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Hiring and Roles of Receivers and Examiners

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APPOINTMENT OF RECEIVER
AN OVERVIEW[1]

A court-appointed receiver is a powerful tool to manage a debtor's financial instability, investigate and address potential fraud, and to collect and liquidate assets for the benefit of secured and unsecured creditors. For the attorney representing a receiver, the time spent tailoring the receivership order to the facts of the case is invaluable. For those representing creditors and other parties-in-interest, early and active participation is key because receivership cases generally are fast moving and can critically impact parties' rights.

Statutory authority for the appointment of receivers varies significantly from state to state. Some states have very general authorizing statutes and leave much of the receiver's authority to the order appointing the receiver and the governance of the receiver to the appointing court. Other states, such as Minnesota, have enacted comprehensive receivership statutes governing appointment, powers, and rights of receivers. *See*, e.g., Minn. Stat. § 576.21 *et seq*.

I. Parties and Basis for Relief

A. Basis for relief

1. Pre-judgment: to protect the interest of a party to an action in property or proceeds that are in danger of loss or material impairment[2]

    a. Except where judgment for failure to answer may be had without application to the court - a limited receiver may be appointed before judgment to protect any party to an action who demonstrates an apparent right to property that is subject of the action and is in the possession of an adverse party, and the property or its rents and profits are in danger of loss or material impairment.

[1] This section was written by Adam Ballinger, a Partner at Ballard Spahr LLP.

[2] Minn. Stat. § 576.25 Subd. 2

2. Post-judgment: to carry the judgment into effect or to preserve property pending appeal or in response to an unsatisfied execution.[3]

    a. A limited or a general receiver may be appointed in a judgment or after judgment to:

        1. Carry the judgment into effect;

        2. Preserve property pending appeal;

        3. When an execution has been returned unsatisfied and the judgment debtor refuses to apply the property in satisfaction of the judgment.

3. Dissolved or insolvent corporations.[4]

    a. A limited or general receiver may be appointed when a corporation or other entity is dissolved; insolvent, in imminent danger of insolvency or has forfeited its corporate rights and in like cases of the property within the state of foreign corporations and other entities.

4. Mortgage foreclosures.[5]

    a. At any time after the commencement of mortgage foreclosure proceedings under Minnesota law, and before the end of the redemption period if the mortgage being foreclosed:

        1. Secures an original principal mortgage of $100,000 or more or is a lien upon residential real estate containing more than four dwelling units; and

        2. Is not a lien on property that was entirely homesteaded, residential property containing four or fewer dwelling units where at least one unit was homesteaded, or agricultural property.

    b. The Court shall appoint a receiver upon a showing that the mortgagor has breached a covenant in the mortgage relating to:

        1. Application of tenant security deposits;

[3] Minn. Stat. § 576.25 Subd. 3

[4] Minn. Stat. § 576.25 Subd. 4

[5] Minn. Stat. § 576.25 Subd. 5

2. Payment when due of prior or current real estate taxes or special assessments with respect to the mortgaged property or the periodic escrow for the payment of the taxes or special assessment;

3. Payment when due of premiums for insurance of the type required by the mortgage or the periodic escrow for the payment of premiums;

4. Keeping of the covenants required of a landlord under Minn. Stat. § 504B.161 Subd. 1.

5. Other equitable powers of the court, i.e., divorce and fraudulent schemes.

II. Differences Between Receivers Appointed under State Law versus Federal Law

Occasionally, a respondent may have property located outside of the jurisdiction of the appointing court. For example, a respondent over which a Minnesota District Court has appointed a receiver may have property in Minnesota, North Dakota, and Iowa. Special issues arise for receivers seeking to obtain possession and control over properties in foreign jurisdictions.

A. Compare State v. Federal Receiverships

Federal equity receivers have an advantage in obtaining control of property located in foreign jurisdictions. Under 28 U.S.C. § 754 "A receiver appointed in any civil action or proceeding involving property, real, personal or mixed, situated in different districts shall, upon giving bond as required by the court, be vested with complete jurisdiction and control of all such property with the right to take possession thereof." However, the receiver must file a copy of the complaint and of the order in each district where property is located within 10 days of being appointed. If property is located in a district after 10 days of being appointed the most efficient way to obtain jurisdiction over the property is to seek reappointment in the home district and then file the amended order within the 10 day period required by 28 U.S.C. § 754.

Under 28 U.S.C. § 1692, "In proceedings in a district court where a receiver is appointed for property, real, personal, or mixed, situated in different districts, process may issue and be executed in any such district as if the property lay wholly within one district, but orders affecting the property shall be entered of record in each of such districts."

B. State receivers do not have the benefit of a federal statute to confer control over foreign receivership property.

State receivers seeking to obtain control over property in foreign jurisdictions face a number of challenges. They include (i) obtaining assistance from foreign law enforcement; (ii) dealing with creditors located in the foreign jurisdiction where the property is located; and (iii) navigating the legal requirements to obtain control of the property.[6]

Since a receiver is an officer of the court which appoints her, the coercive authority bestowed upon her by the appointing court over the property placed in her control and possession cannot, as a matter of right, extend beyond the territorial jurisdiction of the sovereignty which created the appointing court. *See* Clark on Receivers § 317. When a foreign receiver engages in activities or enters into contracts in the foreign state or foreign jurisdiction, she does so as an individual or principal without the coercive power and authority of the court which appointed her, unless a statute enlarges the receiver's extraterritorial power. *Id*.

1. Option Number One - Appointment as an Ancillary Receiver

In Minnesota, permission of the appointing court is not a prerequisite to seeking ancillary appointment in a foreign jurisdiction. Under Minn. Stat. § 576.41, a "receiver appointed by a

[6] Practice Tip: The assistance of law enforcement is sometimes required to obtain control over receivership property. Law enforcement in foreign jurisdictions likely will obey an order entered by a foreign district court. Often, these individuals will only assist the receiver pursuant to an order entered by a judge in the county where the law enforcement officer and the property is located. This requires the receiver to take extra procedural steps to secure foreign property.

court of this state may, without first seeking approval of the court, apply in any foreign jurisdiction for appointment as receiver with respect to any receivership property which is located within the foreign jurisdiction."

a. A receiver or the petitioner may file a petition for the appointment of an ancillary receiver in the foreign jurisdiction.

b. Rule 66 of numerous states' rules of civil procedure provide that: "A foreign receiver shall have capacity to sue in any district court, but the receiver's rights are subordinate to those of local creditors."

c. An ancillary receivership is a new receivership case related to the primary receivership but subject to independent supervisions and duty to the foreign appointing court.

d. The ancillary receiver may or may not be the primary receiver.

e. The ancillary receiver is accountable to the foreign court appointing the ancillary receiver.

f. The foreign court may require the ancillary receiver to prefer local creditors with respect to local assets over the creditors of the primary receivership.

2. Option Number Two - Recognition of the receivership order under the Full Faith and Credit Clause implemented by the Uniform Enforcement of Foreign Judgments Act.

a. Full Faith and Credit Clause: "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State."

b. Uniform Enforcement of Foreign Judgments Act: A uniform law enacted in many states that provides a simplified way of enforcing judgments entered in another state and implementing full faith and credit.

1. A "foreign judgment" is defined as any judgment, decree, or order of a court of the United States or of any other court which is entitled to full faith and credit in this state.

2. File an authenticated copy of the foreign judgment with the Clerk of Court and an affidavit setting forth the name and last known address of the judgment debtor, and the judgment creditor.

3. Typically a stay of enforcement of twenty days applies.

4. Each state may have modified the uniform act when enacting it in their respective states.

3. Option Number Three - Operating under the protections provided to individuals without court authority.

a. The receiver may choose to operate in a foreign jurisdiction without express court approval. In that circumstance, any rights and protections offered to individuals as owners or assignees of property are afforded to the receiver as she stands in the shoes of the property owner.

b. But the receiver may lose its derived judicial immunity for actions undertaken in the foreign state.

c. The best course of action is to always operate under an order entered by a court with jurisdiction over the property that authorizes the receiver to take the intended action.

III. What is a Receiver and What are the Powers of the Court?

Under Minn. Stat. § 576.23, the court has the exclusive authority to direct the receiver and the authority over all receivership property wherever located including, without limitation, authority to determine all controversies relating to the collection, preservation, improvement, disposition, and distribution of receivership property, and all matters otherwise arising in or relating to the receivership, the receivership property, the exercise of the receiver's powers, or the performance of the receiver's duties.

Minn. Stat. § 576.21(p): "Receiver" means a person appointed by the court as the court's agent, and subject to the court's direction, to take possession of, manage, and, if authorized by this chapter or order of the court, dispose of receivership property. Minnesota's receivership statute creates two types of receivers: Limited and General.

A. Limited Receiver.

1. "Limited Receiver" means the receiver appointed in a limited Receivership. Minn. Stat. § 576.21(j).

2. Powers of Limited Receiver (Controlled by the Court) Minn. Stat. § 576.29, subd. 1(a).

   a. To collect, control, manage, conserve, and protect receivership property.

   b. To incur and pay expenses (manage the respondent's assets).

   c. Power to assert rights, claims, causes of action, or defenses that relate to receivership property.

   d. Power to obtain instruction from the court with respect to any matter relating to the receivership property, the exercise of the receiver's powers, or the performance of the receiver's duties.

B. Most Receiverships are Limited Receiverships.

1. Unless the court finds otherwise, receivers are limited receivers. Minn. Stat. § 576.24.

2. Receivers appointed based on the following must be limited receivers (Minn. Stat. § 576.24):

   a. Enforcing an assignment of rents.

   b. Foreclosure of a mortgage lien.

   c. Foreclosure of a mechanic's lien.

   d. Foreclosure of any other lien that provides fee owners statutory right of redemption.

C. General Receiver.

1. "General Receiver" means the receiver appointed in a general receivership. Minn. Stat. § 576.21(g).

2. Powers of General Receiver (similar to a Bankruptcy trustee) Minn. Stat. § 576.29, subd. 1(b).

   a. Assert claims of respondent and creditors.

   b. Engage in discovery.

   c. Operate the business to insure assets maintain value.

   d. If authorized by an order of the court following notice and a hearing, to use, improve, sell, or lease receivership property other than in the ordinary course of business.

IV. Liability of a Receiver

A troubling source of liability for receivers is ultra-vires acts or acts taken without the authorization or the court or outside of the territorial jurisdiction of the court that injure third parties. Under Minn. Stat. § 576.28, the receiver shall be entitled to all defenses and immunities provided at common law for acts or omissions within the scope of the receiver's appointment. In Minnesota, a "receiver, as an officer of the court, is afforded 'full exemption from all personal responsibility' for actions in conformity with the trial court's order." *Nelson v. Quade*, No. C3-91-229, 1991 WL 165990, at *1 (Minn. Ct. App. Sept. 3, 1991); *see also Drexler v. Walters*, 290 F.Supp. 150, 154-55 (D. Minn. 1968) (judicial immunity extends to all quasi-judicial acts of a receiver). "[A] receiver is an officer or representative of the court which appointed him subject to the control of that court." *Drexler v. Walters*, 290 F.Supp. 150, 154 (D. Minn. 1968) (citing *Peterson v. Darelius*, 210 N.W. 38, 39 (Minn. 1926)); *In re Telesports Prods.*, 476 N.W.2d 798, 800 (Minn. App. 1991). Minnesota courts have extended this "quasi-judicial immunity" to court-appointed receivers. *Schmidt v. Gayner*, 59 Minn. 303, 308, 62 N.W. 265, 265 (1895). Judicial immunity applies to conduct within the scope of appointment regardless of the correctness of the conduct or the motivation behind it. *Myers*, 463 N.W.2d at 775. Furthermore, the shield of judicial immunity has been held to extend to all judicial and quasi-judicial acts, however erroneous. *Drexler v. Walters*, 290 F. Supp. at 154 (citing *Roerig v. Houghton*, 175 N.W. 542 (Minn. 1919)).

V. Qualifications of Receivers

The court must make written conclusions based in the record that the person is (1) qualified to serve as an officer of the court and (2) is independent as to the parties and the underlying dispute.

A. Qualified:

1. Knowledge and experience;

2. Financial ability to post the required bond;

3. Any prior disqualifications as a receiver;

4. Felony convictions or other crimes of "moral turpitude."

5. Found liable of fraud, breach of fiduciary duty, civil theft, or other similar conduct.

B. Independence:

1. Relationship to the parties and the property including: party to the action, family member to a party to the action; or officer, director, member to a party to the action.

2. Any interest materially adverse to the interests of any of the parties to the action.

3. Any material financial or pecuniary interest, other than receiver compensation, in the outcome of the underlying dispute, including any contingent fee compensation arrangement.

4. Whether proposed receiver is a debtor, secured or unsecured creditor, lienor of, or holder of any equity interest in any of the parties to the action of the receivership property.

It is imperative that a receiver act in conformity with the order appointing her or risk losing derived judicial immunity from suit. When in doubt ask for direction from the appointing court. If an action is not clearly covered by the receivership order seek and receive authority to act prior to undertaking the act. Under Minn. Stat. § 576.28, (i) a receiver is entitled to all defenses and immunities provided at common law for acts or omissions within the scope of the receiver's appointment; (ii) no person other than a successor receiver duly appointed by the court shall have a right of action against a receiver to recover receivership property or the value thereof; and (iii) a party or party in interest may conduct discovery of the receiver concerning

any matter relating to the receiver's administration of the receivership property after obtaining an order authorizing discovery.

VI. The Receivership Order

In addition to Minnesota's receivership statute, the receivership order entered by the court is the source of the receiver's powers, protections, and duties to the court and the parties to the case. Every receivership order should include provisions stating whether the receivership is general or limited, authorize the receiver to hire professionals, who pays receivership costs and expenses (including professional fees), and mandatory reporting requirements of the receiver. In addition, the following areas should also be considered:

A. Important Provisions

1. Description of the Property

a. The order appointing the receiver or subsequent order shall describe the receivership property with particularity appropriate to the circumstances. Minn. Stat. § 576.25, Subd. 8.

b. If in a general receivership it may be appropriate to describe the receivership property as all of the Respondent's assets wherever located if there is no controversy regarding the scope of the respondent's property or whether valuable property is held by third parties.

c. Failure to adequately described the receivership property can complicate a receiver's ability to obtain control over property.

1. If the property is not adequately described and in the hands of third parties, those parties may resist giving it to the receiver. At best it increases expense and time; at worst the receiver will have to defend claims of acting *ultra vires* or outside the scope of the receivership order.

2. Court-Ordered Cooperation of Respondents

a. The order should direct all parties in possession of receivership assets to surrender them to the receiver.

b. The order should provide access to hard copy and electronic books and records of company.

c. The order should require respondents to fully cooperate with the receiver to discharge her duties under the order.

d. Remain responsible for filing all tax returns, including those returns applicable to periods the receivership is in effect.

3. Injunctions

The Court has the power to issue any number of injunctions to prevent parties from interfering with the receiver or taking actions to obtain receivership property or apply receivership property in satisfaction of judgments (similar to the automatic stay in bankruptcy). Minn. Stat. § 576.42 imposes a stay of certain actions (take possession control over property, enforce lien, create or perfect security interest). But the order can provide additional stays of actions including:

a. No commencement of any suit affecting respondent or its property.

b. No execution, replevin, attachment, garnishment or receivership assets.

c. No perfection of any previously unperfected liens.

d. No setoffs and in particular no setoffs of bank accounts held by the debtor.

4. Expressly include the *Barton* Doctrine in the order:

a. The Barton Doctrine arises from an 1881 Supreme Court case captioned *Barton v. Barbour*, 104 US 126 and states that no party may sue a receiver without first seeking leave of the appointing court. The doctrine is jurisdictional and can be grounds for a dispositive motion under Rule 12. *See McIntire v. China MediaExpress Holdings, Inc.*, 113 F. Supp. 3d 769, 774 (S.D.N.Y. 2015)("The Barton Doctrine is jurisdictional in nature, and failure to seek leave of the receiver's appointing court bars exercise of subject matter jurisdiction over any third-party suit.") *see also Schmidt v. Gayner*, 61 N.W. 333, 334 (Minn. 1894), *on reargument*, 62 N.W. 265 (Minn. 1895)

b. In addition, consider including a provision in the order requiring any party seeking to sue the receiver to show they are reasonably likely to succeed on the merits of the claim.

5. Limitation of Liability of the Receiver

a. Receiver is not personally liable to the Company or any third parties for good faith compliance with the order and its duties except for gross negligence and willful misconduct.

6. The Power to Assert Claims

a. The power to investigate, pursue, compromise and settle claims of (i) the Company; (ii) the receiver in its capacity as receiver of the Company; (iii) fraudulent transfer claims held by creditors of the company (*see* Minn. Stat. § 576.29 Subd. 1(b)(2)).

VII. Common Claims Asserted by Receivers

A general receivership's goals are to maximize the value of the respondent's assets for the benefit of its creditors. In addition to tangible business assets commonly sold to produce value, receivers commonly inherit a number of legal and equitable claims against the respondent and third parties that can produce significant value to the receivership estates.

A. Claims to Avoid and Recover Transfers of Property

After reviewing the books, records, financial statements, and bank account records of the respondent, receivers will commonly discover improvident transfers of the respondent's assets that work to harm its creditors. Recall that Minn. Stat. § 576.29 authorizes a receiver to commence fraudulent transfer claims.

1. Actual Fraudulent Transfer Claims under Minn. Stat. § 513.44(a)(1) to avoid and recover transfers made with the actual intent to hinder, delay, or defraud creditors.

2. Constructive Fraud Claims under Minn. Stat. § 513.44(a)(2) & 513.45 to avoid and recover transfers made without receiving a reasonably equivalent value while insolvent or became insolvent as a result of the transfer.

3. Insider Preference Claims under Minn. Stat. § 513.45(b) if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at the time, and the insider had reasonable cause to believe the debtor was insolvent.

B. Claims Against the Respondent's Officers and Directors

A second category of claims a receiver will investigate are claims against the respondent's officers and directors relating to conduct which harmed the respondent.

1. Claims against directors of the respondent for breaching duties of care, loyalty, and good faith.

2. Claims relating to corporate waste.

3. Claims relating to the fraudulent diversion of corporate assets to the officer or director (a specific case of a breach of the duty of loyalty).

Director and officer insurance may provide a recovery to the receivership estate for some of these claims. A receiver should investigate whether director and officer insurance is available, whether the loss is covered or excluded, and retain experienced counsel to present the claim.

C. Claims Against Professionals and Financial Institutions

A respondent may have dealt with any number of professionals or financial institutions prior to the receiver's appointment including attorneys, accountants, auditors, brokers, dealers, and financial institutions.

1. Malpractice claims against attorneys and accountants

   a. Common issues faced by receivers include proving causation and damages and the related expense of this type of litigation.

   b. Particularly in cases where the respondent is accused of some wrongdoing, the professionals assert the defense of *in pari delicto* against the receiver.

2. Negligent misrepresentation claims against attorneys and accountants

   a. If the respondent is not the client of the professional but received and relied on information prepared by the professional and was damaged a negligent misrepresentation claim may exist.

3. Aiding and abetting fraud and civil conspiracy claims; aiding and abetting breach of fiduciary duty

4. Violations of the Minnesota Uniform Fiduciaries Act - Minn. Stat. § 520.01, *et seq*.

a. The UFA imposes liability against endorsees, payees, transferees, and depository banks for facilitating a breach of a fiduciary's obligations by acting with either (i) actual knowledge that a fiduciary is violating a fiduciary duty; or (ii) awareness of facts such that proceeding with the transaction constitutes an act of bad faith.

D. Turnover of Property

A receiver has the power to demand that any person turn over any receivership property that is within the possession or control of that person. Minn. Stat. § 576.41

1. Motion for Turnover

   a. If the receiver's turnover demand is not followed, the receiver may file a motion for turnover with the appointing court.

   b. If there exists a bona fide dispute with respect to the existence or nature of the receiver's or the respondent's interest in the property, turnover shall be sought by means of an action.

2. Bona Fide Dispute:

   a. At least one court has held that "bona fide dispute" under Minn. Stat. § 576.41 means "good faith dispute."

   b. Employing federal law the Minnesota district court held that First, the movant must establish a prima facie case that no bona fide dispute exists. Second, the burden shifts to the non-moving party to present evidence demonstrating that a bona fide dispute does exist. The court may use factual determination to determine if the dispute is bona fide. *Trude v. Glenwood State Bank*, Court File No. 47-CV-12-176, Order Granting Turnover, November 29, 2016.

VIII. Minnesota allows Receivers to Sell Assets Free and Clear of Liens

1. Only in general receiverships.

2. May be free and clear of lien and redemption rights but not federal or state tax liens.

3. Rights of creditors preserved.

   a. Secured creditors have right to credit bid.

4. All creditors have right to object.

5. Sale amount.

   a. Amount must be equal to or greater than what creditors would otherwise realize within a reasonable amount of time.

   b. Burden of proof is on the receiver.

   c. Liens attach to sale proceeds.

IX. Locating and Recovery Assets in Foreign Jurisdictions

The United States is not a party to any treaties or conventions regarding the foreign recognition of judgments entered by the courts of the United States. Furthermore, the statutory schemes providing a more expedited process for the foreign recognition of U.S. judgments, namely in the British Virgin Islands, the Cayman Islands, and Bermuda, do not recognize judgments from the United States as eligible for that expedited process. Procedures available to holders of U.S. judgments in foreign jurisdictions include both attachment and recognition of the U.S. judgment. Because judgments may be rendered either on the merits or by default, special considerations are to be taken regarding each.

A. No Support from International Treaties or Agreements

The United States is not a party to any treaties or conventions on the recognition of foreign judgments. Instead the judgments of courts in the United States are reviewed for recognition and enforcement in accordance with provisions of the laws of the foreign country where such recognition and enforcement are sought. Currently, the applicability of a treaty to the enforcement of a foreign money judgment remains the exception rather than the rule. These courts follow the rule that, in the absence of a treaty, a foreign nation's judgment will not be enforced unless local law requirements are clearly met.

B. Enforceability Abroad of U.S. Judgments.

Generally, judgments in which the foreign defendant has appeared in a United States court and defended on the merits will be recognized and enforced by foreign courts. The enforcement of judgments abroad often involves both the obtaining of an order of attachment to secure the ultimate award of judgment and the commencement of recognition proceedings. Greater scrutiny is given to judgments obtained by default, taking into account whether due process was provided to the defaulting defendant.

In the absence of a treaty, enforcement of a foreign judgment will be determined by reference to the foreign country's internal law. Typically, the foreign country will hold a hearing to determine whether the judgment meets the local law requirements for enforcement, generally including the following inquiry:

1. That the court of origin had jurisdiction over the judgment debtor;
2. That the judgment debtor was properly notified of the commencement of the court of origin's proceedings;
3. That enforcement of the judgment would not violate local public policy; and
4. That the foreign judgment is a final judgment.

In some, but not all, foreign jurisdictions a court will explore additional issues including: (a) whether reciprocity exists with the country of origin, (b) whether a prior inconsistent judgment exists, and (c) whether the court of origin applied the correct law under a proper conflicts of law analysis. Of these additional issues, the presence of reciprocity may be the most important.

In most cases the foreign court will not review the merits of the original action that gave rise to the judgment unless the judgment debtor alleges that the judgment was obtained by fraud or violates public policy of the foreign jurisdiction. However, nothing prevents the foreign court

from examining the merits of the original action. And Weems suggests that courts appear to be doing so.

1. Lack of Jurisdiction

The lack of jurisdiction of the court of origin over the judgment debtor is perhaps the most noted reason for a foreign court's refusal to enforce a money judgment. Courts in different countries apply different tests of jurisdiction, including whether the local court would have had jurisdiction under the same facts or whether under standards of private international law. Furthermore, the court of origin's jurisdiction over the judgment debtor will not be recognized if that jurisdiction conflicts with the exclusive jurisdiction rules of the foreign country. For example, French courts have exclusive jurisdiction over cases involving French nationals, unless waived by the French national. Switzerland law in this regard is similar to French law. A number of other foreign courts have exclusive jurisdiction over land. However, contractual submission to jurisdiction (through forum selection clauses) or other evidence of a judgment debtor's intent to submit to jurisdiction, such as appearing and defending on the merits, will satisfy waiver of exclusive jurisdiction.

2. Service of Process

Service of process under the 1965 Hague Convention on the Service Abroad of Judicial and Extra Judicial Documents in Civil and Commercial matters is normally sufficient. But care must be taken with foreign countries who have requirements that differ or are in addition to compliance with the Hague Convention.

3. Public Policy Considerations

A number of public policy considerations may prevent foreign enforcement of a U.S. judgment including:

1. No enforcement if there exists no claim under local law;
2. Misapplication of choice of law rules or application of wrong law, especially if the foreign court determines that its law and not that of the originated jurisdiction should have applied;
3. Multiple damages judgments, i.e., double or treble damages are not generally allowed;
4. Potential violations of local substantive law;
5. Pending cases between the parties and prior judgment issues;
6. If the judgment is not "final" under the foreign jurisdiction's law of finality; and
7. Statute of limitations issues related to the timing on bringing an enforcement of a foreign money judgment.

4. Procedural Issues Regarding Enforcement

A foreign money judgment that is otherwise enforceable under substantive law may also be hindered by procedural barriers to enforcement in the foreign jurisdiction. Such procedural issues include:

1. The foreign country may refuse to hear a case that solely involves a nonresident even if the nonresident judgment debtor has assets in the foreign country;
2. The foreign country may require a government official or agency to approve or give an opinion on enforcement;
3. An appeal from a non-enforcement may not be available to the losing party;
4. Repatriation of funds from the foreign country may not be possible;
5. Potential losses from currency exchange rates;
6. The potential for additional unforeseen hearings extending the collection time in the foreign country.

5. Collection of US judgments in United Kingdom and its Overseas Territories

In 2012, the English Supreme Court decided *Rubin and another v. Eurofinance SA and Ors* 2012 UKSC 46. Prior to Rubin, judgments entered in foreign insolvency proceedings (including United States' bankruptcy courts) were directly enforceable against defendants in the United Kingdom. In contrast, all other judgments entered by foreign courts were subject to predictable rules concerning if and whether they would be enforceable abroad.

Rubin held that judgment entered in foreign insolvency proceedings were not entitled to any different treatment from all other judgments. The enforceability of default judgments entered in insolvency proceedings are of particular importance post-Rubin. Because a default judgment occurs after a defendant has failed to appear in the insolvency proceeding, the enforcement of the default judgment must meet certain jurisdictional rules, namely the Dicey Rule, which states: "a court of a foreign country outside the United Kingdom has jurisdiction to give a judgment in personam capable of enforcement or recognition as against the person against whom it was given in the following cases:

> First Case – If the person against whom the judgment was given was, at the time the proceedings were instituted, present in the foreign country.
>
> Second Case – If the person against whom the judgment was given was claimant, or counterclaimed, in the proceedings in the foreign court.
>
> Third Case – If the person against whom the judgment was given submitted to the jurisdiction of that court by voluntarily appearing in the proceedings.
>
> Fourth Case – If the person against whom the judgment was given had before the commencement of the proceedings agreed, in respect of the subject matter of the proceedings, to submit to the jurisdiction of that court or the courts of that country.

As a result, it should be expected that a foreign defendant that is not present in the United States, who has not claimed or counterclaimed, who has not appeared to defend on the merits,

and has not otherwise agreed to submit to the jurisdiction of the United States courts, would not be directly liable in the United Kingdom (and many other jurisdictions) for a United States judgment entered in either an insolvency proceeding or other proceeding. In order to remedy this problem, a separate proceeding would need to be commenced against the foreign defendant in a court that could exert either in personam jurisdiction over the foreign defendant or in rem jurisdiction over the foreign defendant's property and ultimately enter, on the merits, either an in personam or in rem judgment, as the case may be.

X. Dealing with Governmental Agencies

A. Parallel Criminal Proceedings

A parallel criminal proceeding relating either to the party in receivership or the property subject to a receivership proceeding can present significant hurdles for a court-appointed receiver. Once of the main issues presented by a parallel criminal proceeding is the potential for criminal or civil forfeiture of receivership assets. This presents two concerns for court-appointed receivers. First, the receiver and her professionals commonly are paid from receivership assets. If the assets of the receivership matter are primarily litigation claims, significant expenses can accrue prior to recovering assets to cover those expenses. Criminal and civil forfeiture can divest a receiver of those assets prior to their application to such expenses. Second, criminal and civil forfeiture of such assets to the government removes those assets from the administrative powers of the receiver and the court and significantly upsets the expectations of receivership claimants as to the value of their claim, whether and if they will be paid, and in what priority. Generally, the government has discretion to apply forfeited assets in ways that are very different from state law distribution and priority schemes. The government, instead, tends to focus on a parties status as a victim of crime and relative hardship imposed by the loss of funds more than following state law payment and priority schemes.

1. Forfeiture Basics

Any property which constitutes or is derived from proceeds of certain criminal activity--including wire fraud and securities fraud--or from a conspiracy to commit such offenses is subject to forfeiture by the United States. *See generally* 18 U.S.C. § 981 and 982. Forfeiture applies to any property, of any kind, whether real or personal, and also includes any property involved in money laundering offenses.

Forfeiture will "relate back" and vest title in the United States upon the commission of the act giving rise to forfeiture under the relevant statute. *See* 21 U.S.C. § 853(c); *United States v. United States Currency in the Amount of $228,536.00*, 895 F.2d 908, 916 (2d Cir. 1990); *see also United States v. Emerson*, 128 F.3d 557, 567, n. 5 (7th Cir. 1997) ("Once the Government wins a judgment of forfeiture, the relation-back doctrine provides that the right, title, and interest in the forfeited property vests in the United States at the time the defendant committed the offense that gives rise to the forfeiture."); *United States v. One Silicon Valley Bank Account*, 549 F. Supp. 2d 940, 958 (W.D. Mich. 2008) (relation back divests debtor's legal interest in seized assets prior to the commencement of the bankruptcy cases); *United States v. Zaccagnino*, No. 03-10095, 2006 WL 1005042, *4 (C.D. Ill. 2006).

While the relation back doctrine has the most pronounced effect on the interest of the criminal/property owner, it also may have a significant effect on a later trustee in bankruptcy, court-appointed receiver, or upon a third party asserting rights in or to the forfeited property, unless through an ancillary proceeding the fiduciary or third-party can meet the statutory requirements to have its interest recognized and enforced.

2. Criminal Forfeiture Process and Procedure

a. Preliminary Order of Forfeiture

An indictment or information must contain a notice to the defendant that the government will seek forfeiture of property as part of the sentence. Fed. R. Crim. P. 32.2. Once the defendant is convicted whether by trial or a plea, the court must enter the preliminary order of forfeiture. The preliminary order of forfeiture cuts off the defendant's interest in the property, and allows the government to step into the defendant's shoes. "Of course, final adjudication of the government's claim is not resolved until trial, at which time the defendant may ultimately be found entitled to these assets should the government fail to prove its case for forfeiture." *United States v. Bissell*, 866 F.2d 1343, 1349 (11th Cir. 1989). After a preliminary order of forfeiture is obtained, the government is required to serve notice of its intent to forfeit the property on any potentially interested third party--either by publication or where practicable by individual notice, prior to obtaining a final order of forfeiture. See 21 U.S.C. § 853(n)(1); Rule 32.2(b)(6).

b. Ancillary Proceeding

Within 30 days of receiving the above notice, a third party wishing to assert an interest in the forfeited property may file a petition to assert such right in an "ancillary proceeding" to be conducted by the court. 21 U.S.C. § 853(n)(2).

A petition in an ancillary proceeding is the exclusive means by which a third party may lay claim to forfeited assets. *See DSI Assocs. LLC v. United States*, 496 F.3d 175, 183 (2nd Cir. 2007). A third party is barred from intervening in a criminal case to challenge forfeiture of property.

> Except as provided in subsection (n) of this section, no party claiming an interest in property subject to forfeiture under this section may--(1) intervene in a trial or appeal of a criminal case involving the forfeiture of such property under this section; or (2) commence an action at law or equity against the United States concerning the validity of his alleged interest in the property subsequent to the filing of an indictment or information alleging that the property is subject to forfeiture under this section.

21 U.S.C. § 853(k). "There is no provision in § 853(n) to relitigate the outcome of [the]legal proceedings [against the defendant]" which gave rise to a preliminary order of forfeiture. *United States v. Porchay*, 533 F.3d 704, 710 (8th Cir. 2008).

Even a bankruptcy Trustee is limited to using the petition/ancillary proceeding process to assert an interest in forfeited property--an action usually not successful. *Stettin v. Alu (In re Rothstein)*, No. 09-34791, Adv. No. 10-03775, 2012 WL 4320479 at *5 (Bankr. S.D. Fla. 2012). *But see Adler v. Rothstein (In re Rothstein)*, 717 F.3d 1205 (11th Cir. 2013). In *Stettin* the bankruptcy trustee on appeal caused a restraining order issued pursuant to 18 U.S.C. § 1963(d)(1)(A) and 21 U.S.C. 853 § (1)(A) prior to the preliminary order of forfeiture being issued to be lifted because money in the debtor/defendants account was commingled from criminal and non-criminal activity. This, in essence, allowed the trustee to circumvent the prohibition against intervening in a criminal case to challenge the forfeiture.

The government may file a motion to dismiss a petition in an ancillary proceeding "for lack of standing, for failure to state a claim, or for any other lawful reason." Rule 32.2(c)(1)(A). Such a motion is treated as a motion under Federal Rule of Civil Procedure 12(b). *United States v. Petters (Petters 1)*, 857 F. Supp. 2d 841, 844 (D. Minn. 2012). The court may permit the parties to conduct discovery and a party may move for summary judgment in an ancillary proceeding. Fed. R. Crim. P. 32.2(c)(1)(B).

c. Final order of forfeiture

A final order of forfeiture is entered following the expiration of the third party notice period and after resolution of any third-party petitions. This gives the United States clear title to the forfeited property. *See* 21 U.S.C. § 853(n)(7); Fed. R. Crim. P. 32.2(b)(4)(A) & (c)(2).

3. Standing

A petitioner must have a "legal interest" in the forfeited property in order to have standing. 21 U.S.C. § 853(n)(2). A creditor with a security interest in the LLC membership interest of an entity which owned a lodge forfeited by the government does not have standing to pursue a petition in an ancillary proceeding involving the LLC's property because it was one step too far removed from the forfeited property. *Petters I*, 857 F. Supp. 2d at 844 citing *United States v. All Funds in Account of Prop. Futures, Inc.*, 820 F. Supp. 2d 1305 (S.D. Fla. 2011) ("just as shareholders lack standing to contest the forfeiture of corporate assets, LLC members lack standing to contest the forfeiture of assets owned by an LLC").

4. Unsecured Creditor Rights in Forfeiture Proceeding

Unsecured creditors generally do not have standing to assert a claim in an ancillary proceeding because they do not have an interest in any particular asset. *See, e.g., United States v. White*, 675 F.3d 1073, 1080-81 (8th Cir. 2012); *In re Douglas*, 190 B.R. 831, 836 (Bankr. S.D. Ohio 1995); *United States v. One 1965 Cessna 320C Twin Engine Airplane, Serial No. 0813841-1, License No. N3062T*, 715 F. Supp. 808, 812 (E.D. Ky. 1989) (collecting cases).

B. Forfeiture vs. Bankruptcy Trustee or Receiver

If the government obtains an order of forfeiture covering specific property of the defendant who is or becomes a debtor in bankruptcy, the property does not become property of the bankruptcy estate. *United States v. Pelullo*, 178 F.3d 196, 201 (3d Cir. 1999); *United States v. One Silicon Valley Bank Account*, 549 F. Supp. 2d 940,958 (W.D. Mich. 2008).

Courts have dismissed lawsuits by trustees against the United States seeking turnover of bankruptcy estate assets that are the subject of criminal forfeiture. *See In re Global Vending*, No. 04-23562-BKC-PGH, 2005 WL 2451763, at *3 (Bankr. S.D. Fla. June 1, 2005) *In re GuildMaster, Inc.*, No. 12-62234, 2013 WL 1331392, at *8 (Bankr. W.D. Mo. Mar. 29, 2013).

Section 853(k) prevents parties from commencing an action against the United States concerning the validity of their interest in property subsequent to the filing of an indictment. Arguably the trustee stands in the shoes of the criminal defendant itself – and § 853(k) might not apply to actions of the criminal defendant to challenge forfeiture of its property. At least one court has rejected this argument. In *In re GuildMaster, Inc.*, the court held that § 853(k) is not expressly limited to third parties and that § 853(k) imposes an absolute bar on all suits claiming an interest in forfeitable property unless the action is brought within the confines of an ancillary proceeding under § 853(n). *In re GuildMaster, Inc.*, 2013 WL 1331392 at *7.

C. Coordination Agreements

In the Mark Dreier and Petters Ponzi schemes, there was tension between the governments right to forfeit assets including any cash recovered from avoidance actions in a bankruptcy, and the Trustees' interests in maximizing assets for their bankruptcy estates and in not expending resources to claw back payments only to later have these funds forfeited by the government.

These potential fights were avoided by entering into Coordination Agreements among the United States Attorney and the various bankruptcy estates, which among other things allocated certain assets and causes of action among the government and the Trustees. For example, in Petters the government agreed not to forfeit any of the entity (corporate) assets, which are all administered through the entities various bankruptcy cases.

XI. Selecting a Receiver[7]

Receivers are neutral parties appointed by a court to act as a fiduciary, an agent of the court, and to hold assets to protect and preserve the property of a party in a lawsuit. There is no federal statutory law defining who may be appointed as a receiver and Federal Rules of Civil Procedure 66 broadly states a receiver "must accord with the historical practice in federal courts or with local rule." This allows for receivers to be tailored to the specific company, assets, and situation. The plaintiff nominates a receiver whom the court may appoint. In Michigan, specifically, statutory law requires appointed receivers to have sufficient "competence, qualifications, and experience to administer the receivership estate." The moving party must describe how the nominated receiver meets these requirements. The court shall appoint the requested receiver, unless another party objects to the receiver or the court finds that a different receiver should be appointed. The Michigan courts have the final say in the appointed receiver, even if the appointed receiver is stipulated or uncontested. Should the court find that a different receiver should be appointed, the court must state its rationale as it relates to MCR 2.622(B)(5).

Considerations for a Michigan receiver:

1. Experience in the operation and/or liquidation of the type of assets to be administered;
2. Relevant business, legal and receivership knowledge, if any;
3. Ability to obtain the required bonding of more than a nominal bond is required;
4. Not disqualified under MCR 2.622(B)(6)

XII. Roles and Authority of a Receiver

A federal receivership is based on the court's inherent equitable powers rather than statutory law; therefore, the role and authority of a federal receivership is expressly stated in the appointment order on a case-by-case basis. State law generally provides more clearly defined

[7] This section was written by Patrick M. O'Keefe, Founder and CEO of O'Keefe, and Katie Gerdes, Associate at O'Keefe.

roles and authority for receivers, which vary state-to-state. Common roles and authority afforded to receivers are:

1. Collect all revenues, profits, income, and rents earned, paid to, recognized, or realized by the debtor;
2. Sell assets in the ordinary course of business, such as inventory, and outside the ordinary course;
3. Enforce and terminate contracts;
4. Retain, hire, or discharge employees;
5. Pay taxes, prepare and file tax returns;
6. Oversee day-to-day operations;
7. Authority to sue on behalf of the receivership;
8. Take control of books and records;
9. Wind-down affairs and liquidate assets; and
10. File for relief under the Bankruptcy Code.

The roles and authority expressly stated in the receivership order can play a vital role in countless situations, including determining who has the authority to file for bankruptcy on behalf of the debtor and whether the receiver has the authority to sell assets on behalf of the debtor.

XIII. Receiver's Authority to File Bankruptcy

Case law throughout the country is divided on whether receivers hold the authority to file Chapter 11 on behalf of the debtor. Some courts afford this authority to the appointed receiver, while others allow those with corporate governance to continue to hold it. Generally, the bankruptcy courts defer to state law to determine who has the authority to file for bankruptcy on behalf of the debtor.

In *First S. & L. Ass'n v. First Fed. S. & L. Ass'n,* 531 F. Supp. 251 (D. Haw. 1981), the court explained that "when a receiver is appointed for a corporation, the corporation's management loses the power to run its affairs and the receiver obtains all of the corporation's powers and assets." This appears to support that a receiver exclusively holds the authority to file for Chapter 11. Conversely, there is strong case law supporting the opposite: that the appointment of a receiver in state court does not necessarily preclude the principals of the debtor from seeking relief under the Bankruptcy Code. *See Merritt v. Mt. Forest Fur Farms of Am., Inc*., 103 F.2d 69 (6th Cir. 1939) ("The fact that a state receivership existed is not controlling."); *In re Greater Atlanta Apartment Hunter's Guide, Inc.,* 40 B.R. 29, 31 (Bankr. N.D. Ga 1984) ("a state court receivership cannot operate to deny a corporate debtor access to this nation's federal Bankruptcy Courts").

Recently, an Arizona Bankruptcy Court addressed the issue. *See In re Corporate and Leisure Event Prods., Inc.,* 351 B.R. 724 (Bankr. D. Ariz. 2006). In C*orporate and Leisure Event Productions*, several creditors commenced state court actions claiming they had been defrauded by the debtor. The state court appointed a receiver and authorized the receiver to remove any corporate officers and directors from operations and prohibited the officers and

directors from filing "any petition on behalf of [the debtors] for relief under the … Bankruptcy Code … without permission" from the state court. The receiver removed two of the controlling officers. One of the removed officers filed for relief under Chapter 11 on behalf of seven of the debtors just prior to removal. The other officer filed for relief under Chapter 11 on behalf of the remaining debtors just after removal. The receiver then filed a motion to dismiss the Chapter 11 proceedings on the grounds that the officers were not authorized to file based on the receivership appointment order in state court. Citing federal common law, the court found that the officers were authorized to file on behalf of the debtor. The court concluded that "federal bankruptcy law preempts state law and remains available to an eligible debtor and its constituents notwithstanding creditors' use of state law remedies in an attempt to bar the bankruptcy courthouse door." The Court further opined "Before this country had a federal bankruptcy law, a debtor who had been discharged by one state's insolvency law remained at risk that creditors could send him to debtor's prison in another state, if he ventured there. It was to put an end to this practice that the Constitution conferred on Congress the unique uniform bankruptcy power. Once Congress exercises that power, it preempts and supersedes all state bankruptcy and insolvency laws and other state law remedies that might interfere with the uniform federal bankruptcy system."

The court in *In re Kreisers, Inc.,* 112 B.R. 996 (Bankr. D. S.D. 1990) had a similar opinion to *Corporate and Leisure Events*. The state court in *Kreisers* entered an interim order prohibiting the debtor and its principals from doing anything out of the usual course of business until a receivership issue was resolved. A hearing regarding the receivership

was held and, within minutes of the conclusion of the hearing, but before the receivership appointment order was filed, the debtor filed for Chapter 11 bankruptcy. The court eventually

found that although the state had enjoined the debtor from filing for Chapter 11, "an order restricting bankruptcy court access, other than specifically provided by Congress, would not be in the public interest."

Since a receivership order cannot enjoin corporate officers and directors from filing for relief under the Bankruptcy Code, the question is posed: should a receiver remove all corporate officers and directors upon appointment? The court in *Corporate and Leisure Event* explained that "if removal of corporate officers and directors by a receivership order were sufficient to prevent a bankruptcy filing, creditors who seek their state court remedies to the exclusion of all other would routinely obtain receivership orders with such boilerplate language."

Other courts have reasoned that a receivership order precluding corporate officers and directors from filing for bankruptcy does not actually preclude the *debtor* from filing for bankruptcy. The District Court for the District of Nevada supports that, if the receivership order suspends or removes the officers and directors, the officers and directors no longer have the authority to file for bankruptcy on behalf of the debtor. See *Sino Clean Energy, Inc. v. Siden,* 565 B.R. 677 (D. Nev. 2017). A receivership order was filed to take over management of Sino, which also allowed the receiver to replace the directors. Several months after the receivership order was filed, the former directors filed a petition for bankruptcy on behalf of the debtor. The court granted the receiver's motion to dismiss the bankruptcy noting that the former directors no longer had the authority to file on behalf of the debtor. The former directors argued that *Corporate and Leisure Events* supports that a receivership order cannot preclude the debtor the opportunity to file for bankruptcy. The Sino court, however, explained that the receivership order does not preclude the debtor from filing for bankruptcy and merely determines who is authorized to file on behalf of the debtor.

A receivership order in place, then, does not appear to be enough to prohibit directors and officers from filing for bankruptcy on behalf of the debtor; however, a receivership order removing the officers and directors from their duties *might be* effective in preventing an unwanted filing.

XIV. Receiver's Authority to Sell

The Michigan Court of Appeals, in *Stock Bldg Supply, LLC v Crosswinds Cmtys, Inc*, ___NW2d___; 2016 Mich App LEXIS 1685 (Ct App, Sep. 13, 2016), addresses the authority of a receiver to sell real estate "free and clear of all claims, liens and encumbrances." The case began in July 2008 when Stock Building Supply, LLC ("Stock") sued the developer and its guarantor to foreclose on its construction liens for failure to pay for materials provided. Church & Church, Inc. ("Church") filed a counterclaim shortly thereafter seeking payment for its liens and mortgages that also arose from supplying materials to certain units. In response, the senior mortgage holder Citizens Bank ("Citizens") filed a cross-complaint seeking foreclosure on all mortgages, including Church's, and also successfully requested the appointment of O'Keefe as Receiver.

Central to Church's, the Third-Party Plaintiff-Appellant, claims were the sale of four specific units, each of which Church had a $20,000 mortgage. In July 2009, O'Keefe requested the authority to sell one of these encumbered units, "free and clear of all claims, liens and encumbrances without redemption periods, with the proceeds received therefrom to be distributed in accordance with the same priorities as held prior to consummation of such sales." Church's attorney not only received notice, but signed the stipulated order without objection. Thereafter additional sales, including the remaining units encumbered by Church mortgages, were sold and the proceeds distributed to Citizens pursuant to further court order. In each

instance, Church was provided notice and challenged neither the sales nor the distribution until nearly three years elapsed and the case was long closed.

On September 11, 2013, Church moved to have the case reopened alleging it still maintained valid mortgages on the original four units. Church argued the mortgages were not discharged and the trial court did not have the authority to grant the sale without a foreclosure. On January 9, 2015, the Oakland County Circuit Court denied Church's motion, holding that "the clear language of its orders and the declaration of O'Keefe that the intent of the language "free and clear of all claims, liens and encumbrances" included Church's mortgages.

Church appealed the ruling to the Michigan Court of Appeals. The 2016 opinion addresses a variety of topics relevant for Metro Detroit Receivers and is highly recommended for an in-depth review. However, in upholding the trial court, the Court of Appeals specifically noted that while there is neither a rule nor statute that grants Receivers the authority to sell properties free of any encumbrances, "evidence was submitted in the trial court that it was common practice for Receivers in the Metro Detroit to request and be granted authority to sell distressed properties free and clear of all encumbrances." Moreover, the Court reviewed law from other jurisdictions and concluded that as long as proceeds from any such sale is applied to a senior lien holder (in this case Church's mortgages were junior to those of Citizen's) that the trial court properly exercised their authority.

While the scope of Receivers remains less than easily answered, the Stock ruling sheds some light on the view of Michigan courts.

XV. Roles and Authority of a Receiver - Michigan

State law typically provides a more detailed explanation regarding the roles and authority of appointed receivers. Michigan law defines the roles and authority bestowed upon a receiver in MCR 600.2926. "Subject to limitations in the law or imposed by the court, the receiver shall be charged with all of the estate, real and personal debts of the debtor as trustee for the benefit of the debtor, creditors and others interested."

Roles

1. File acceptance of the receivership with the court within 7 days of the order of appointment.
2. Provide notice of entry of the order of appointment to any person or entity having a recorded interest in all or any part of the receivership estate within 28 days of the filing of acceptance.
3. File an inventory of the property of the receivership estate within 35 days of the order of appointment.
4. Account for all receipts, disbursements, and distributions of money and property of the receivership estate.
5. May request creditors file a written proof of claim with the court if there are sufficient funds for distribution. The receiver may also contest the allowance of any claim submitted.
6. Furnish information concerning the receivership estate and its administration as reasonably requested by any part to the action or proceeding.
7. File with the court a final written report and final accounting of the administration of the receivership estate.

Authority

1. General power to sue for and collect debts, demands, and rents of the receivership estate, and compromise or settle claims
2. Liquidate personal property of the receivership estate into money
3. Pay ordinary expenses of the receivership but may not distribute the funds in the estate to a party to the action without court order
4. May only be discharged by order of the court

APPOINTMENT OF EXAMINERS UNDER 11 U.S.C. § 1104(c) AN OVERVIEW[8]

I. Introduction

This article provides a brief overview of the appointment of an examiner under 11 U.S.C. § 1104(c) of the U.S. Bankruptcy Code. Section 1104 authorizes the appointment of an independent trustee or examiner. *See generally* 11 U.S.C. § 1104. Generally, when a company files a chapter 11 bankruptcy, the existing management remains in place as debtor-in-possession (the "DIP"), and handles the day-to-day business affairs of the company for the duration of the reorganization effort. *See* 11 U.S.C. § 1107(a). In some cases, however, where there is evidence of incompetence, fraud, or other wrongdoing on behalf of the DIP, a party in interest or the United States Trustee ("UST") can file a motion to request the appointment of a trustee. *See* 11 U.S.C. § 1104(a). If appointed, the trustee replaces the DIP. *Id.*

Alternatively, and less drastically, when a party in interest or UST suspects wrongdoing in certain aspects of the case or in the debtor's business operations, but lacks sufficient evidence to prove such wrongdoing, it may file a motion with the bankruptcy court to request the appointment of an examiner. *See* 11 U.S.C. § 1104(c); *see also In re Brookfield Clothes, Inc.*, 31 B.R. 978, 985 (S.D.N.Y. 1983) ("If a creditor or party in interest is of the view that a debtor-in-possession is improperly exercising the trustee's powers . . . the proper course is to petition the bankruptcy judge for the appointment of a trustee or examiner . . . ."). If appointed, the examiner will act as an independent investigator in the case, and report his or her findings to the bankruptcy court. 11 U.S.C. § 1104(c).

[8] Written by Judge Deborah L. Thorne, U.S. Bankruptcy Court, Northern District of Illinois and Miriam Peguero Medrano, J.D., Northwestern University Pritzker School of Law, 2018.

II. Appointment of an Examiner

Section 1104(c) provides, in relevant part, that the bankruptcy court "shall order the appointment of an examiner . . . as is appropriate" if (1) prior to the confirmation of the plan, (2) no trustee has been appointed, (3) one is requested by a party in interest or UST, and (4) "such appointment is in the interest of the creditors," *or* "the debtors fixed, liquidated, unsecured, debts . . . exceeds $5, 000, 000. *See generally* 11 U.S.C. § 1104(c); *See also In re UAL Corp.*, 307 B.R. 80, 84 (Bankr. N.D. Ill. 2004).

A "party in interest" is any party to the case, such as an unsecured or secured creditor or a debtor. Because an examiner typically focuses on the impropriety involving the DIP or the DIP's management, the DIP is generally not the party that requests the appointment of an examiner. *But see* Notice of Mot. for An Order (A) Appointing an Examiner and (B) Granting Related Relief at ¶ 5, *In re Caesars Entertainment Operating Company, Inc.*, No. 15-01145 (Feb. 13, 2015), ECF No. 363 (debtor's motion seeking entry of an order appointing an examiner to investigate complex pre-petition transfers); Mot. of Official Committee of Second Priority Noteholders for Appointment of Examiner with Access to and Authority to Disclose Privileged Materials at ¶ 5, *In re Caesars Entertainment Operating Company, Inc.*, No. 15-01145 (Feb. 17, 2015), ECF No. 367 (noting that the debtors have conceded to the appointment of an examiner to investigate the debtor's pre-petition transfers).

Some courts have *sua sponte* appointed an examiner; that is, without the request of a party in interest or UST. *See In re Moshaashaee*, No. 15-02941-5-DMW, 2015 WL 4689019, at *1 (Bankr. E.D.N.C. Aug. 6, 2015) ("Based on the plain language of the Code and the clear weight of supporting authority, the court has authority to appoint an examiner without motion or request by a party in interest.") (citing *In re Landscaping Servs.*, Inc., 39 B.R. 588, 590 (Bankr.

E.D.N.C .1984)); *See also, generally In re Mirant Corp.*, 2004 WL 2983945 (Bankr. N.D. Tex. Sept. 1, 2004) (court entered an order *sua sponte* directing the trustee to appoint an examiner).

Despite the Code's mandatory language, section 1104(c)(1) provides the court with discretion to appoint an examiner when a party in interest or UST requests one and "such an appointment is in the interest of the creditors," so long as the debtor's debts do not exceed $5 million. *See* 11 U.S.C. § 1104(c)(1) . If the debtor's debts exceed $5 million, section 1104(c)(2) mandates the bankruptcy court to appoint an examiner at the request of a party in interest or UST. 11 U.S.C. § 1104(c); *see also* 7 Collier on Bankruptcy ¶ 1104.03[2] (Richard Levin & Henry J. Somme eds., 16th ed.). Some courts, however, have held that the "as is appropriate" language of § 1104(c) permits a bankruptcy court to deny the appointment of an examiner even when a party in interest or UST has requested one and the debtor's debts exceed $5 million if the appointment is not appropriate under the facts and circumstances of the case. 11 U.S.C. 1104(c); *See also, e.g.*, *In re Residential Capital, LLC*, 474 B.R. 112, 120 (Bankr. S.D.N.Y. 2012); *In re Spansion, Inc.*, 426 B.R. 114, 127 (Bankr. D. Del. 2010); *See also* 7 Collier on Bankruptcy ¶ 1104.03[2][a] (citing *In re GHR Companies, Inc.*, 11 C.B.C.2d 604, 43 B.R. 165 (Bankr. D. Mass. 1984); *In re Shelter Resources Corp.*, 35 B.R. 304 (Bankr. N.D. Ohio 1983)).

III. Role of an Examiner

The primary role of a § 1104(c) examiner is to act as an investigator and reporter when the need in a particular case arises. Unlike the appointment of a trustee in a chapter 11 bankruptcy, the appointment of an examiner does not displace the DIP—the DIP remains in control of the company and reorganization process while the examiner performs his or her investigation. *See* 11 U.S.C. § 1104(c); *see Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 578 (3d Cir. 2003)

(explaining that an examiner cannot "serve as a substitute for a trustee"). Instead, an examiner is appointed as an independent third party to investigate any aspect of the case, the business, or events leading up to the bankruptcy case, and "usually focuses on alleged fraud, dishonesty, incompetence, misconduct, mismanagement, or other irregularities." *In re Gliatech, Inc.*, 305 B.R. 832, 835 (Bankr. N.D. Ohio 2004); *In re Gordon Props., LLC*, 514 B.R. 449, 456, 463 (Bankr. E.D. Va. 2013) (appointing an examiner to investigate the process by which a settlement agreement was reached to determine whether the settlement was in the best interest of the estate).

While the primary function of an examiner is to investigate and report, bankruptcy courts have broad discretion in defining the scope of an examiner's role. *In re Loral Space & Commc'ns, Ltd.*, No. 04 CIV. 8645RPP, 2004 WL 2979785, at *5 (S.D.N.Y. Dec. 23, 2004) ("it is 'well established that the bankruptcy court has considerable discretion in designing an examiner's role.'") (citing *In re Revco D.S., Inc.*, 898 F.2d 498, 501 (6th Cir. 1990); 7 *Collier* ¶ 1104.03[2][b]); *In re SRJ Enters.*, 151 B.R. 189, 196 (Bankr.N.D.Ill.1993) (characterizing bankruptcy court authority to appoint duties to examiner as broad); *In re Mirant Corp.*, 2004 WL 2983945, at *2 (same).

For example, several bankruptcy courts have expanded the examiner's role to include duties other than, or in addition to, investigating and reporting. *See* 7 Collier on Bankruptcy ¶ 1104.03[1] (describing that "examiners have been used to assist debtors in possession in operating their business, to mediate disputes between parties in the case, and in other flexible roles"); *see also, e.g.*, *In re Pub. Serv. Co. of New Hampshire*, 99 B.R. 177, 182 (Bankr. D.N.H. 1989) (appointing an examiner to mediate and aid breaking a deadlock in plan negotiations); *Williamson v. Roppollo*, 114 B.R. 127, 129 (W.D.La.1990) (bankruptcy court may empower examiner to initiate suits to recover preferences and fraudulent transfers); *In re Mirant*

Corp., 2004 WL 2983945, at *1 (reasoning that the expanded role of the examiner did not exceed the scope of a legally permissible assignment for an examiner).

The courts that have expanded the role of the examiner beyond investigation and reporting rely on section 1106(b) of the Code, which allows a bankruptcy court to authorize an examiner appointed under section 1104 to perform "any other duties of a trustee that the court has ordered a debtor in possession not to perform." Robert J. Feinstein & Ilan D. Scarf, *Update on the Role of Examiners in Chapter 11* Cases, Ann. Surv. of Bankr.Law 18 (2004) [hereinafter Feinstein & Scarf, *Update on the Role of Examiners in Chapter 11* Cases]; *see also* 11 U.S.C. § 1106(b); *In re Patton's Busy Bee Disposal Service, Inc.*, 182 B.R. 681, 686 (Bankr. W.D.N.Y. 1995) (relying on section 1106(b), the court held that an examiner may commence an action with the approval of the bankruptcy court). Therefore, the role of an examiner can be "broad or narrow, simple or complex, restrictive or flexible" depending on the particularities of each case and the need for his or her appointment. *See* Krista Fuller, *Chapter 11 Examiner When Why What and How Part I*, Am. Bankr. Inst. J. (Mar. 1, 2005).

IV. Benefits and Drawbacks of the Appointment of an Examiner

The appointment of an examiner can be a very useful tool for creditors and other interested parties when confronted with suspicions of a debtor or its management's misconduct. Thus, from the perspective of an interested party, the appointment of an examiner is beneficial to uncovering wrongdoing on behalf of the DIP and its management. *See e.g.*, *In re Keene Corp.*, 164 B.R. 844 (Bankr. S.D.N.Y. 1994) (creditor's sought the appointment of an examiner to investigate alleged fraudulent transfers made by debtor's present and former officers);

An examiner is also helpful when it comes to resolving complex issues, such as large complex reorganizations of failed LBOs or complex pre-petition transfers and fraudulent

conveyances. See Paula D. Hunt, *Bankruptcy Examiners Under Section 1104(b): Appointment and Role in Complex Chapter 11 Reorganizations of Failed LBOs*, 70 Wash. U. L. Q. 821, 824, 839 (1992); *see also In Caesars Entertainment Operating Co., Inc.*, 2016 WL 7477566, at *1 (Bankr. N.D. Ill., 2016) (noting that "an examiner was appointed to investigate, among other things, a series of transactions that the parties have generally called 'the disputed transactions' for short"); *First American Health Care of Georgia, Inc. v. U.S. Department of Health and Human Services*, 208 B.R. 992 (Bankr. S.D. Ga. 1996) (cause to appoint an examiner existed where there was complex legal factual issues regarding debtor and management's alleged fraud).

Despite these benefits, there are two noteworthy drawbacks of appointing an examiner: cost and delay. While the appointment of an examiner in a chapter 11 bankruptcy is usually more economical than the appointment of a trustee*, see In re Gilman Services*, Inc., 46 B.R. 322, 328 (Bankr. Mass. 1985) (noting that "[t]he appointment of an examiner is a cautious, intermediate procedure which is more economical than the appointment of a trustee"), an examiner's investigation and report is often costly and could cause undue delay. *See In re Winston Indus., Inc.*, 35 B.R. 304, 305 (Bankr. N.D. Ohio 1983) (explaining that the bankruptcy court is not required to appoint an examiner when his or her appointment is "costly and non-productive and would impose a grave injustice on all parties herein").

Accordingly, courts apply a cost-benefit analysis to "analyze costs . . . to ensure that such costs are not 'disproportionally high'" so that "the benefit to the estate . . . outweigh the expenses." *In re Gilman Services*, 46 B.R. at 328. Similarly, courts also balance the need for the investigation against the delay the investigation would cause to determine if the appointment is appropriate. *Id.* at 328 (holding that "the need for further inquiry for the protection of creditors

and shareholders . . . outweighs any delay" that would result from the appointment of an examiner).

V. Examiners Appointed in High-Profile Mega Cases

Examiners have been appointed in many high-profile mega cases, such as Enron and Lehman Brothers, to investigate alleged fraud and other conflicts of interest that led to billions of lost invested money. *See generally* Feinstein & Scarf, *Update on the Role of Examiners in Chapter 11* Cases; Trucy Rucinski, *Factbox: Examiner reports on U.S. bankruptcies, their success and cost*, Thomas Reuters (Mar. 4, 2016) [hereinafter Rucinski, *Factbox: Examiner reports on U.S. bankruptcies, their success and cost*]. The examiner's reports under these cases were lengthy and widely publicized and uncovered the massive fraud committed by these companies. *Id.*

For example, in the Enron bankruptcy, which was one of the ten largest bankruptcies in U.S. history, the court appointed an examiner to investigate the transactions involved in the massive financial scandal and to report any potential causes of action that were available to the creditors arising out of those transactions. Feinstein & Scarf, *Update on the Role of Examiners in Chapter 11 Cases*. The Enron examiner submitted a 2, 000 page report finding that Enron violated several accounting rules in multiple transactions and misrepresented the company's value to deceive investors, and concluded that there were several causes of actions available to creditors that could assist in the recovery of millions of dollars' worth of assets to the estate. Feinstein & Scarf, *Update on the Role of Examiners in Chapter 11 Cases*; Rucinski, *Factbox: Examiner reports on U.S. bankruptcies, their success and cost*. While the cost of the examiner's report in Enron was over a hundred million dollars, the examiner was "able to conduct a broad investigation into the facts using judicial process relatively quickly" compared to other

investigations that were taking place at the same time. Feinstein & Scarf, *Update on the Role of Examiners in Chapter 11 Cases*.

Other high-profile mega cases that have appointed an examiner include: *In re Residential Capital, LLC*, 474 B.R. 112 (Bankr. S.D.N.Y. 2012) (court appointed an examiner to conduct an investigation on the debtor and its affiliated subsidiaries pre- and post-petition transfers); *In re Lehman Bros. Securities and Erisa Litigation*, 799 F.Supp.2d 258 (S.D.N.Y. 2011) (noting that in 2010, the court-appointed examiner issued a nine-volume report on his investigation of the debtor, Lehman*); In re Washington Mutual, Inc.*, 442 B.R. 314, 325 (Bankr. D. Del. 2011) (noting that the court granted the appointment of an examiner to conduct investigations on the merits of multiple claims of the estate); *In re WorldCom, Inc. Sec. Litig.*, No. 02 CIV 3288 DLC, 2005 WL 375315, at *6 (S.D.N.Y. Feb. 17, 2005) (explaining that the bankruptcy court approved the appointment of an examiner to submit a report on the "potential causes of actions the examiner believed would most likely survive motions to dismiss or summary judgment").

VI. Conclusion

In short, section 1104(c) is a less drastic alternative to the appointment of a trustee in a chapter 11 bankruptcy. Unlike an appointed trustee, an examiner does not replace the DIP. Instead, the primary purpose of an examiner is to investigate and report on misconduct on behalf of the DIP and its management. In some cases, under the court's broad discretion in defining the scope of an examiner's role, the examiner's role has been expanded beyond investigating and reporting to best serve the certain circumstances and issues in particular cases. While the appointment of an examiner can be a highly useful tool, it could, however, also be costly and time-consuming. As such, in determining whether an examiner is appropriate, courts must

consider whether the benefit of the examiner's investigation and report outweigh the cost and delay involved in the appointment.

ROLE OF A FINANCIAL ADVISOR TO AN EXAMINER AN OVERVIEW[9]

I. Introduction

This article provides a brief overview of the role a financial advisor (FA) plays to an examiner appointed under 11 U.S.C. § 1104(c) of the U.S. Bankruptcy Code. As discussed above, in some bankruptcy cases, where evidence of incompetence, fraud, or suspicion exists of wrongdoing, but the UST or a party in interest lacks sufficient evidence to prove such wrongdoing, it may file a motion with the bankruptcy court to request the appointment of an examiner. *See* 11 U.S.C. § 1104(a). If appointed, an examiner often engages a FA to assist in their investigation.

II. Examiner's Selection of a Financial Advisor

The primary role of a FA is to assist the examiner in independently investigating the potential fraud and wrongdoing by the debtor. Specifically, a FA provides accounting and financial expertise often necessary to conduct investigations related to allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or other irregularities. Unlike an examiner, the FA is not appointed under 11 U.S.C. § 1104(c) of the U.S. Bankruptcy Code. Typically, the appointed examiner selects a FA based on a previous working relationship or through a solicitation of qualifications. Sometimes, however, a potential examiner appointee will team up with a FA during the examiner pitch process.

[9] This section was written by Andrea Gonzalez, Managing Director with Alvarez & Marsal's Disputes and Investigation services group in Chicago.

III. Role of Financial Advisor to an Examiner

Once an examiner appoints a FA, the examiner and FA will work hand-in-hand in: 1) confirming the scope of work; 2) developing a work plan and schedule; 3) identifying information necessary to perform the investigation and gathering evidence; 4) performing the research and financial investigation; 5) and reporting the examiner's findings. After understanding and confirming the scope (i.e., investigating pre-petition transfers, fraudulent conveyances, etc.), identifying and gathering information to conduct the investigation, the examiner and the FA will begin the investigation. During this phase of the engagement, a FA assists the examiner in investigating the accounting and financial issues. Every investigation is different, and as a result, the investigative steps will vary on a case-by-case basis. Therefore, while it is difficult to identify all the roles / services a FA may play/provide in each investigation, below is a general list:

- Reconstruct financial records / evaluate internal controls and financial reporting;
- Analyze inter-company / related-party transactions;
- Investigate fraudulent transfers / preferences and other avoidance actions;
- Perform solvency analyses;
- Analyze cause of business failure and viability;
- Identify anti-corruption / funds tracing and asset identification;
- Forensic interrogation of electronic media and data remediation;
- Data mining and forensic analysis;
- Evaluate contract or rejection damages;
- Perform asset and business valuation, including intellectual property and other intangible assets;
- Prepare damage assessments; and
- Evaluate and pursue actions to maximize recovery.

- Investigate accounting irregularities / financial restatements
- Preserve, validate, mine and manage data

IV. Financial Advisor's Role to the Caesar's Examiner

The above list is informative, in that, it provides different examples of a FA's role / service offerings during an investigation. However, to effectively illustrate the benefits of a FA, this section walks through the investigative steps undertaken during the examiner's investigation of Caesars Entertainment Operating Company (CEOC), a subsidiary of Caesars Entertainment Corp. (CEC). A brief description of the investigation follows.

On January 15, 2015, CEOC filed for bankruptcy protection. Shortly thereafter, or on March 25, 2015, the bankruptcy court appointed an examiner to investigate certain pre-petition transactions among the CEOC, CEC, the sponsors and other affiliated entities, as well as claims against attorneys and other advisors. After the examiner was appointed he retained a financial advisor. To understand the complexity of the CEOC bankruptcy and the potential issues, it is important to note that over a six-year period, CEOC engaged in over 40 transactions that extended maturities, amended credit agreements, reduced debt and transferred assets in exchange for cash. The creditors attacked these transactions, including pre-petition litigation, on the basis that the transactions were designed to shield valuable assets from a CEOC bankruptcy and preserve value for CEC's sponsors to the detriment of creditors.

In this matter, the examiner was charged with analyzing and evaluating: 1) the operations of over 52 properties and/or businesses; 2) various debt transactions; 3) asset transfers related to more than 15 disputed transactions over a five year period with aggregate values in excess of $3 billion; 4) the leveraged buy-out and resulting debt burden, payments to insiders and related

parties; 5) numerous debt restructurings; 6) evaluation of the use and worth of the customer loyalty program; and 6) issues related to piercing the corporate veil.

To assist the examiner with the investigation, the FA (a team of over 50 different professionals):

- Analyzed numerous budgets, projections and actual financial performance by entity/property and evaluated the processes in which they were prepared;
- Researched and benchmarked performance against industry and economic factors;
- Performed complex data analytics related to the use and benefits derived from centralized services, cost sharing, and customer loyalty programs by various legal entities;
- Met with and objectively evaluated / analyzed numerous presentations and financial analyses presented by various constituents;
- Assessed organization structure as it evolved over time;
- Evaluated decisions to close certain businesses and fund others, including the ability to service various levels of debt;
- Analyzed various debt restructurings and the participants related thereto;
- Assisted in the evaluation of corporate governance and the independence of various boards;
- Performed detailed solvency analyses at the time of the LBO in 2008 and through 2014;
- Valued various assets including properties/real estate; (ii) intellectual property, including trademarks, loyalty programs, management contracts, and other rights; (iii) retail development, hotel towers, raw land, and amusement/entertainment projects; and (iv) consideration received including non-cash items such as preferred stock and avoided corporate overhead costs'
- Evaluated activities related rate setting, asset transfers, and cost allocations between legal entities under common ownership and related parties;
- Assessed third party payments for services; and debt exchanges to determine the use of funds, including payments to existing debtholders who were insiders or related entities;
- Assisted with the evaluation of the independence of members of certain boards and their counsel

- Assessed the consideration being contributed under various RSAs;
- Helped to develop a framework and then evaluated the relative strength of claims asserted and investigated as well as the projected range of recoveries for each;
- Assessed the use of tax attributes and tax sharing agreements; and
- Reviewed/analyzed more than 8.8 million documents and interviewed more than 75 individuals including current and former employees of the company and its parent, various professionals employed by the Debtor, and private equity investors.

On March 15, 2016, the examiner issued an 1,800-page report[10] concluding: 1) actual and constructive fraudulent transfers; 2) breaches of fiduciary duty against CEOC directors and officers, and CEC; and 3) aiding and abetting breach of fiduciary duty against the sponsors and CEC's directors. The examiner, with the assistance of the FA, estimated potential damages for all claims range between $3.6 billion to $5.1 billion.

[10] https://cases.primeclerk.com/ceoc/Home-DocketInfo?DockSearchValue=examiner.