of the debtor's attorney. On the other hand, if a Chapter X proceeding is initiated, a disinterested trustee is appointed and counsel for the debtor has a greatly reduced function. Although proponents of Chapter XI generally talk about speed and economy, control and the "best interests" test obviously are the dominating reasons for the preference. The obvious advantages of Chapter XI to the debtor and his counsel have led to its use by large corporations. This has caused litigation as to the propriety of the use of Chapter XI, primarily generated by the Securities and Exchange Commission's filing a section 328 application.
>
> The Commission on the Bankruptcy Laws is of the opinion that the conclusions and recommendations of the protective committee study and the Congressional policy embodied in the Chandler Act are still valid. Unfortunately, the creation of several chapters for reorganization has substantially frustrated the reform achieved by Chapter X, since Chapter XI can usually be utilized. Chapter XI has the same potential for abuse as the equity receivership.

H.R. DOC. NO. 137, *supra* note 35, at 247-48.

mence reorganization proceedings until they were forced to do so—a time that might be too late to salvage the business.[43] Consequently, the mandatory trustee provision of Chapter X became one of the most troublesome aspects of that reorganization remedy.

### *B. Bankruptcy Commission Report*

In 1973, a Commission established by Congress[44] issued a report evaluating the Bankruptcy Act and recommending changes in the Act. Among the issues the Commission studied were whether the different business rehabilitation chapters should be merged and, pertinent to the matter at hand, what role trustees and examiners should serve in a merged proceeding.

Under the Commission's proposal, the main task of operating and, ultimately, reorganizing the debtor would fall generally on the debtor-in-possession. Although the Commission recognized that trustees could serve a useful role in some reorganization cases, it rejected the Chapter X concept of a mandatory trustee. In the Commission's view, the idea of an independent trustee was "sound," but had its limitations. Because a trustee was viewed as a party that normally would operate the business, ousting existing management, mandatory appointment of a trustee could cause inefficiencies. Moreover, mandatory displacement of existing management could deter some debtors from filing for reorganization at a time when the business could realistically be reorganized.[45] The Commission was comfortable with the debtor-in-possession concept, in part because its proposed statute contained provisions for an administrative agency that could independently investigate the debtor and serve as a watchdog over the reorganization process.[46]

Nevertheless, the Commission's proposed statute authorized the court to order the appointment of a trustee on application of the administrator[47]

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43. *See id.* at 253 ("[The mandatory trustee provision] also has probably been a factor in delaying the commencement of reorganizations, to the ultimate detriment of security holders.").

44. The Commission on the Bankruptcy Laws of the United States was established by Pub. L. No. 91-354, 84 Stat. 468 (1970). Its charge was to "'study, analyze, evaluate, and recommend changes' in the Bankruptcy Act." H.R. DOC. NO. 137, *supra* note 35, at 1.

45. H.R. DOC. NO. 137, *supra* note 35, at 249-53.

46. *Id.* at 253.

47. In order to understand fully the Commission's approach to trustees and examiners, it is necessary to review the Commission's proposal for an administrator to oversee the bankruptcy system. The administrator the Commission sought would have been somewhat similar to, but more powerful than, the United States trustee. The Commission described

or any party in interest. In larger cases involving corporations with debts of $1,000,000 or more and 300 or more security holders, the Commission proposed a presumption that appointment of a trustee would be warranted unless the court found "that the protection afforded by a trustee is unnecessary or that the expense would be disproportionate to the protection

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the duties of the administrator in reorganization cases as follows:

> Chapter VII of the proposed Act assigns a number of administrative functions to the administrator that are now given to judges of courts of bankruptcy in cases under Chapter X, including the following: authorization of the operation of a debtor's business; appointment of a receiver to conduct the business; appointment of trustees (subject to court approval); receipt and custody of reports and records of the debtor's property and operations; authorization of the issuance of certificates of indebtedness; issuance of notices to creditors, equity security holders, and other parties interest; calling and conducting meetings of creditors and equity security holders; authorization of the employment of attorneys and accountants by the trustee; policing compliance by representatives of creditors and equity security holders with statutory provisions and rules regulating solicitation of proxies and other activities on behalf of those whom they represent; authorization of the lease or sale of property when in the ordinary course of business; determination of the manner of proving claims; designation of classes of creditors and equity security holders; determination of the schedule for filing plans and modifications, transmission of plans to creditors and equity security holders, and for filing acceptances; and determining the mode of carrying out a confirmed plan . . . .
>
> The administrator will not, however, in cases under Chapter VII, perform the duties and exercise the rights and powers of a trustee, since it is not contemplated that the administrator will have the staff able to carry out these responsibilities when the management of a debtor undergoing reorganization is displaced. The administrator will, nevertheless, perform the functions now delegated to the Securities and Exchange Commission in Chapter X cases of the present Act, including the preparation of an advisory report on proposed plans and the recommendation of compensation to be allowed trustees, attorneys, and accountants.
>
> Finally, there are functions assigned the administrator under Chapter VII that are not now performed by any official, including the appointment of members of committees of creditors and equity security holders as provided in section 7-101 and the allowance to an individual debtor under Chapter VII of an amount from his postpetition income for support of himself and his family.

*Id.* at 124-25.

Because under the Commission's proposal the administrator was authorized to perform the investigatory functions of a trustee, there was no need for the appointment of an examiner. However, the administrator was authorized to delegate the investigatory duties to "a disinterested person, whose selection shall be subject to approval of the court." H.R. 32, 94th Cong., 1st Sess., § 7-103(b), at 221 (1975). Apparently that disinterested person would have served as an examiner in all but name.

afforded."[48] Interestingly, the Commission's proposal provided no standard for determining whether to appoint a trustee in smaller cases.

### *C. Congressional Action*

The Commission's proposal was introduced in Congress, as was an alternative bill proposed by the National Conference of Bankruptcy Judges.[49] Although there were significant differences between the two bills, their provisions with respect to trustee appointments were similar.[50] Both granted the court considerable discretion in deciding whether to order the appointment of a trustee. However, they created a presumption in favor of appointment of a trustee in larger cases.

These proposals, which sought the elimination of a mandatory trustee in larger cases, drew the strong opposition of the SEC.[51] Others were

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48. H.R. DOC. NO. 137, *supra* note 35, at 25 (proposed § 7-102(a)).

49. The Commission's proposed bill was introduced in the 93d Congress as H.R. 10792 and S. 2565, 93d Cong., 1st Sess. (1973), and was reintroduced in the 94th Congress as H.R. 31 and S. 236, 94th Cong., 1st Sess. (1975). The Judges' bill was introduced in the 93d Congress as H.R. 16643 and S. 4060, 93d Cong., 1st Sess. (1973), and was reintroduced in the 94th Congress as H.R. 32 and S. 235, 94th Cong., 1st Sess. (1975). The bills received intensive consideration in the 94th Congress.

50. Section 7-102(a) of H.R. 31 provided as follows:

> On the application of the administrator or any party in interest, and after hearing on notice, the court may order the administrator to appoint a trustee. If the debtor is a corporation having debts of $1,000,000 or more and three hundred or more security holders, the administrator shall apply to the court to determine whether a trustee should be appointed, and the court shall order such appointment unless it finds that the protection afforded by a trustee is unnecessary or that the expense would be disproportionate to the protection afforded.

H.R. 31, 94th Cong., 1st Sess. § 7-102(a), at 191 (1975).

Section 7-102(a) of H.R. 32 provided as follows:

> On the application of any party in interest, the court may, when necessary in the best interest of the estate, order the Director to appoint a trustee to take charge of the property and operate the business of the debtor. If the debtor is a corporation having debts of $1,000,000 or more and three hundred of more security holders, the Director shall appoint a trustee unless the debtor on application obtains from the court an order finding that the protection afforded by a trustee in unnecessary and that the expense would be disproportionate to the protection afforded.

H.R. 32, *supra* note 47, §7-102(a), at 218.

51. *See Report of Securities and Exchange Comm'n on S. 235 and S. 236, Hearings on S.235 and S.236 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess, pt. II, at 738, 749-54 (1975) [hereinafter *SEC Report*].

equally opposed to any mandatory appointment of a trustee in reorganization cases.[52] After extensive hearings and debate on the proposed bills, new proposals were introduced in the 95th Congress. The bills introduced in the House and the Senate differed considerably with respect to the use of independent third parties in reorganization cases.

The House bill called for a cost-benefit analysis of whether a trustee should be appointed. It provided that, upon the request of a party in interest or the United States trustee, a trustee could be appointed, but only upon a showing that "(1) the protection afforded by a trustee is needed; and (2) the costs and expenses of a trustee would not be disproportionately higher than the value of the protection afforded."[53] The bill pointedly did not require the appointment of a trustee, providing only that upon a proper showing the court "may" order the appointment. According to the House Report, testimony had strongly indicated that too frequent appointment of trustees might delay debtors' bankruptcy filings until they are beyond the ability to reorganize successfully. The Report indicated that a trustee would properly be appointed "only if the protection afforded by a trustee is needed and the costs and expenses of a trustee would not be higher than the protection afforded."[54]

The House bill also provided for the appointment of an examiner under standards identical to those applicable to the appointment of a trustee. Of course, since the costs of an examiner would normally be considerably less than the costs of a trustee, the value of the protection would presumably not need to be as high as would be needed for a trustee. Thus, it appears that the examiner was viewed as the less drastic alternative when third-party intervention seemed desirable.[55]

The Senate bill required the appointment of a trustee in "public company" cases.[56] A "public company" was defined as "a debtor who, within twelve months prior to the filing of a petition for relief under this chapter, had outstanding liabilities of $5,000,000 or more, exclusive of liabilities for goods, services, or taxes and not less than 1,000 security

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52. *See, e.g.*, *Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the Comm. of the Judiciary*, 94th Cong., 2d Sess., pt. IV, at 2475, 2478-79 (1977).

53. H.R. 8200, 95th Cong., 1st Sess. § 1104(a), at 180-81 (1977).

54. H.R. REP. NO. 595, *supra* note 4, at 402, *reprinted in* 1978 U.S.C.C.A.N. at 6359.

55. The examiner's role under the House bill was "to conduct such an investigation of the debtor as is appropriate." H.R. 8200, *supra* note 53, § 1104(b), at 181. However, as with the current Bankruptcy Code, the examiner would also perform any duties of a trustee that the court ordered the debtor-in-possession not to perform. *Id.* § 1106(b), at 183-84.

56. S. 2266, 95th Cong., 1st Sess. § 1104(a) (1977).

holders."[57] In other cases, the bill provided that the court "may" order the election of a trustee or appoint a trustee "for cause" and that the court "shall" order the appointment of a trustee "if such appointment would be in the interests of the estate and security holders."[58]

The Senate bill also provided for the appointment of an examiner under certain circumstances. The standard for appointment of an examiner was particularly flexible. The bill provided that the court "may" order the appointment of an examiner to conduct such an investigation "as is appropriate." It also provided that the court "shall" order the appointment of an examiner "if such appointment would serve the interests of the estate and security holders."[59]

Eventually, the House and Senate reached a compromise with respect to the use of independent third parties in bankruptcy proceedings. Under the compromise, the Senate's reference to a mandatory trustee in public company cases was eliminated. Instead, the final conference version of the bill seems to have contained a provision requiring the appointment of an examiner in public company cases.[60] Thus, the mandatory trustee was apparently replaced with a mandatory examiner.

However, this provision was changed once again, at the last minute, to require a request by a party in interest before an examiner would be appointed, even in those cases that the Senate would have described as public company cases. Apparently, the final provision meant that an examiner would be available in large public cases as long as any party in interest requested one. This was the last vestige of Senate's insistence on an independent third party in public company cases.

It appears that the compromise version was intended to recognize that a firm rule either requiring the appointment of a trustee or examiner, or

57. *Id.* § 1101(3).

58. *Id.* § 1104(b).

59. *Id.* § 1104(c). The duties of an examiner under the Senate bill were identical to the duties under the House bill. *Id.* § 1106(b).

Interestingly, neither bill adopted the Bankruptcy Commission's proposal for an administrator with a broad mandate to oversee the reorganization effort; however, the House bill did provide for a United States trustee with some of the duties that the Commission would have assigned to its administrator. These duties did not contain the broad investigative mandate or oversight functions envisioned by the Commission. Consequently, a debtor-in-possession retained extensive control over both information and case management except to the extent that an active creditors' committee might monitor the debtor and the proceedings.

60. Prior to the final changes in the legislation, in describing the compromises agreed to between the House and the Senate, Senator DeConcini indicated that the final bill called for the automatic appointment of an examiner in large public cases. 124 CONG. REC. 33989, 34003 (1978).

refusing such an appointment, in every reorganization case would neither promote efficient and economical reorganization nor protect creditors and the public interest from mismanagement, fraud, misdealing, or unfairness. Congress was apparently seeking to balance the perceived need for an independent third party to protect the interests of creditors, equity holders, and the public, with the desire to facilitate the reorganization effort, by encouraging the debtor to commence a case while the debtor could still be saved and by leaving in place those managers familiar with the business and its creditors. Congress sought flexible provisions that could inject an independent third party into the process where such intervention would reasonably assist in assuring that the various constituencies are well served, while not requiring a third party in all cases.[61] It also sought to protect constituents in larger cases by making available an independent third party when a party in interest felt a need for independent input.

## III. THE STATUTORY PROVISIONS

### *A. Trustee Appointments*

One means of bringing an independent third party into a Chapter 11 case is through the appointment of a trustee. A trustee normally operates the business and is generally required to perform certain duties, such as filing reports and schedules, investigating the debtor's affairs, and filing a reorganization plan.[62] In effect, the trustee normally replaces the debtor-in-

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61. *See, e.g.*, *In re* Lenihan, 4 B.R. 209 (Bankr. D.R.I. 1980).

62. 11 U.S.C. § 1106 (1988). Section 1106, which prescribes the duties of trustees and examiners in reorganizations, provides as follows:

(a) A trustee shall—

(1) perform the duties of a trustee specified in section 704(2), 704(5), 704(7), 704(8), and 704(9) of this title;

(2) if the debtor has not done so, file the list, schedule, and statement required under section 521(1) of this title;

(3) except to the extent that the court orders otherwise, investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;

(4) as soon as practicable—

(A) file a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate; and

(B) transmit a copy or a summary of any such statement to any creditors' committee or equity security holders' committee, to any indenture

possession and runs both the business and the Chapter 11 case.[63]

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> trustee, and to such other entity as the court designates;
> (5) as soon as practicable, file a plan under section 1121 of this title, file a report of why the trustee will not file a plan, or recommend conversion of the case to a case under chapter 7, 12, or 13 of this title or dismissal of the case;
> (6) for any year for which the debtor has not filed a tax return required by law, furnish, without personal liability, such information as may be required by the governmental unit with which such tax return was to be filed, in light of the condition of the debtor's books and records and the availability of such information; and
> (7) after confirmation of a plan, file such reports as are necessary or as the court orders.
> (b) An examiner appointed under section 1104(c) of this title shall perform the duties specified in paragraphs (3) and (4) of subsection (a) of this section, and, except to the extent that the court orders otherwise, any other duties of the trustee that the court orders the debtor in possession not to perform.

*Id.*

Section 704, which prescribes the duties of a trustee in a liquidation, provides as follows:

> The trustee shall—
> (1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;
> (2) be accountable for all property received;
> (3) ensure that the debtor shall perform his intention as specified in section 521(2)(B) of this title;
> (4) investigate the financial affairs of the debtor;
> (5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;
> (6) if advisable, oppose the discharge of the debtor;
> (7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a part in interest;
> (8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires; and
> (9) make a final report and file a final account of the administration of the estate with the court and with the United States trustee.

*Id.* § 704.

63. The trustee's role may, however, be limited if appropriate under the circumstances. For example, a trustee need not replace managers in the day-to-day operation of the business if the managers are competently running the business. In such a case, the trustee might investigate the debtor and its operations and might formulate a reorganization plan, but would not operate the debtor.

Bankruptcy Code section 1104(a) provides that "on request of a party in interest or the United States trustee, . . . the court shall order the appointment of a trustee—(1) for cause . . . ; or (2) if such appointment is in the interest of creditors, any equity security holders, and other interests of the estate."[64] The first basis for appointment of a trustee—cause, including fraud or mismanagement—is intended primarily to address shortcomings in the debtor's current management. If management has been seriously dishonest or grossly incompetent, it would be inappropriate to subject creditors or equity interests to continued fraud, dishonesty, or incompetence. Consequently, a trustee is called for when management is clearly incapable of honestly and competently managing the business and guiding it through the reorganization process.[65]

The second basis for the appointment of a trustee requires a more generalized analysis of the interests of the creditors, any equity security holders, and other interests of the estate. The statute offers no express guidelines for determining when the appointment of a trustee will serve the various interests. However, the statute is drafted to require that the appointment be in the interest of all of the constituencies described in the provision. Consequently, it appears that the primary criterion is whether such an appointment would benefit the estate, rather than any particular constituency.[66]

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64. 11 U.S.C. § 1104(a). Under section 1104(a), appointment of a trustee is not, on its face, discretionary. The statute directs the court that it "shall" appoint a trustee under certain circumstances, rather than that it "may" appoint one. *Compare* H.R. 31, *supra* note 49, § 7-102, at 191 (providing that court "may" appoint trustee under certain circumstances). However, the standards for the appointment of a trustee require the exercise of discretionary authority. A finding of "cause" or "interests" requires the court to exercise its discretion and good judgment. *See, e.g.*, Committee of Dalkon Shield Claimants v. A.H. Robins Co., 828 F.2d 239, 242 (4th Cir. 1987) ("[A] determination of cause . . . is within the discretion of the court."); *see also In re* Ionosphere Clubs, Inc., 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990) (noting that Congress adopted "a flexible standard for the appointment of trustees"). Nevertheless, use of the word "shall" instead of a more discretion-based word, such as "may," suggests that a trustee is essential under certain circumstances and that a court should not be reluctant to order the appointment of a trustee when a trustee appears necessary to protect the various constituencies.

65. In *In re* William A. Smith Constr. Co., 77 B.R. 124 (Bankr. N.D. Ohio 1987), the court found cause for the appointment of a trustee when the debtor's president and chief executive officer resigned from the company on the date the bankruptcy case was commenced. In the absence of anyone to run the business objectively, the court had little choice but to appoint a trustee.

66. Use of the word "and" indicates that appointment of a trustee must be in the interest of the various constituencies. It must serve some positive purpose for the estate, rather than simply further the interests of one constituency.

There is no requirement that particularly egregious circumstances be present.

Courts have described various factors to be considered in determining whether appointment of a trustee is in the interest of the parties and the estate.[67] In general, these factors seem to require a balancing of the costs involved in a trustee appointment with the benefits to be derived from such an appointment.[68]

There are several potential costs associated with the appointment of a trustee. First, of course, there is the cost of the trustee. However, to the extent that the trustee replaces current managers, who were themselves compensated for managing the business, this cost would not necessarily increase the expenses already being incurred by the estate.[69]

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Instead, the only limitations on the face of the provision are that a party in interest or the United States trustee must request the appointment of a trustee and the court must look to the interests of all concerned parties, not merely one constituency. In fact, notwithstanding the directive that a party in interest or the United States trustee must request the appointment of a trustee, § 105 seems to authorize the court to act *sua sponte* if the court believes that the standards for appointment of a trustee have been met.

The House Report describes the standard for appointment of a trustee as follows:

> The twin goals of the standard for the appointment of a trustee should be protection of the public interest and the interests of creditors, as contemplated in current Chapter X, and facilitation of a reorganization that will benefit both the creditors and the debtors, as contemplated in current Chapter XI. Balancing the goals is a difficult process, and requires consideration of many factors.

H.R. REP. NO. 595, *supra* note 4, at 232, *reprinted in* 1978 U.S.C.C.A.N. at 6192.

67. One court described these factors as

> (i) the trustworthiness of the debtor; (ii) the debtor in possession's past and present performance and prospects for the debtor's rehabilitation; (iii) the confidence—or lack thereof—of the business community and of creditors in present management; and (iv) the benefits derived by the appointment of a trustee, balanced against the cost of the appointment.

*In re* Ionosphere Clubs, Inc., 113 B.R. at 168 (citations omitted).

68. *See, e.g., In re* Parker Grande Dev. Inc., 64 B.R. 557 (Bankr. S.D. Ind. 1986). The House Report described this balancing in conjunction with the House bill that explicitly called for a cost-benefit analysis:

> It may be difficult now to determine the precise contours of the standard, because in any particular case, the projection of the cost of and the protection afforded by a trustee will be uncertain. However, a case law will quickly develop defining the circumstances in which a trustee should be appointed.

H.R. REP. NO. 595, *supra* note 4, at 234, *reprinted in* 1978 U.S.C.C.A.N. at 6194.

69. *See, e.g., In re* Microwave Prods. of Am., Inc., 102 B.R. 666 (Bankr. W.D. Tenn. 1989) (trustee would replace outside management consultant who was costing estate $7,500 per week). During the hearings on bankruptcy reform proposals, the Securities and Exchange Commission recognized that, in a cost-benefit analysis, the proper comparison is between the cost of a trustee and the value of its services to the estate. In this regard, the SEC noted: "The trustee's compensation in reorganization is

Similarly, although the trustee will likely need legal counsel and perhaps the assistance of other professionals, the debtor will not normally need counsel and professionals separate from the trustee's, so there need not be duplication of professional expenses. Indeed, several courts have recognized that once a trustee is appointed, the debtor's counsel is no longer entitled to compensation from the estate, except to the extent that debtor's counsel is performing services that benefit the estate.[70] Thus, the cost need not be quite as great as some courts have envisioned.

More significantly, there is the cost of delay and "education" as the trustee learns about the business and the various constituencies involved in the bankruptcy case. This delay and expense would not be incurred by current management; it represents an extra cost attributable to the appointment of a trustee. The delay and education can be particularly costly if, as is often the case with a Chapter 11 debtor, the debtor is at a critical juncture requiring immediate action.

Related to this cost is the danger that management personnel who are essential to the proper and successful functioning of the business cannot be replaced adequately by a trustee. In smaller cases, the business may be the creature of its owners or managers. Ousting those managers may destroy the business if they are essential to the smooth and successful continuation of the business. Even in larger businesses, employees, customers, and suppliers may be familiar with current management and may be less willing to deal with a new manager, particularly if the new manager is a bankruptcy

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based on the services he renders and should represent the cost of a good executive." *SEC Report*, *supra* note 51, at 751. The SEC continued, stating,

> We do not mean to suggest that a reorganization proceeding is not expensive, or that the trustee is only a chief executive. A trustee has broader and different responsibilities than the chief executive of a solvent business. There is more work to be done for which payment must be made. But the extra costs depend on the requirements of the reorganization and the need for due process in a court proceeding. Although the elimination of the trustee may reduce direct administrative costs, the trustee's fee is not the principal factor in that calculation. There is, moreover, no ultimate saving if the lack of a trustee leads to a reorganization which is inadequate or incomplete and which results eventually in a return engagement to the court at a later date. Finally, additional costs may be offset if the investigation by a trustee results in bringing back into the estate substantial assets through suits against former management and others.

*Id.*

70. *See, e.g.*, *In re* Xebec, 147 B.R. 518 (Bankr. 9th Cir. 1992); *In re* Ginji Corp., 117 B.R. 983 (Bankr. D. Nev. 1990); *In re* TS Indus., 125 B.R. 638 (Bankr. D. Utah 1991); *cf. In re* NRG Resources, Inc., 64 B.R. 643 (W.D. La. 1986) (trustee's attorney replaces debtor's attorney); *In re* Ionosphere Clubs, Inc., 113 B.R. 164, 172 (Bankr. S.D.N.Y. 1990) (debtor's professionals retained to represent estate).

trustee.

However, when operating management is competent to maintain day-to-day operations, the trustee need not actually displace that management and delay the debtor's return to health.[71] Instead, the trustee may serve as a general overseer, in a role similar to that of a board of directors, while current managers maintain continuing operations.[72]

For example, in *In re Colorado-Ute Electric Association, Inc.*,[73] the court ordered the appointment of a trustee because there were "formidable" conflicts among the debtor's board of directors and because the debtor's management seemed unsuited to the task of reorganizing the debtor. Nevertheless, the court acknowledged that, because the debtor's current management was capable of maintaining the day-to-day operations of the debtor, "the trustee may determine to retain current management throughout this case to operate the debtor, and to assist and support the trustee."[74]

Similarly, in *In re Cardinal Industries, Inc.*,[75] the court ordered the appointment of a trustee after various creditor constituencies lost confidence in management's ability to generate accurate financial information, to determine impartially an appropriate business direction for the debtor, or ultimately to effect successfully a reorganization of the debtor. Nevertheless,

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71. *See, e.g.*, *In re* Cardinal Indus., 109 B.R. 755, 766 (Bankr. S.D. Ohio 1990); *In re* Microwave Prods. of Am., 102 B.R. 666, 676 (Bankr. W.D. Tenn. 1989); *In re* Parker Grande Dev., Inc., 64 B.R. 557, 561 (Bankr. S.D. Ind. 1986); *see also In re* Bonded Mailings, Inc., 20 B.R. 781 (Bankr. E.D.N.Y. 1982) (trustee appointed in "watch dog" capacity, debtor's managers retained to run day-to-day operations).

72. In analyzing the cost of a trustee, courts seem to have lost sight of the two very different roles that a trustee might serve in a reorganization case: (1) management of the business and (2) general oversight of the case. In the various proposals for mandatory appointment of a trustee, proponents recognized that a trustee need not, in all cases, displace current operating management. For example, in describing Senate bill 2266 which required the appointment of a trustee in cases involving "public companies," Senator Wallop observed:

> In the very large public company case where there is great public interest and the creditors, stockholders and interested parties may be located throughout the country, a trustee will automatically be appointed *to supervise the proceedings. He will be able to retain the current management if he desires* but will not be required to do so.

124 CONG. REC. S14715, S14719 (1978) (emphasis added). Thus, Senator Wallop acknowledged that a trustee may serve the role of supervisor of the proceeding, rather than active manager, and that current operating management need not be displaced even in those cases in which a trustee is appointed.

73. 120 B.R. 164 (Bankr. D. Colo. 1990).

74. *Id.* at 177; *see also In re* McCordi Corp., 6 B.R. 172 (Bankr. S.D.N.Y. 1980); *cf. supra* note 35 (discussing prior Bankruptcy Act provisions for retention of management).

75. 109 B.R. 755 (Bankr. S.D. Ohio 1990).

the court recognized that the debtor's current managers had skills and knowledge related to the debtor's operations that could be useful to a trustee. Thus, the court suggested that the managers "should be retained and utilized by any appointed trustee."[76] By authorizing the employment of current management, the court was able to protect the rights of creditors and other constituencies without depriving management of its authority over many of the day-to-day operations of the business.[77]

Apart from the perceived monetary costs of a trustee are related, intangible costs that must be considered. The debtor is divested of possession and control of the business, the debtor's exclusive period to propose a plan is terminated, and the debtor's principals generally suffer substantially decreased influence over the reorganization effort.

In general, Chapter 11 attempts to set up a negotiating process in which the debtor's principals can often be at the table and perhaps salvage some role or equity in the reorganized debtor.[78] The debtor's exclusive right to propose a plan not only provides structure to plan negotiations, but also affords the debtor some leverage to protect the debtor's principals. Although a trustee may be able to serve as the lightening rod that provides some

76. *Id.* at 767.

77. One commentator has suggested that the Bankruptcy Code authorizes the appointment of a "limited powers trustee." *See* Leonard L. Gumport, *The Bankruptcy Examiner*, 20 CAL. BANKR. J. 71, 132-34 (1992). Such a trustee would be charged with the duty of investigating the debtor and pursuing any causes of action disclosed by the investigation. By limiting the trustee's role pursuant to sections 363(c)(1) and 1108 of the Code, a court can engage a trustee to bring actions on behalf of the estate without ousting a debtor's management. To the extent that a trustee both investigates and brings causes of action, however, the trustee is subject to the same appearance of conflict Congress sought to avoid by barring an examiner from later serving as a trustee. The investigating trustee has incentive to find viable causes of action because pursuit of those actions is the only role of the trustee.

Another possibility would be to place the trustee in the role of the board of directors and to require that the trustee at least seriously consider retaining current operating management. The trustee could then investigate the debtor, oversee management's pursuit of causes of action, and maintain general control over the reorganization effort, while permitting current management to continue day-to-day operations.

The problem with this approach is that the managers may not feel that they have a sufficient stake in the operation if their control has been superseded by a trustee. However, operational managers are already subject to the control of a board of directors. They may not object to control by a trustee instead of a board. When they do object, as might occur particularly when operational managers and board members are the same or related persons, a trustee may be able to create incentives to induce managers to remain with the debtor.

78. *See* Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125 (1990).

structure to plan negotiations, the Bankruptcy Code's attempt to provide some leverage to the debtor is defeated when a trustee is appointed. Without that leverage, the debtor's principals, as opposed to the business, are largely excluded from the reorganization effort. This exclusion, and the likely disenfranchisement of the debtor's principals, is certainly a cost to the principals; it is also a cost to the process of reorganizing the debtor.

Once a court determines the predicted costs of a trustee, it can weigh them against the benefits to be gained by the appointment of a trustee in appropriate cases. The benefits of a trustee depend on the particular facts of each individual case. When the management of the debtor-in-possession is competent, when it can adjust adequately to its modified fiduciary obligations, and when a creditors' committee is properly functioning, there may be virtually no marginal value to appointment of a trustee, in which case the cost will clearly outweigh the benefit.

On the other hand, when the debtor has engaged in fraud or has incompetently managed the business, the benefit of a trustee is obvious. A competent, independent third party can investigate honestly and effectively the prior management's conduct and dealings, manage the business, and guide the debtor through the reorganization process.

Even when the debtor has not acted fraudulently or incompetently, a trustee may be able to diffuse tensions that may exist between current management and creditors and generally to increase the confidence level of the various constituencies if they are dissatisfied with current management.[79] In appropriate cases, the intervention of a third party with control over the debtor and its operations may assist meaningfully in obtaining agreement on a reorganization plan for the debtor.

A trustee may also be able to resolve more convincingly than current management the corporate governance and fiduciary duty issues that can arise in a Chapter 11 case. Unlike the debtor's current management, the trustee is not retained by a board elected by shareholders and has no history with the various constituencies. Consequently, there is less danger that the trustee will unfairly favor (or appear to favor) one constituency over another.[80] Moreover, a trustee is less likely than the prebankruptcy managers to perceive a need to protect its own position within the business. The trustee will not have been a previous owner of the business and is not generally viewed as an integral part of the ongoing management of the

79. *See, e.g., In re* Bonded Mailings, Inc., 20 B.R. 781 (Bankr. E.D.N.Y. 1982) (trustee appointed in part to mediate with major creditor and either propose reorganization plan or report that no plan is possible).

80. If anything, the trustee seems to be more likely to follow the absolute priority rule, favoring senior interests over junior interests. Consequently, junior claimants rarely seek the appointment of a trustee. *See* LoPucki & Whitford, *supra* note 1, at 700.

business. Instead, once the business is successfully reorganized the trustee will usually move on to another venture.

Although considerable benefits may sometimes flow from the appointment of a trustee, most courts, after weighing the costs and benefits, recognize a strong presumption in favor of leaving in place the debtor-in-possession.[81] They have generally been reluctant to order the appointment of a trustee unless there is a strong showing that the benefit to be derived will far outweigh the costs that flow from the appointment of a trustee.

Consistent with this judicial orientation, appointment of a trustee is typically described as an "extraordinary remedy" to be granted only on a showing by clear and convincing evidence that the remedy is warranted.[82] However, although certainly many cases exist in which the expense, upheaval, and interference of a trustee would outweigh the benefits, the strong presumption in favor of the debtor-in-possession may lead courts to refuse to order the appointment of a trustee even when such an appointment may assist meaningfully in the debtor's reorganization. In view of the flexible role that a trustee can serve in a reorganization case, courts may, at times, be missing an opportunity to provide increased protection and confidence for various constituencies and to resolve in a more efficient and economical manner the reorganization issues.

### *B. Examiner Appointments*

A less drastic alternative for providing an independent third party in a reorganization proceeding is the appointment of an examiner. Unlike a trustee, an examiner does not displace the debtor-in-possession. Instead, the examiner's statutory role is primarily investigative. The court may order the examiner to investigate any aspect of the case or the underlying business operation and to file a report of his or her findings.[83]

Bankruptcy Code section 1104(b) provides that if the court does not order the appointment of a trustee, it "shall order the appointment of an examiner . . . if—(1) such appointment is in the interests of creditors, any

81. *See, e.g., In re* Ionosphere Clubs, Inc., 113 B.R. 164, 167 (Bankr. S.D.N.Y. 1990); Committee of Dalkon Shield Claimants v. A.H. Robins Co., 828 F.2d 239, 241 (4th Cir. 1987).

82. *Ionosphere Clubs*, 113 B.R. 164. One commentator has argued that, in fact, a preponderance of the evidence standard would be more appropriate because the court could more flexibly balance the needs of creditors and shareholders against the interest of the debtor in remaining in possession. *See* Gumport, *supra* note 77, at 106-07.

83. As courts and parties to Chapter 11 cases have begun to recognize the potential value of limited third-party intervention, examiners, as the only statutorily sanctioned third parties who do not displace the debtor-in-possession, have also been asked to serve limited noninvestigative roles. *See infra* Part IV.

equity security holders, and other interests of the estate; or (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000."[84] The first statutory standard, "interests of creditors, any equity security holders, and other interests of the estate," mirrors the standard for the appointment of a trustee.[85] As with the standard for trustee appointments, the examiner standard looks to the collective interest of all of the constituencies described; the interest of the estate is the primary concern under the interests test. Apparently this standard requires a comparison of the costs and benefits of an examiner appointment similar to that required for trustee appointments.

The costs of an examiner, however, should be significantly lower than those of a trustee. The examiner does not generally become a manager of the business and does not need to be compensated for a management role. Management is not generally displaced, so the perceived delay and expense of replacing management is not incurred. Similarly, the examiner remedy is less severe because the debtor remains in possession of the business and retains its exclusive right to propose a plan. Consequently, the debtor retains the leverage accorded by exclusivity, and the plan negotiation process can proceed in the manner envisioned by the Code.

Nevertheless, there can be significant costs attributable to the appointment of an examiner. The examiner must be compensated for its time and, if the examiner has retained professionals, they must be compensated as well.[86] In some cases, these fees have been considerable. However, if an examiner is investigating the debtor or its business, this should relieve the committees from the need to engage in a similar investigation. Particularly if an examiner is appointed early in a Chapter 11 case, the costs of the examiner may be offset in significant part by the savings of committees and their professionals. In fact, if several committees would have investigated

84. 11 U.S.C. § 1104(6) (1988).

85. *See supra* note 64 and accompanying text. As with trustee appointments, the statute provides that the court "shall" order the appointment of an examiner if the appointment is in the interests of the various constituencies. Use of the mandatory "shall" suggests an intention to ensure that an examiner is readily available when such an appointment is in the interests of the various constituencies.

86. Although the Bankruptcy Code contains no explicit authorization for an examiner to retain professionals, examiners have been authorized to retain professionals when necessary to enable the examiner to perform successfully his or her duties. Alternatively, an organization may be appointed examiner, perhaps obviating the need to retain professionals. Bankruptcy Code § 1104(c) requires the appointment of a "disinterested person." 11 U.S.C. § 1104(c). The term "disinterested person" means a "person" who meets the standards of 11 U.S.C. § 101(14). The term "person" includes an "individual, partnership and corporation." 11 U.S.C. § 101(41). Thus, for example, a law firm or accounting firm could be appointed examiner, eliminating a need for separate retention of either lawyers or accountants.

the same issues, there may actually be a net saving attributable to the appointment of an examiner.

Because the costs are lower, an examiner should be available more readily than a trustee to investigate matters or to serve other limited roles. However, because the estate may nevertheless incur substantial costs, a party requesting an examiner under the "interests" test must still be able to show a commensurate benefit that makes the appointment one that is in fact in the interest of the various constituencies.

For example, in *In re Table Talk, Inc.*,[87] the United States trustee moved for the appointment of an examiner because the trustee was concerned about the debtor's failure to meet its projections and about the debtor's continuing losses. Although the failures and losses suggested that the debtor's management might not have been capable of reorganizing the debtor, the court refused to order the appointment of an examiner because it found such an appointment was not in the interest of the estate. The court observed that the creditors' committee had retained a distinguished accounting firm to investigate the debtor's operations and that no party had shown why that firm's investigation would not be sufficient. In the absence of such a showing, the court refused to find that it would be in the interest of the various constituencies to add another "functionary" to the parties already involved in the case.[88]

Similarly, in *In re Mechem Financial of Ohio, Inc.*,[89] the court refused to appoint an examiner even though the debtor had failed to place trust funds in a financial institution, as required by Ohio law, and may have misallocated funds among related corporations. The court observed that the debtor had subsequently retained a financial institution to act as independent trustee of the funds and was, by the time of the hearing, in compliance with Ohio law.[90] The court found that any remaining investigation that might be necessary could be performed by the creditors' committee and that, in the absence of any evidence of fraud or dishonesty on the part of the debtor, there was simply insufficient cause to justify the imposition of another layer of expense on the estate.[91]

Although not all cases are ripe for an examiner, there are significant potential benefits that may result from the appointment of an examiner in appropriate cases. An examiner can assist in determining early in a case whether there is any meaningful chance that a viable business can emerge from the reorganization. An examiner also can clear the air with respect to

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87. 22 B.R. 706 (Bankr. D. Mass. 1982).
88. *Id.* at 712.
89. 92 B.R. 760 (Bankr. N.D. Ohio 1988).
90. *Id.* at 760-61.
91. *Id.* at 761.

other factual and, perhaps, legal issues that are of concern to the parties. An independent, impartial examination may have more credibility than an investigation by the debtor or a committee, who likely has an interest in the conclusions reached after investigation. Investigation by an examiner may avoid multiple investigations about the same issue. Moreover, because an examiner is usually not distracted by other aspects of the reorganization effort, the examiner's investigation may be concluded relatively quickly, giving the parties the benefit of the information obtained and the conclusions reached early in a case, before positions have hardened.

An examiner may provide other benefits available from the intervention of an independent third party without incurring the costs, or creating the disruption, of a trustee. As the only other independent third party expressly recognized by the Code, an examiner may be able to diffuse tensions among the various constituencies by mediating in plan negotiations or other disputes, assisting the debtor with management or reorganization decisions, or performing other tasks that can best be accomplished by a party unconnected with any of the constituencies in the case.

Moreover, although a party requesting an examiner should be required to show a benefit commensurate with the cost, that benefit need not necessarily be enhanced value to the estate. In a bankruptcy proceeding, there is value to maintaining the credibility of the process in the eyes of the various constituencies. The availability of an objective investigation of the debtor's conduct or operations may have considerable value even if it is not intended to lead to any recovery of property or reduction of claims.

The second ground for appointment of an examiner differs entirely from the grounds for trustee appointments. In larger cases—those in which the debtor's fixed, liquidated, unsecured debts, other than normal trade debts, taxes, and insider obligations, exceed $5,000,000—section 1104(b)(2) requires the court to order the appointment of an examiner upon the request of any party in interest or the United States trustee.[92] Under this standard, the court may be required to order the appointment of an examiner even if the appointment is not in the interest of the estate generally.

This mandatory ground for the appointment of an examiner applies only in larger cases, in which there are more likely to be multiple constituencies, public debt or equity holders, and parties who may not be represented adequately by the debtor or the committees. This standard appears to be the last vestige of the "public company" exception in the Senate bill. As such, it seems to provide any party in interest with a right to demand intervention by an independent third party in order to assure a proper investigation of issues of concern in the case and to validate the reorganization process.[93]

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92. 11 U.S.C. § 1104(6)(2) (1988).

93. For example, in Morgenstern v. Revco D.S, Inc. (*In re* Revco D.S., Inc.), 898

Although some courts have given effect to the mandatory language of section 1104(b),[94] other courts have refused to follow the command and have been unwilling to authorize the appointment of an examiner without a showing of need, even when the request is made by a party in interest in a case that meets the financial standard of section 1104(b). For example, in *In re Shelter Resources Corp.*[95] the court denied a request for the appointment of an examiner even though the financial test was met. In *Shelter Resources* both the Securities and Exchange Commission and an indenture trustee moved for the appointment of an examiner to investigate allegations made in a shareholders' derivative action. After the hearing on the examiner motion, the shareholders' derivative action was settled, but the examiner motion was not withdrawn. The court found that the issue underlying the examiner request had become moot as a result of the settlement and that appointment of an examiner would entail undue expense and delay to the estate; therefore, the court denied the motion. In doing so, the court determined that it was not bound by the mandatory language of section 1104(b) because "to slavishly and blindly follow the so-called mandatory dictates of Section 1104(b)(2) is needless, costly and non-productive and would impose a grave injustice on all parties herein."[96]

Similarly, in *In re GHR Cos.*,[97] the court denied the appointment of an examiner notwithstanding that the financial standard of section 1104(b)(2) may have been satisfied. The United States trustee, who was joined by a group of secured bank creditors and certain other creditors, requested an examiner for the following reasons: (1) the debtor had been consistently late in filing reports and schedules; (2) appointment of one independent investigator would avoid duplication of effort by the various creditor committees and their professionals; (3) an examiner could investigate why prior confirmed plans had failed, whether there was mismanagement, and the debtors' general financial picture; (4) an examiner could monitor the disposition of estate assets and perhaps provide a framework for developing

F.2d 498 (6th Cir. 1990), the court held that § 1104(b)(2) mandates the appointment of an examiner upon the request of a party in interest, even if the bankruptcy court believes that an examiner is unnecessary or unwarranted. Thus, the court of appeals refused to permit the bankruptcy court to deny the appointment once an examiner was properly requested. The court acknowledged, however, that the bankruptcy court can define the role of the examiner in a manner that will be useful to the progress of the case. In this regard, the bankruptcy court presumably would not be bound by the parties' vision of an examiner's role, although the needs perceived by the parties would undoubtedly inform the court's charge to the examiner.

94. *E.g.*, *id.*

95. 35 B.R. 304 (Bankr. N.D. Ohio 1983).

96. *Id.* at 305.

97. 43 B.R. 165 (Bankr. D. Mass. 1984).

a reorganization plan; and (5) an examiner could investigate numerous legal issues presented by the debtors' complicated structure.[98]

The court reviewed the legislative history of the examiner provision and found that the provision was intended to protect public security holders. Because the debtor in *GHR* was a private company, the court found that it was not bound by the mandatory language of section 1104(b)(2). The court also observed that it had already authorized the retention of "numerous investigatory-type functionaries"[99] and that certain parties had moved for the appointment of a trustee and a change of venue. Therefore, in the court's view, appointment of an examiner would entail unnecessary expense and delay to the detriment of the estate.

Interestingly, if the United States trustee's rationale for seeking the appointment of an examiner were taken at face value, *GHR* would appear to present a compelling case for an independent third party. There were clearly issues to investigate; there was a problem of potential duplication of effort; and there were hints of management failures. Perhaps the court's reluctance flowed from its intention to grant the change of venue motion, which might entail appointment of a new examiner or trustee in the new venue. Yet, if that was the primary motivation for the court's holding, it would have been preferable for the court simply to transfer venue before deciding the motion, and let the new court address the request. Instead, the case seems to stand for the proposition that the mandatory language is not mandatory and that even the compelling circumstances described by the United States trustee are insufficient to justify the appointment of an examiner. In view of the potential value of an examiner in a case like *GHR*, it would be unfortunate if the case were viewed as authority for the discretionary denial of an examiner when there are issues to be investigated and there is doubt about the parties' ability to investigate satisfactorily those issues.

Even when denial of a request for the appointment of an examiner appears to be in the interest of the estate, as it appeared to the courts in *Shelter Resources* and *GHR*, disregarding the clear, mandatory language of section 1104(b)(2) is a disturbing example of judicial legislation. The statute could not be more clear in mandating the appointment of an examiner under certain circumstances. If concerned about expense or delay, a court can limit the scope of the examiner's task or can place a cap on compensation.[100] Disregard of such a clear statutory provision merely encourages disregard of other clear legislative mandates.

98. *Id.* at 167.

99. *Id.* at 175.

100. *See, e.g.*, Morgenstern v. Revco D.S., Inc. (*In re* Revco D.S., Inc.), 898 F.2d 498 (6th Cir. 1990).

Moreover, a discretionary approach to the appointment of an examiner may fail to acknowledge properly the underlying policy of providing third party intervention in those cases in which a party in interest is uncomfortable with the representation provided by the debtor and the committee structure. As a final remnant of the "public company" trustee sought in the Senate's bankruptcy bill, it seems clear that Congress intended to validate the Chapter 11 reorganization process by assuring that third party intervention would be available in larger cases any time a party in interest desires such intervention.[101]

## IV. ROLES FOR TRUSTEES AND EXAMINERS

Although Chapter 11 represents a relatively unstructured process that often calls out for third party intervention, courts, as well as parties to Chapter 11 proceedings, seem generally to focus more on the perceived expense, delay, and disenfranchisement of the debtor that may result from such intervention than on the potential benefits of such intervention in a reorganization effort. In view of the enormous flexibility afforded by the trustee and examiner concepts, however, in many cases an independent third party might in fact prove useful in protecting various constituencies and lending credibility to a reorganization effort.[102] The value of third-party intervention is illustrated by some of the uses of trustees and examiners in reported cases.[103] The broad range of tasks assigned to trustees and examiners, and the instances in which trustees or examiners have been appointed, suggests that these independent third parties can play a useful role in many bankruptcy cases.

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101. One problem that is sometimes raised is that a request for appointment of an examiner late in a case, for example on the eve of confirmation of a plan, may unfairly delay resolution of the Chapter 11 case and may represent a strategic bargaining move rather than a good-faith desire for an investigation. *See, e.g.*, *In re* Schepps Food Stores, Inc., 148 B.R. 27 (S.D. Tex. 1992) (examiner request made on eve of confirmation denied). *See generally* 5 COLLIER ON BANKRUPTCY, ¶ 1104.03 (Lawrence P. King ed., 15th ed. 1992). In such a case, a court might deny the appointment based on a theory such as laches or, alternatively, might severely limit the scope of the examiner's duties or compensation such that confirmation would not be unduly delayed. *Id.*

102. *See* Lawrence K. Snider, *The Examiner in the Reorganization Process: A Need to Modify*, 45 BUS. LAW. 35, 39 (1989) (stating that courts should adopt broad test for examiner appointment because examiners can play useful roles in satisfying creditors' "right to know" and in resolving "the many conflicting interests in the reorganization process").

103. Apparently, only a small percentage of cases in which trustees or examiners are appointed result in reported opinions. Therefore, there are likely many unreported cases in which trustees and examiners have played useful roles in protecting parties' interests and assisting in reorganization efforts.

Trustees and examiners have traditionally performed two primary functions in reorganization cases. First, they have been expected to investigate the debtor's management and operations to determine whether current management was appropriate, whether the debtor could be reorganized, and whether causes of action that might benefit the estate should be pursued. Second, they have replaced the debtor's management when management appeared to be dishonest, incompetent, or incapable of successfully reorganizing the debtor.

However, as bankruptcy cases have increased in complexity and parties' interests have diverged, other potentially useful roles have developed. An independent third party can defuse contentious disputes among the parties, pursue tasks untainted by the appearance of conflict that may, in some cases, infect various parties, and generally provide structure to a case to enable the parties to reach agreement on a realistic and appropriate plan for reorganizing the debtor.

A court has enormous flexibility in delegating tasks to an independent third party in a reorganization case. For example, a trustee may completely replace the management of a debtor-in-possession or may be assigned a more limited role. In those cases in which the debtor's management is important to the ongoing business operations, a trustee may retain that management for day-to-day operations and serve more of an oversight role with respect to the business. A trustee may take the lead in investigating the debtor or its operations[104] and perhaps in formulating a reorganization plan. Or a trustee may play the more limited role of mediator or facilitator to induce agreement on a plan among the various parties.

Similarly, an examiner may investigate and report on issues of importance to the parties or may perform other roles in the case. In general, the Code offers considerable flexibility with respect to a role for an examiner in a Chapter 11 case.[105]

Indeed, even the investigatory function itself is broad. Unless the court orders otherwise, the examiner is not limited to investigation of fraud or alleged misdeeds. Instead, the investigation may include "the operation of the debtor's business and the desirability of the continuance of such busi-

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104. *See, e.g.*, *In re* Madison Management Group, 137 B.R. 275 (Bankr. N.D. Ill. 1992) (trustee appointed to investigate causes of action available to debtor and to pursue viable actions).

105. 11 U.S.C. § 1106(b) (1988); *see, e.g.*, *In re* Boileau, 736 F.2d 503 (9th Cir. 1984) (approving examiner with expanded powers). This flexibility may be increased through the use of the court's general equity power granted by 11 U.S.C. § 105. *See, e.g.*, *In re* Gaslight Club, Inc., 782 F.2d 767 (7th Cir. 1986) (appointment of "person in control" instead of trustee); *In re* FSC Corp., 38 B.R. 346 (Bankr. W.D. Pa. 1983) (appointment of "responsible officer" when debtor had no officers or directors).

ness"[106] and, even more broadly, "any other matter relevant to the case or to the formulation of a plan."[107] Thus, the examiner may truly serve as the "eyes and ears" of the court and the various constituencies involved in the case.

The flexibility of the trustee and examiner concepts affords the court the opportunity to create a role that is best suited to assisting in the management or investigation of the debtor and in resolving issues that arise during the case. The reported cases and other commentary suggest various useful roles for an independent third party. A discussion of some of these roles follows.

### *A. Management of Debtor*

When there is substantial evidence that the debtor's management has engaged in fraud, gross mismanagement, or other conduct inconsistent with its role as fiduciary for the estate and its various constituencies, appointment of a third party to manage the business is mandated both by the language of section 1104 and by the underlying policy of protecting the constituencies who have a real economic interest in the proper functioning of the debtor.[108] In a Chapter 11 case, creditors and shareholders have such a strong interest in the economic operation of the debtor and the honest formulation of a reorganization or liquidation proposal that they should not be saddled with a management team that cannot properly represent their interests. When the debtor's management has engaged in serious fraud, mismanagement, or other conduct inconsistent with its role as a fiduciary, the management cannot provide the various constituencies with comfort that the reorganization effort will be pursued diligently and honestly.[109]

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106. 11 U.S.C. § 1106(a)(3).

107. *Id.*

108. *See, e.g., In re* U.S. Communications of Westchester, Inc., 123 B.R. 491, 495 (Bankr. S.D.N.Y. 1991):

> In the instant case, the debtor has engaged in certain conduct which reveals a lack of competence to conduct a business operation in furtherance of its fiduciary duty to its creditors. . . . Such conduct results in a complete erosion of trust and confidence by creditors. A court's willingness to allow a debtor's management to remain in possession "is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee."

(quoting Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343 (1985) (quoting Wolf v. Weinstein, 372 U.S. 633 (1963))).

109. *Id.* In *In re* Mako, Inc., 102 B.R. 809 (Bankr. E.D. Okla. 1988), the court attempted to describe the type of mismanagement that would support the appointment of a trustee: "Incompetency has its roots in mismanagement, requiring a showing of a lack of business acumen and ability. . . . Gross mismanagement suggests some extreme ineptitude on the part of management to the detriment of the organization. But it must

The court typically discovers management's misdeeds through a motion by a creditor, creditors' committee, or United States trustee for the appointment of a trustee. The motion process provides an opportunity to explore fully the allegations of fraud, misconduct, or mismanagement that led to the request for a trustee.

Sometimes the examiner and trustee concepts can work together to flesh out misbehavior. For example, in *In re Cumberland Investment Corp.*,[110] the court appointed an examiner to investigate allegations of management misconduct. The examiner reported significant management failures, obstructions, falsities, and unauthorized actions that suggested the need for a trustee to take over and terminate the business. The court adopted the examiner's suggestion and ordered the appointment of a trustee.[111]

Although management's gross misconduct normally leads to the appointment of a trustee, a few courts have authorized examiners to run debtors' businesses or otherwise to control the reorganization.[112] These courts may have been seeking to avoid the loss, automatic upon the appointment of a trustee, of the debtor's exclusive period to file a reorganization plan.[113] Alternatively, they may simply have been seeking to preserve some role for the debtor's current owners or managers.

However, it is difficult to justify appointment of an examiner, as opposed to a trustee, to run the business. Such an appointment appears to be inconsistent with both the statutory language describing the examiner's duties and with the underlying debtor-in-possession policy of Chapter 11. Section 1106(b) authorizes the examiner to investigate and report, and to perform "any other duties of the trustee that the court orders the debtor-in-possession not to perform."[114] The trustee's duties, which are primarily

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rise above simple mismanagement to achieve the level envisioned by the Code." *Id.* at 812 (citations omitted); *see also In re* Ionosphere Clubs, Inc., 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990):

> [S]ome degree of mismanagement exists in virtually every insolvency case. . . . While a certain amount of mismanagement of the debtor's affairs prior to the filing date may not be sufficient grounds for the appointment of a trustee, continuing mismanagement of the affairs of a debtor after the filing date is evidence of the need for the appointment of a trustee.

(citations omitted).

110. 118 B.R. 3 (Bankr. D.R.I. 1990).

111. *Id.* at 7.

112. *See, e.g.*, *In re* John Peterson Motors, Inc., 47 B.R. 551 (Bankr. D. Minn. 1985) (giving examiner powers and duties of trustee); *In re* Liberal Market, Inc., 11 B.R. 742 (Bankr. S.D. Ohio 1981) (authorizing examiner to operate business); *see also In re* Boileau, 736 F.2d 503 (9th Cir. 1984) (approving examiner with expanded powers).

113. 11 U.S.C. § 1121(c)(1) (1988).

114. *Id.* § 1106(b).

investigative and reporting duties, are listed in section 1106(a).[115]

Notably absent from the list of a trustee's duties is a duty to operate the business. Instead, section 1108 provides that the trustee "*may* operate the debtor's business."[116] This appears to be a right or power of a trustee rather than a duty. Indeed, section 1107, in describing the role of a debtor-in-possession, distinguishes between rights and powers, on the one hand, and functions and duties, on the other.[117] If this distinction applies to section 1106, the authorization to operate the business would seem to be a right or power, rather than a duty, and would, under this analysis, be excluded from the examiner's charge.[118]

This analysis is consistent with the underlying Chapter 11 policy of attempting to leave the debtor in possession of the business, subject only to oversight by committees, the court, and, perhaps, an examiner. If a court could displace management without finding that the more stringent standards for appointment of a trustee have been satisfied, then that policy may not be well served.

Nevertheless, the flexibility of the examiner concept may allow for useful intervention when discrete management issues must be resolved. For example, in *In re Apex Oil Co.*,[119] the relationship between the debtor and its bank lenders had become so bitter by the time the debtor commenced its Chapter 11 case that it seemed likely that litigation between them would prevent the debtor from continuing to operate or reorganizing successfully. The examiner was able to stabilize the relationship by monitoring budget and operating reports, obtaining commitments for preparation of an asset deployment plan, and facilitating exchange of financial and budgetary information. The examiner also arranged permission for the debtor to trade oil futures contracts on the Mercantile Exchange, expedited approval of government contracts, monitored retention of professionals and their compensation applications, preserved utility services, preserved executory contracts and unexpired leases, and dealt with various reclamation claimants. These management efforts had the effect of preserving the debtor's operations and, through that, its going concern value, without replacing existing management.

In other cases, the examiner might, in addition to investigating the

115. *Id.* § 1106(a). The duties also include filing a plan, reporting on why a plan is not being filed, or recommending that the case be converted.

116. *Id.* § 1108 (emphasis added).

117. *See id.* § 1107.

118. *See In re* International Distrib. Ctrs., Inc., 74 B.R. 221 (S.D.N.Y. 1987); *see also* Snider, *supra* note 102, at 47.

119. 111 B.R. 235 (Bankr. E.D. Mo. 1990), *rev'd*, 132 B.R. 235 (E.D. Mo. 1991), *aff'd in part, rev'd in part*, 960 F.2d 728 (8th Cir. 1992).

debtor's operations, provide management consulting advice that could assist the debtor in running the business without replacing the debtor-in-possession. This less drastic alternative may be appropriate when management is somewhat weak, but neither dishonest nor grossly incompetent. In such cases, the Code's preference for leaving the debtor in possession of the business and retaining the debtor's exclusive right to propose a reorganization plan may be well served by assigning an examiner an advisory role that does not displace the debtor.

### *B. Provide Confidence Level for Various Constituencies*

The Chapter 11 process is relatively informal. In most cases, the debtor's management operates the business, making a wide range of short- and long-term business decisions. Although these decisions may be subject to the general oversight of a creditors' committee[120] and may require court approval,[121] the debtor is accorded some deference and retains considerable flexibility in operational decisions.[122] The debtor's management also influences the plan negotiation process through the debtor's exclusive right to propose a plan. Through this process, the debtor can often shape the postbankruptcy operation.

Creditor oversight of the debtor's operations, and involvement in plan negotiations, is often limited to the creditors' committee appointed to represent creditors. Yet in some cases there is no active creditors' committee, and in others the creditors' committee may not represent all of the creditor constituencies adequately. Similarly, equity interests may have difficulty attracting attention for their views, particularly if an equity committee is not appointed.[123]

Parties to this unique process of reorganizing a business may develop concerns about whether their interests will be represented and protected

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120. Some commentators have noted that, particularly in smaller cases, it is not uncommon for a creditors' committee to be either inactive or nonexistent. *See, e.g.*, Jensen-Conklin, *supra* note 31, at 326 (survey of Chapter 11 cases in Poughkeepsie, N.Y. found that creditors committees were appointed in only 49% of cases in sample in which Chapter 11 plan was confirmed). In those cases in which there is no creditors' committee, the debtor may have even greater discretion unless there is a large creditor who is willing to devote resources to monitoring the debtor's operations.

121. *See* 11 U.S.C. § 363(b) (requiring court approval for use, sale, or lease of property out of ordinary course of business); *id.* § 364(b),(c),(d) (requiring court approval for most post-petition financing arrangements); *id.* § 365(a) (requiring court approval for assumption or rejection of executory contracts).

122. *See, e.g., In re* Minges, 602 F.2d 38 (2d Cir. 1979) (applying business judgment rule to debtor's decision to assume or reject executory contracts).

123. *See* LoPucki & Whitford, *supra* note 78.

adequately. When realistic concerns arise, the intervention of an independent third party may alleviate many of these concerns by providing greater access to information, management skills, and a general sense of fairness. This confidence-building function has taken various forms in reported cases.

### *1. Investigative Functions*

An independent third party is often particularly well suited to investigate issues of concern to the parties and to provide an impartial report that has greater credibility than a report from an interested party. By fleshing out facts and issues for the parties, an impartial report can assist the parties in resolving disputed issues and reaching agreement on a reorganization plan. An investigation might also determine whether the debtor's business is viable and worth reorganizing.[124]

In cases in which a trustee is appointed, one of the primary tasks for the trustee is to investigate the debtor's business, including its prior management and its prospects for the future. A report by an independent trustee will, of course, have a level of credibility that would be unavailable to prior management if there were suspicions of fraud, gross mismanagement, or other failings.[125] The trustee is generally expected to investigate the debtor's past dealings, the current state of the business, the future prospects of the business, and any other matters that may be relevant to the case or to the development and confirmation of a plan.[126]

Even when the debtor remains in possession of the business, an independent, impartial investigation may create an increased confidence level in the parties' grasp of underlying facts in order to enable the parties to resolve a case.[127] For example, in *In re 1243 20th St., Inc.*,[128] the debtor was managed by another corporation in which the debtor's president was an

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124. When a debtor remains in possession of the estate, the trustee's duty to investigate the debtor is not imposed on the debtor-in-possession. *See* 11 U.S.C. § 1107(a) (1988). This is sensible because a debtor is unlikely to be able to investigate credibly its own conduct and operations. In such cases, the investigatory duty is normally assumed by the creditors' committee. *See id.* § 1103(c)(2).

125. *See, e.g., In re* Madison Management Group, 137 B.R. 275, 281-82 (Bankr. N.D. Ill. 1992) (explaining that trustee needed to investigate various causes of action against controlling persons when debtor's manager was hired by controlling persons).

126. *See* 11 U.S.C. § 1106(a)(3).

127. One commentator has suggested that an early, nonadversarial, independent review of the viability of the business and the advisability of leaving management in contro might better serve the interests of parties in the case. *See* Lynn M. LoPucki, *The Debto in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (pt. 1) 5' AM. BANKR. L.J. 99, 114 (1983).

128. 6 B.R. 683 (Bankr. D.D.C. 1980).

officer and director. The management company also managed other companies in which the debtor's president had an interest, and there were some suspicious transactions between the debtor and the other companies. The creditors' committee sought the appointment of an examiner to investigate the debtor's dealings with the related companies and other allegations of fraud and mismanagement.

The court found that a report by a disinterested third party would enable the parties to clear the air and ultimately to resolve issues crucial to the reorganization process. The court also observed that an examiner was better suited than a creditors' committee to perform the investigation because the examiner would be completely disinterested and would therefore have greater credibility. Moreover, the court did not believe that a committee could undertake effectively an in-depth investigation of the debtor's prior dealings, as opposed to monitoring the debtor's finances and operations.[129]

Similarly, in *In re Apex Oil Co.*,[130] the court explained that an examiner had been appointed, in part, to investigate the debtor's affairs, including numerous transactions with insiders and nondebtor affiliates.[131] According to the court, the examiner identified several substantial claims against principals of the debtor and nondebtor affiliates; however, he concluded that settlement, rather than protracted litigation, would be in the estate's interest. The examiner's report served as a catalyst to negotiations that led eventually to the debtor's proposing a reorganization plan that was more favorable to the unsecured creditors than earlier proposals. Moreover, with the facts clearly set out for them, the parties had less need to litigate the issues addressed in the examiner's report and were instead able to settle their differences.[132]

In cases with multiple constituencies, the appointment of an examiner may provide a means of avoiding the duplicative expense of various constituencies investigating the same issues. Moreover, an impartial examiner's report will not be subject to the suspicion of bias that might taint a committee's report. For example, in some cases, independent examinations of fraudulent conveyance and other issues obviated the need for various committees to perform similar tasks and provided unbiased factual and legal analyses that could serve as a basis for settling complex issues.[133] In

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129. *Id.* at 685-86.

130. 111 B.R. 235 (Bankr. E.D. Mo. 1990), *rev'd*, 132 B.R. 613 (E.D. Mo. 1991), *aff'd in part, rev'd in part*, 960 F.2d 728 (8th Cir. 1992).

131. *Id.* at 242. The examiner's charge was to take "any necessary and appropriate actions in furtherance of assisting the Court and parties in bringing these proceedings to a just, prompt and economic disposition." *Id.* at 237.

132. *See also In re* Hamiel & Sons, Inc., 20 B.R. 830 (Bankr. S.D. Ohio 1982) (examiner appointed to investigate allegations of self-dealing by principals of debtor).

133. For example, in both the *Revco D.S.* and the *Interco* bankruptcies, examiners

addition, parties may be more willing to co-operate with an impartial, independent examiner, who will not be pursuing litigation against them, than with the debtor or committee representatives. Accordingly, the examiner may be able to obtain more complete information in a more efficient manner.

Particularly in smaller cases, in which there may not be an active creditors' committee, another subject for investigation might be whether the debtor's business is viable and worth reorganizing. Although the reported cases do not suggest that such investigations are common, an early viability study might weed out the cases involving businesses that have little or no hope of survival. An independent third party is more likely than the debtor to be able to take a fresh, hard look at the business and determine whether the reorganization is worth pursuing.

### *2. Conflicts of Interest*

In a Chapter 11 proceeding, there is considerable potential for conflicts of interest. Principals of the debtor represent the estate, but they may have been the beneficiaries of avoidable transfers or may otherwise be in a position to benefit at the expense of the estate or the creditors. Members of the creditors' committee represent the creditor body generally, but they will also have in mind their own individual interests. A debtor may have affiliates with whom it deals on terms that are not at arms length. When the appearance or fact of conflict becomes a significant impediment to resolution of issues in a case, the intervention of an independent third party may alleviate the difficulty.

For example, in *Oklahoma Refining Co. v Blaik (In re Oklahoma Refining Co.)*,[134] the conflict involved a debtor's preferential dealings with affiliated companies. In *Oklahoma Refining*, creditors moved for the appointment of a trustee after they discovered that the debtor had dramatically increased sales to affiliated companies on credit and at substantially discounted prices. The creditors alleged that the debtor had artificially inflated the prices it charged third parties in order to discourage others from buying its fuel and to assure ample fuel to sell to its affiliates on credit. The court held that the questionable transactions with affiliated companies constituted cause for the appointment of a trustee under section

were appointed to investigate and report on causes of action flowing from highly leveraged transactions. *See* Morgenstern v. Revco D.S., Inc. (*In re* Revco D.S., Inc.), 898 F.2d 498, 500-01 (6th Cir. 1990); Official Comm. of Unsecured Debenture Holders v. Interco, Inc. (*In re* Interco, Inc.), 135 B.R. 631, 632 (Bankr. E.D. Mo 1992). These reports provided some basis for consensual reorganization plans.

134. 838 F.2d 1133 (10th Cir. 1988).

1104(a)(1).[135]

In *In re Madison Management Group*[136] the managers and directors of the debtor resigned prior to the commencement of the Chapter 11 case and were replaced by a workout specialist, who was elected as the sole director and then as president of the debtor. After the commencement of the bankruptcy case, several creditors moved for the appointment of a trustee, alleging that they had a lack of confidence in the workout specialist. Moreover, the creditors asserted that the specialist would be reluctant to pursue avoidance actions available against the major stockholder of the debtor because the stockholder had hired the specialist. The court found no evidentiary basis for the creditors' lack of confidence, but held that a trustee should be appointed for the sole purpose of pursuing the avoidance actions against the stockholder. The court further found that the specialist's appointment by the stockholder created an appearance of conflict that could be overcome by appointing an independent trustee. At the same time, the court could discern no reason to replace the specialist and thereby incur the cost and delay of starting with new management.

Interestingly, the role to be played by the trustee in *Madison Management* illustrates the flexibility available to courts in utilizing third parties. The trustee was not expected to manage the business or propose a Chapter 11 plan; its role was limited to investigating the basis for avoidance actions and pursuing those actions if appropriate. By retaining the workout specialist to manage the business and to propose a reorganization plan, the court avoided the expense and delay involved in installing new management.[137]

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135. *Id.* at 1136; *see also In re* State Capital Corp., 51 B.R. 400 (Bankr. M.D. Fla. 1985); *In re* William H. Vaughan & Co., Inc., 40 B.R. 524 (Bankr. E.D. Pa. 1984); *In re* Humphreys Pest Control Franchises, 40 B.R. 174 (Bankr. E.D. Pa. 1984); Smith v. Concord Coal Corp. (*In re* Concord Coal Corp.), 11 B.R. 552 (Bankr. S.D. W. Va. 1981); *In re* Main Line Motors, Inc., 9 B.R. 782 (Bankr. E.D. Pa. 1981); *In re* L.S. Good & Co., 8 B.R. 315 (Bankr. N.D. W. Va. 1980).

In *In re* Nautilus of N.M., Inc., 83 B.R. 784 (Bankr. D.N.M. 1988), the debtor leased space from its president, who was also a co-owner of the debtor. Although several significant debts incurred during the reorganization effort remained unpaid, the president assured that lease payments were made. The court found that the conflict between the president's role as manager and his role as a creditor, coupled with the debtor's failure to file reports in a timely fashion, necessitated the appointment of a trustee. *Id.* at 789-90.

In *In re* Microwave Prods. of Am., Inc., 102 B.R. 666 (Bankr. W.D. Tenn. 1989), the court justified appointment of a trustee in part because the debtor had failed to investigate or pursue potential claims against insiders.

136. 137 B.R. 275 (Bankr. N.D. Ill. 1992).

137. However, appointment of a trustee to serve such a limited role could have unacceptable costs under the current statute. By appointing a trustee instead of an examiner, the court subjected the debtor to the expiration of its exclusive period to file

Conflict issues can sometimes be resolved by the appointment of an examiner. An examiner may at least be able to investigate and report on issues that underlie the conflict. For example, in *In re Hamiel & Sons, Inc.*,[138] an examiner was appointed to investigate allegations of self-dealing by principals of the debtor in a case in which there was no creditors' committee to investigate the allegations. However, an examiner may not be able to implement recommendations for resolving issues, in which case a trustee may become necessary after all.

### *3. Pursuit of Litigation on Behalf of Estate*

An independent third party may be able to pursue litigation on behalf of the estate more effectively than a debtor-in-possession or, perhaps, a creditors' committee. In some cases, conflicts of interest may prevent the debtor or a committee from pursuing litigation. In others, the debtor may be unwilling or unsuited to pursue litigation, and a creditors' committee may not be able to fill the void. For example, a debtor may resist pursuing trade preferences or certain fraudulent conveyance actions, and a creditors' committee may be composed of potential targets of the litigation. If other creditors would benefit from pursuit of the litigation, it may be necessary to identify a party to pursue the action. In the absence of any proper party in interest, an independent third party may be necessary.

A trustee is certainly expected to pursue litigation on behalf of the estate in order to recover property of the estate, or pursuant to the trustee's avoidance powers. Indeed, in *Madison Management* the trustee was appointed specifically to investigate and pursue any available claims against controlling persons.[139]

In *In re Carnegie International Corp.*,[140] an examiner was authorized to pursue litigation on behalf of the estate. In *Carnegie International*, the examiner had completed and reported on an investigation of potential causes of action available to the estate. Three days after the examiner filed his report, the court entered an order authorizing the examiner to institute litigation based on the causes of action identified by the examiner in his

a plan, *see* 11 U.S.C. § 1121(c) (1988), a result that does not seem to have been intended by the court. This result suggests that perhaps a court needs some discretion to protect the debtor's exclusivity when a trustee does not actually replace current management. Discretion might be found in 11 U.S.C. § 105, the provision granting general equitable power to the Bankruptcy Court. It would be preferable, however, to increase the court's flexibility in using third parties by clarifying that exclusivity is lost only when management is actually displaced by a trustee.

138. 20 B.R. 830 (Bankr. S.D. Ohio 1982).

139. 137 B.R. at 282.

140. 51 B.R. 252 (Bankr. S.D. Ind. 1984).

report. A party that was a target of the litigation objected to the expansion of the examiner's duties.

The objecting party maintained that an examiner is entitled to investigate issues, but cannot be given the power to litigate matters that were the subject of an examiner's report. According to the objector, authorizing the examiner to pursue litigation would defeat the underlying purpose of the Bankruptcy Code provisions that prohibit an examiner from serving as a trustee in a case.[141] These provisions are designed to remove any appearance of incentive for an examiner to report that a trustee is necessary. According to the objector, if an examiner can pursue the litigation that he or she recommends, then the recommendation itself will be suspect.

The court rejected this argument and found that it could expand the examiner's power to include the pursuit of litigation. It pointed out that the estate would save expense that would be incurred if a new party, unfamiliar with the facts and theories underlying the causes of action, were engaged to pursue the litigation.[142]

In response to the argument that the examiner's conclusions were suspect because he might have expected to be retained to pursue causes of action, the court pointed out that the examiner neither actively sought the expanded duties nor knew that he would be asked to pursue the litigation. Moreover, the court observed that both the creditors' and the equity securities holders' committees moved for the expansion in the examiner's powers instead of the appointment of a trustee, a special counsel, or pursuit of the litigation by one of the committees.

The court also rejected the objector's argument that it had provided information to the examiner in his quasi-judicial role and should not now be subject to suit by the examiner who was given the information when he was not, and did not expect to be, a litigant. The court observed that the examiner's report was made available to the parties in the bankruptcy case and would be available to any party pursuing litigation based on the report. In the court's view, since any party would have the information, the fact that the examiner would be pursuing the litigation should not be fatal. Thus, the court held that it had properly authorized the examiner to initiate litigation on behalf of the estate.[143]

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141. 11 U.S.C. §§ 321(b), 327(f) (1988).

142. *Carnegie Int'l*, 51 B.R. at 256.

143. *Id.* at 256-58. The court also relied on authority under the prior Bankruptcy Act which, it claimed, supported the view that an examiner may be authorized to bring litigation on behalf of the estate. Section 167 of the prior Act directed a trustee, if ordered by the court, to investigate the debtor and its business and required that the trustee report facts ascertained and any causes of action available to the estate. Bankruptcy Act § 167, 11 U.S.C. § 567 (1976) (repealed 1978). Bankruptcy Rule 10-208(a)(5) required the trustee to file a report of his or her findings. Bankr. R. 10-108(a)(5). Bankruptcy Rule

However, although the *Carnegie International* court's authorization may have seemed efficient under the facts of that particular case, the court failed to appreciate sufficiently the potential adverse effect on examiners in other cases. The independence and impartiality of examiners, who normally serve in a quasi-judicial role, will be compromised if parties believe that an examiner who recommends litigation may obtain a lucrative representation pursuing the litigation.[144] Moreover, parties will be less likely to co-operate willingly with an examiner if they believe that there is a meaningful possibility that they will subsequently be litigating against the examiner. The mere possibility that an examiner could pursue litigation recommended by the report will make the examiner's task more difficult, even in those cases in which the examiner is not ultimately authorized to pursue litigation on behalf of the estate.

Consequently, examiners should not be authorized to pursue litigation if the litigation results from an examiner's report. Even though the facts of a particular case, such as *Carnegie International*, may seem to justify the expansion of an examiner's powers to enable the examiner to initiate litigation on behalf of the estate, courts must appreciate the potential for problems that might be caused in future cases by such an expansion.

Nevertheless, an absolute rule that an examiner can never pursue litigation on behalf of an estate would be unfortunate. In some cases, the debtor and the creditors' committee may be so hopelessly conflicted that only an independent third party can meaningfully pursue particular litigation on behalf of the estate. A trustee may not be appropriate if the debtor is otherwise suitable to remain in possession and retain the exclusive right to propose a reorganization plan. In such cases, an impartial examiner may be well suited to pursue the litigation. However, because of the examiner's own "appearance of conflict" issues, an examiner's ability to pursue litigation on

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10-610 authorized the trustee to commence and prosecute any action on behalf of the estate. Bankr. R. 10-610. Finally, Bankruptcy Act § 168 authorized the court to appoint an examiner "to prepare and file a plan and to perform the duties imposed upon a trustee under [the provisions of section 167 discussed above]." Bankruptcy Act § 168, 11 U.S.C. § 568 (1976) (repealed 1978). According to the *Carnegie Int'l* court, these provisions, taken together, authorized an examiner to bring an action on behalf of the estate. The court pointed out that the structure of Bankruptcy Code §§ 1104 and 1106, providing for the appointment of trustees and examiners and delineating their duties, is similar to the structure of the provisions under the prior Act. Therefore, the court found authority under the prior Act persuasive for purposes of determining the permissible scope of an examiner's powers under the Bankruptcy Code. *See Carnegie Int'l*, 51 B.R. at 255-57.

144. The same policies that underlie the prohibition on examiners serving as trustees or being employed by trustees, *see* 11 U.S.C. §§ 321, 327 (1988), would support a prohibition on examiners pursuing litigation recommended in their own reports. *See* Snider, *supra* note 102, at 49.

behalf of the estate should be limited to matters that were not investigated by the examiner and on which the examiner did not report.[145] If the examiner has reported on the matter, recommending litigation, and if there is no party well positioned to bring the litigation, the court may have to appoint a trustee or, perhaps, another examiner or "responsible person" to pursue the litigation on behalf of the estate.

### 4. *Fraud*

An independent third party can increase parties' confidence levels when the debtor is suspected of fraud or serious dishonesty. Bankruptcy Code section 1104(a) requires the appointment of a trustee "for cause, including fraud, [or] dishonesty."[146] In cases of fraud, then, the usual remedy is appointment of a trustee, who can replace the debtor-in-possession and both investigate and cure fraudulent activities.[147]

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145. Under the prior Bankruptcy Act, a Chapter X reorganization plan could provide for settlement or compromise of claims and, if the claims were not resolved, "for their retention and enforcement by the trustee or, if the debtor has been continued in possession, *by an examiner appointed for that purpose.*" Bankruptcy Act § 216(13), 11 U.S.C. § 616 (13) (1976) (repealed 1978) (emphasis added). Apparently the examiner could enforce the debtor's rights when the examiner was appointed specifically for that task.

Similarly, 11 U.S.C. § 1123(b)(3)(B) provides that a Chapter 11 plan may provide for "the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose" of causes of action belonging to the debtor or to the estate. The House report refers to an "agent" appointed to enforce causes of action. H.R. REP. NO. 595, *supra* note 4, at 407, *reprinted in* 1978 U.S.C.C.A.N. at 6363. Presumably the statute is referring to a representative, or agent, appointed on or after confirmation for the express purpose of pursuing causes of action on behalf of the debtor. To maintain the examiner's quasi-judicial neutrality, such an interpretation seems appropriate. Nevertheless, the language seems broad enough to enable a court, hopefully only in extraordinary cases, to designate an examiner as the "representative" to pursue litigation on behalf of the estate.

One commentator has argued that, because 11 U.S.C. §§ 321(b) and 327(f) prevent an examiner from serving as a trustee, or from being employed by the trustee, the examiner cannot bring litigation on behalf of the estate. He has maintained that pursuing litigation is a "trustee-type" function that can be performed only by a trustee. *See* Gumport, *supra* note 77, at 126. However, although the limitations in §§ 321 and 327 may have been intended to eliminate any incentive for an examiner to suggest litigation or management changes in order to obtain a lucrative engagement, the Code does not expressly bar the court from assigning the examiner a limited role in representing the estate.

146. 11 U.S.C. § 1104(a) (1988).

147. *See, e.g.*; *In re* Anniston Food-Rite, Inc., 20 B.R. 511 (Bankr. N.D. Ala. 1982); *In re* Bonded Mailings, Inc., 20 B.R. 781 (Bankr. E.D.N.Y. 1982).

Nevertheless, appointment of a trustee need not be automatic upon a party's allegation of fraud, even if the allegation is believed. One benefit of the flexible trustee and examiner concepts is that they enable the court to fashion a remedy appropriate to the circumstances involved.

Yet some courts have failed to recognize the degree of flexibility accorded to them. For example, in *In re McCordi Corp.*,[148] prior to commencing a Chapter 11 case, the debtor engaged in a check kiting scheme, which fraudulently induced a secured lender to cover overdrafts over an approximately two-week period just prior to the bankruptcy filing.[149] After the bankruptcy filing, the lender moved for the appointment of a trustee based on the debtor's prepetition fraud. The debtor and the creditors' committee objected.

The court found that it was obligated to order the appointment of a trustee once it found that the debtor had committed prepetition fraud. Although the court acknowledged that this was "not a case in which fraud has permeated all the operations of the debtor," that the case did not "involve fraudulent transfers of property or the concealment of assets," and that the fraud affected only one creditor,[150] the court believed that it had no choice but to order the appointment of a trustee because "'fraud' is sufficient 'cause' mandating such appointment [under section 1104]."[151]

Yet the posture of the case suggests that perhaps the lender was acting strategically for its own benefit rather than seeking a remedy for the benefit of the estate.[152] Surely the court retains some discretion to determine whether a particular fraud rises to the level of "cause" required by section 1104 for the appointment of a trustee.

In justifying its order for the appointment of a trustee, the *McCordi* court observed that a trustee could review the debtor's business operations and investigate prepetition payments, which would benefit the estate generally. However, the court did not explain why the creditors' committee or an examiner could not perform those tasks. If the court was concerned that a major creditor had no confidence in management and was thus entitled to an independent third party's intervention, it did not discuss any such concern. Moreover, even if that were the case, the court might have obtained sufficient intervention through the less drastic measure of appointing an

148. 6 B.R. 172 (Bankr. S.D.N.Y. 1980).

149. The debtor claimed that the secured lender was pressuring it to make payments that it was unable to make and that it was forced to engage in the scheme in order to survive. *Id.* at 176.

150. *Id.*

151. *Id.* at 178.

152. Interestingly, the lender may have gotten more than it bargained for. The court ordered that the trustee investigate not only the debtor's fraud, but also whether the payments to the lender might be avoidable as preferences or otherwise. *See id.*

examiner.

The *McCordi* court may have been somewhat less concerned than some courts about the expense and interference of a trustee because the court seems to have envisioned retention of the debtor's management to operate the business. The court authorized the trustee to "discretionally retain the present management with suitable controls."[153] However, unlike the appointment of an examiner, which could have served the investigative and business oversight functions without divesting the debtor of control, the appointment of a trustee ended the debtor's exclusive period to propose a plan and divested the debtor of control over the business. If, in fact, the lender's behavior was strategically based, the remedy may have been unduly harsh in light of the debtor's limited misconduct.

### 5. *Eyes and Ears*

When the 1978 Bankruptcy Code removed from the bankruptcy courts' jurisdiction a broad range of administrative matters that arise in Chapter 11 cases, it limited the information available to the courts. Although these courts may hold status conferences from time to time, they generally receive information about the progress of a case and about underlying issues in the context of litigation. Similarly, parties to a Chapter 11 proceeding typically receive somewhat limited information about the debtor and its operations, and are dependent on the debtor for the information they do receive.

One area in which third-party intervention can sometimes be useful is in addressing these informational disadvantages. A party that is not a litigant and represents no particular constituency may be able to investigate and report more credibly than the debtor or the creditors. Information thus gained about the debtor and the progress of the case may assist both the court and the parties in resolving particular issues, as well as the Chapter 11 case generally.

In this regard, some bankruptcy courts have employed examiners as the "eyes and ears" of the court and the various constituencies in an effort to move a case along and to assure that various constituencies are properly protected during the proceeding. For example, in *In re Public Service Co.*,[154] the court ordered the appointment of an examiner to, among other things, assist the court in understanding concepts involved in utility-rate setting and in evaluating the accuracy of any competing disclosure statements. Similarly, in *In re Apex Oil Co.*,[155] the examiner pursued

153. *Id.*

154. 99 B.R. 177 (Bankr. D.N.H. 1989).

155. 111 B.R. 235 (Bankr. E.D. Mo. 1990), *rev'd*, 132 B.R. 613 (E.D. Mo. 1991), *aff'd in part, rev'd in part*, 960 F.2d 728 (8th Cir. 1992).

various tasks and investigations to apprise the court and the parties of the facts underlying certain issues and of the progress of the case.

### *6. General Loss of Confidence*

In some cases, creditors may experience a general loss of confidence in the ability of the debtor's management to run the business or to reorganize the debtor. The loss of confidence may be so severe that it requires a complete change of management. Sometimes, however, confidence may be restored by providing assistance to the current managers. In either case, the intervention of an independent third party may assist in restoring the parties' confidence in the debtor and the Chapter 11 process.

For example, in *In re Cardinal Industries*,[156] the debtor had made various detrimental management decisions both before and after the commencement of the Chapter 11 case. The debtor also failed to submit certain financial reports and made numerous mistakes in the reports that were submitted because it had failed to maintain adequate and accurate books and records. Because the debtor's principals had guaranteed substantial debt of the debtor and affiliated partnerships, the principals were subject to potential conflicts of interest. Moreover, the debtor discharged its bankruptcy counsel and paid a retainer to new counsel, whose retention was then denied by the court because of a conflict. These events caused uncertainty about who would represent the debtor. Finally, the debtor had been unable to develop an adequate business plan that could be used as a basis for a reorganization plan. The lack of a business plan, coupled with the debtor's discharge of its counsel and the debtor's inability to determine exactly where it stood financially, stalled the reorganization plan negotiation process.

Ultimately, the creditors moved for the appointment of a trustee to replace current management, in whom the creditors had no confidence. The court found that although any of the factors cited by the creditors, taken alone, might not justify the appointment of a trustee, the general loss of confidence in the debtor's management justified the appointment of a trustee. Moreover, the court determined that such an appointment would be in the best interest of the various constituencies. The court pointedly observed that the creditors' assertions of loss of confidence did not appear to be "a ploy" but followed "good faith efforts by the Creditors to permit the Debtors to direct their own reorganizations."[157]

The *Cardinal* court's action was consistent with the underlying bankruptcy policy of ousting current management when the various

156. 109 B.R. 755 (Bankr. S.D. Ohio 1990).
157. *Id.* at 765.

constituencies lose confidence in management's ability to continue the business and reorganize successfully In this case, it appears that a strong, hands-on, independent third party was necessary to restore that confidence and effectuate a reorganization plan. Thus, an examiner probably would not have fit the bill; a trustee, with its broad range of powers, was necessary to assure that the various constituencies could rely on the fairness, impartiality, and efficiency of the process.

### *C. Provide Structure for Cases*

Chapter 11 of the Bankruptcy Code presents a relatively unstructured process for reorganizing a debtor. In most cases the debtor remains in possession of the business, negotiates with creditors, and ultimately proposes a reorganization plan. Yet the debtor may fail to pursue energetically and effectively the reorganization effort, and other parties may be unable or unwilling to pursue it themselves. Even when the debtor is focused on the effort, various constituencies may be unable to agree upon acceptable terms for a reorganization.

In some cases, the intervention of an independent third party may assist in moving the process forward. When the debtor simply fails to pursue effectively the reorganization, a trustee may be necessary to replace the debtor and to represent the estate in developing a reorganization plan or liquidating the business.[158] In other cases an independent party may assist the various constituencies in resolving the reorganization effort.

#### *1. Mediation of Plan Negotiations*

In several cases examiners have been appointed to mediate in deadlocked plan negotiations.[159] Mediation seems particularly useful when the debtor's exclusive period to file a plan has expired and there is an increased likelihood that competing plans could be filed.[160] The debtor's exclusive period to file a plan imposes some structure on a Chapter 11 case. All of the parties must work through the debtor; the debtor can assist in bringing the parties to the table and hammering out an agreement. Once the debtor's period of exclusivity has expired, parties may feel less compulsion to

158. *See, e.g., In re* Bonded Mailings, Inc., 20 B.R. 781 (Bankr. E.D.N.Y. 1982) (trustee appointed in part to mediate dispute with major creditor, propose reorganization plan, or report that no plan is possible).

159. *See, e.g., In re* Public Serv. Co., 99 B.R. 177 (Bankr. D.N.H. 1989); *In re* Ionosphere Clubs, Inc., No. 89-B-10449 (Bankr. S.D.N.Y. Mar. 30, 1989).

160. In *Public Serv. Co.*, 99 B.R. 177, the examiner was authorized to mediate the plan negotiations after the debtor's exclusivity had been terminated.

negotiate because any party can file a plan and then attempt to obtain the agreement of other constituencies. In that environment, an independent third party may become a lightening rod for the parties, imposing structure on plan negotiations that can increase the likelihood of a consensual plan.

This was exactly the situation in *In re Public Service Co.*.[161] In that case, the court ordered the appointment of an examiner at the same time the court terminated the debtor's exclusivity. In doing so, the court expressed concern that, without a neutral third party to mediate in plan negotiations and related rate negotiations, the parties would introduce competing reorganization plans and would be unable to resolve their differences. In fact, competing plans were filed by several outside bidders for PSNH, and a bid was accepted by the major parties only after around-the-clock negotiations.[162]

The mediation role served by the examiner in *Public Service Co.* and in other cases may not necessarily require an examiner. For example, in the *Zale Corp.* bankruptcy, the court appointed a mediator "to assist the creditor constituencies herein in their efforts to negotiate a consensual consolidated Chapter 11 plan of reorganization covering all of the debtors."[163] In effect, the mediator appointed by the court would serve in a role similar to that served by examiners in other cases, perhaps without engendering the fear and strategic behavior sometimes present when an examiner is appointed and expected to file a written report of findings. Yet, although the *Zale* court decided to forego an examiner in favor of a mediator, there is no explicit authority in the Bankruptcy Code for the appointment of a mediator, a "responsible person," or any independent third party other than a trustee or an examiner.[164] The apparent desire to provide independent input while avoiding appointment of a trustee or examiner may suggest a need for statutory recognition of some type of independent third party with a more limited role than a trustee or examiner.

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161. 99 B.R. 177 (Bankr. D.N.H. 1989).

162. John Milne, *Chronology of PSNH Bankruptcy, Jan. 28, 1988*, BOSTON GLOBE, Dec. 10, 1989, New Hampshire Weekly, at 12.

163. *In re* Zale Corp., No. 392-30001-SAF-11 (Bankr. N.D. Tex. Nov. 4, 1992). The court's order required the parties to co-operate with the mediator and to provide information, including confidential information. The order also directed that no information provided could be introduced at any subsequent trial or hearing in the case and that the mediator could not be called as a witness or be hired as a consultant by any party to the case.

Similarly, in the *El Paso Electric* bankruptcy, the court appointed a "mediator" charged with "mov[ing] this case to a successful conclusion." DAILY BANKR. REV., Jan. 27, 1993, at 1.

164. To justify its appointment of a mediator, the *Zale* court relied on 11 U.S.C. § 105 (1988), which grants the court general equity jurisdiction.

### 2. *Other Mediation Efforts*

In some cases, an independent third party has served as a mediator of various underlying disputes that must be resolved in order to enable the debtor to develop, and obtain confirmation of, a plan. By fostering settlement of these disputes, an independent third party may assist in the ultimate resolution of the reorganization effort.

For example, in *In re Apex Oil Co.*,[165] the examiner was directed to mediate a bitter dispute between the debtor and its bank lenders concerning the debtor's relationship with a nondebtor affiliate. The dispute was so contentious that the lenders had commenced an action to substantively consolidate the estates of the debtor and its nondebtor affiliate on the same day that the debtor commenced its Chapter 11 case. According to the court, "[f]ull blown litigation of these conflicting claims appeared inevitable and would have been extraordinarily disruptive."[166] According to the debtor, the examiner's successful mediation effort "'eliminated a major dispute . . . which, if not settled, might have jeopardized the prospects for a successful reorganization.'"[167]

## *D. Provide Both Confidence and Structure*

In several larger bankruptcy cases, examiners or trustees have been used both to provide the various constituencies with some assurance that the debtor is being investigated and monitored properly and to provide structure to the case. For example, in *In re A.H. Robins Co.*, the court gave the examiner a broad mandate to investigate matters concerning the debtor's business operations, to monitor the plan formulation process, to evaluate and suggest provisions for proposed plans, and "'to take all other necessary and appropriate action in furtherance of assisting to bring this case to a just, prompt and economic disposition."[168]

In the *Eastern Airlines* bankruptcy,[169] the examiner was directed to

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165. 111 B.R. 235 (Bankr. E.D. Mo. 1990), *rev'd*, 132 B.R. 613 (E.D. Mo. 1991), *aff'd in part, rev'd in part*, 960 F.2d 728 (8th Cir. 1992).

166. *Id.* at 239.

167. *Id.* at 240 (quoting Apex Disclosure Statement). The examiner in *Apex* also successfully resolved a significant number of personal injury claims that had been brought against the debtor. The resolution of these claims at amounts substantially lower than the plaintiffs' initial demands assisted in the debtor's reorganization effort. *Id.* at 240-41.

168. *In re* A.H. Robins Co., No. 85-01307-R (E.D. Va. Aug. 7, 1986), *quoted in* Snider, *supra* note 102, at 50.

169. *In re* Ionosphere Clubs, Inc., No. 89-B-10449 (Bankr. S.D.N.Y. Mar. 30, 1989), *quoted in* Snider, *supra* note 102, at 50.

investigate certain allegations with respect to asset sales, to mediate between unions and management with respect to contentious labor relations issues, and generally to mediate with respect to the plan negotiation process.[170] When even this broad charge was apparently insufficient to guide the parties towards resolution of the case or to provide a sufficient confidence level for the various constituencies,[171] the court determined that new management was necessary to restore that confidence and ordered the appointment of a trustee to take over and run the airline.[172]

### *E. Propose Reorganization Plan*

One effect of the unstructured Chapter 11 process, particularly in smaller cases, is that there may be no party to propose a realistic reorganization plan.[173] The debtor's principals may be content simply to run the business in Chapter 11, being compensated for their services. If there is no active creditors' committee, even termination of the debtor's exclusivity may fail to lead to the proposal of a plan unless there is a large creditor with sufficient economic interest.

If the court discerns that no one is proposing a plan to bring the debtor out of bankruptcy, it may appoint an independent third party to move the process along and to propose a reorganization plan. For example, in *In re Bonded Mailings, Inc.*,[174] the court found that a trustee was necessary because the debtor had failed to file a reorganization plan after almost a year in Chapter 11. The court gave the trustee four months within which to file a plan or to submit a report indicating why a plan could not be filed.[175]

In *In re Great Barrington Fair & Amusement, Inc.*,[176] the court had previously ordered an examiner to file a statement of the basic essentials of a plan or a statement of why the debtor could not be reorganized.[177] The

170. *See* WALL ST. J., Apr. 6, 1989, at 4; Snider, *supra* note 102, at 50-51.

171. The debtor experienced "devastating, constantly expanding and unending losses," failed to predict adequately the results of its operations, reneged repeatedly on proposed reorganization plans, and generally lost the confidence of its creditors. *In re* Ionosphere Clubs, Inc., 113 B.R. 164, 166 (Bankr. S.D.N.Y. 1990).

172. *Id.* at 171. Even after the trustee's intervention, however, business failed to improve sufficiently, and the airline was eventually liquidated.

173. *See* Kerkman, *supra* note 31, at 175-88; Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (pt. 2), 57 AM. BANKR. L.J. 247, 272 (1983).

174. 20 B.R. 781 (Bankr. E.D.N.Y. 1982).

175. *Id.* at 787.

176. 53 B.R. 241 (Bankr. D. Mass. 1985).

177. Alternatively, the court directed the examiner to explain why the case should be converted to Chapter 7 or dismissed.

examiner filed a liquidating reorganization plan that was confirmed by the court.

Interestingly, the *Great Barrington* court did not explain why it had appointed an examiner, rather than a trustee, particularly where the debtor was liquidating. It would appear that under 11 U.S.C. § 1106(b), which authorizes the court to order the examiner to perform any trustee duties,[178] coupled with 11 U.S.C. § 1106(a)(5), which imposes on a trustee a duty to file a plan or a statement of why a plan cannot be filed,[179] the court technically may have had authority to order an examiner to file a plan. However, any such authority to use an examiner to propose a plan should be used sparingly, if at all. Because the debtor's exclusive right to file a plan is an important component of the debtor-in-possession construct, a court should not lightly permit a third party to file a plan on behalf of the debtor unless the court has found that displacement of the debtor-in-possession and appointment of a trustee is appropriate. Thus, it would have been preferable for the *Great Barrington* court to have considered the appointment of an independent third party under the more rigorous standard for appointing of a trustee.[180]

## V. CONCLUSION

In the relatively unstructured environment of Chapter 11, the intervention of independent third parties can assist in the reorganization or liquidation of debtors. Flexible use of trustees and examiners also can help add credibility to the Chapter 11 process. Trustees and examiners have been used, *inter alia*, to manage debtors' businesses, investigate troublesome issues, resolve conflicts of interest, pursue litigation, mediate disputes, assist in plan negotiations, and propose plans. As courts and parties to Chapter 11 cases further recognize the positive and flexible roles that can be served by trustees and examiners, some of the perceived problems with Chapter 11

178. 11 U.S.C. § 1106(b) (1988).

179. *Id.* § 1106 (a)(5).

180. In limited circumstances, appointment of a third party to propose a plan may be appropriate even when the debtor has proposed a plan, if the debtor's plan is unrealistic and has no meaningful chance of being confirmed. For example, in Hotel Assocs. v. Trustees of Cent. States Pension Fund S.E. & S.W. (*In re* Hotel Assocs.), 3 B.R. 343 (Bankr. E.D. Pa. 1980), the court held that appointment of a trustee was appropriate when there was a need for a party other than the debtor to propose a reorganization plan. According to the court, the debtor's plan seemed unrealistic and unsatisfactory. Moreover, there was one large secured creditor that had taken over and was operating the property. In the court's view, only an independent third party could propose a plan that would adequately protect the needs of unsecured creditors. *Id.* at 344-45.

reorganizations may be resolved through the use of these independent third parties.