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CONCURRENT SESSION

2023

SO ORDERED,

Judge Selene D. Maddox

United States Bankruptcy Judge

The Order of the Court is set forth below. The case docket reflects the date entered.

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF MISSISSIPPI

IN RE: EXPRESS GRAIN TERMINALS, LLC[1]	**CASE NO.: 21-11832-SDM**
DEBTOR	**CHAPTER 11**

MEMORANDUM OPINION AND ORDER APPROVING AMENDED APPLICATION FOR FINAL EMPLOYMENT OF CR3 PARTNERS, LLC IN PART AND DENYING MOTION FOR APPOINTMENT OF A CHAPTER 11 TRUSTEE

This case came before the Court on several matters: (1) the *Application to Approve Interim and Final Employment of CR3 Partners, LLC to (I) Provide a Chief Restructuring Officer and Additional Personnel; and (II) Designate Dennis Gerrard as the Chief Restructuring Officer* (the "Application to Employ")(Dkt. #345) filed by Express Grain Terminals, LLC ("Express Grain" or the "Debtor"); (2) the *Amended Application to Approve Interim and Final Employment of CR3 Partners, LLC to (I) Provide a Chief Restructuring Officer and Additional Personnel; and (II) Designate Dennis Gerrard as the Chief Restructuring Officer filed by Express Grain* (the "Amended Application to Employ")(Dkt. #1154) also filed by Express Grain; and (3) the *Motion*

[1] The above styled case is being jointly administered with *In re Express Biodiesel, LLC*, Case No. 21-11834-SDM and *In re Express Processing, LLC*, Case No. 21-11835-SDM.

for Appointment of a Chapter 11 Trustee (the "Motion to Appoint a Chapter 11 Trustee")(Dkt. #779) filed by three attorneys representing multiple farmers and farming entities (the "Farm Group") [2].

Other interested parties filed joinders, responses, or objections to the Application to Employ, the Amended Application to Employ, and the Motion to Appoint a Chapter 11 Trustee. For the sake of simplicity, the Court will briefly note those parties and their filings. Concerning the Application to Employ, the parties filed the following pleadings:

(1) Objection filed by the Farm Group (Dkt. #778);

(2) Joinder in Farm Group's Objection filed by Southern AgCredit, ACA ("Southern Ag")(Dkt. #1078);

(3) Response filed by three other attorneys who represent several farmers and farming entities ("Farm Group II" and "Farm Group III")(Dkt. #1082);

(4) Joinder in Farm Group II and III's Response filed by 446 Farms, LLC ("446 Farms")(Dkt. #1087);

(5) Joinder in Farm Group II and III's Response filed by, similarly, farmers and farming entities ("Farm Group I")(Dkt. #1088);

(6) Joinder in the Farm Group's Objection filed by Farm Group II and III (Dkt. #1093);

(7) Joinder in the Farm Group's Objection and to Southern Ag's Joinder filed by Bank of Commerce and First South Farm Credit, ACA (collectively, the "Production Lenders")(Dkt. #1137);

(8) Joinder in the Joinder filed by the Production Lenders filed by Staple Cotton Discount Corporation ("Staple Cotton")(Dkt. #1193); and

[2] Based on the number of farmers and their related entities involved in this bankruptcy case, the Court grouped and named certain farmers and farming entities together. Specifically, attorneys J. Walter Newman, IV, Derek A. Henderson, and Eileen N. Shaffer represent the farmers and farming entities named the "Farm Group". Attorney Jim F. Spencer represents the farmers and farming entities entitled "Farm Group I". Attorneys D. Andrew Phillips, James Wilson, Jr., Rosamond Posey, and Amanda Burch represent "Farm Group II" and "Farm Group III". Several crop production lenders may also be similarly grouped together. The Court may periodically reference each of these groups based on their arguments in the pleadings or at the hearing.

(9) Joinder in the Farm Group's Objection filed by the Mississippi Department of Agriculture and Commerce (the "MS Department of Ag")(Dkt. #1142).

The pleadings filed relating to the Amended Application to Employ are as follows:

(1) Objection filed by the Farm Group (Dkt. #1167);

(2) Joinder in the Farm Group's Objection filed by Farm Group I (Dkt. #1174);

(3) Joinder in Farm Group's Objection filed by MS Department of Ag (Dkt. #1178);

(4) Joinder in Farm Group's Objection filed by 446 Farms (Dkt. #1184);

(5) Objection filed by the United States Trustee (the "UST")(Dkt. #1188);

(6) Response filed by Farm Group II and III (Dkt. #1191);

(7) Joinder in the Farm Group's and Farm Group II and III's Objections filed by the Production Lenders (Dkt. #1192);

(8) Joinder in Farm Group II and III's Objection filed by 446 Farms (Dkt. #1199).

As to the Motion to Appoint a Chapter 11 Trustee, the parties filed the following pleadings:

(1) Joinder filed by Farm Group I (Dkt. #780);

(2) Joinder filed by Farm Group II and III (Dkt. #918);

(3) Joinder filed by 446 Farms (Dkt. #990);

(4) Response in Support filed by the Production Lenders (Dkt. #1136);

(5) Objection filed by StoneX Commodity Solutions LLC f/k/a FC Stone Merchant Services, LLC ("StoneX")(Dkt. #1138);

(6) Joinder and Response to Production Lenders filed by Staple Cotton (Dkt. #1140);

(7) Objection filed by Macquarie Commodities (USA) Inc. ("Macquarie")(Dkt. #1141);

(8) Joinder filed by MS Department of Ag (Dkt. #1143);

(9) Answer and Response filed by Express Grain (Dkt. #1144); and

(10) Objection and Response filed by UMB Bank, N.A. ("UMB")(Dkt. #1145).

To aid in judicial economy and avoid repetitive testimony and arguments, the Court considered the above matters simultaneously at one live, in-person hearing on November 30, 2021. At the conclusion of the hearing, the Court took the legal issues presented under advisement. Later, on December 14, 2021, the Court conducted a telephonic status hearing at which the Court issued its ruling approving the Amended Application to Employ in part and denying the Motion to Appoint a Chapter 11 Trustee. This Memorandum Opinion and Order incorporates the Court's bench ruling made on December 14, 2021 by reference and includes any findings of fact and conclusions of law. Based on the law and facts as detailed below, the Court finds that the Amended Application to Employ should be approved in part and that the Motion to Appoint a Chapter 11 Trustee should be denied. Further, the Court finds requiring Express Grain to sell the entirety of the prepetition raw grain under 11 U.S.C. § 557(i)[3] is premature at this stage in the § 557 procedures.

I. JURISDICTION

This Court has subject matter jurisdiction pursuant to 28 U.S.C. § 1334(a), 28 U.S.C. § 157(a) and the Standing Order of Reference signed by Chief District Judge L.T. Senter and dated August 6, 1984. This is a "core proceeding" under 28 U.S.C. § 157(b)(2)(A) (matters concerning the administration of the estate).

[3] Unless noted otherwise, any statutory references will be to Chapter 11 of the United States Code.

II. FACTS AND PROCEDURAL HISTORY

The Debtor in this Chapter 11 bankruptcy case, Express Grain, is a large grain terminal employing approximately 160 people and operating in several locations across the Mississippi Delta. While Express Grain operates as a grain terminal and stores crops (grain, soybeans, corn, etc.), the Debtor primarily operates as a grain "crushing" facility.[4] The crushing process involves turning grain into byproducts like meal, oil, hulls, and pellets, which the Debtor then sells for, ideally, a profit over and above the grain purchase price.[5] As all the parties are aware, Express Grain filed its bankruptcy case in the middle of harvest season. During this crucial time, many farmers rely on Express Grain's continued operation. In fact, many of the farmers' livelihoods depend on it. This fact is not lost on the Court, and so, as this bankruptcy case has progressed over the past several months, the Court has done its best to facilitate a forum where the reorganization process can continue in the most expeditious means possible.

A case like this is never simple, and there are many competing interests: the farmers, the farmers' crop production lenders, the Debtor, and the Debtor's Creditors to name a few. At the crux of the case, and what will eventually be decided by this Court, is the parties' interests in and lien priority to the prepetition grain. But at this juncture, the Court was tasked with deciding whether to allow the final employment of CR3 Partners, LLC ("CR3") and its personnel to help Express Grain restructure and operate. Also, or in the alternative, the Court had to decide whether the appointment of a chapter 11 trustee was warranted.

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[4] The Debtor operates at least three grain terminal facilities, but its grain manufacturing operation is located in Greenwood, Mississippi.

[5] The nature of the Debtor's business and other facts giving rise to this bankruptcy case have been spelled out in previous motions for use of cash collateral and the Court's orders on those motions. The Court need not expound upon many of those details for the purposes of this Memorandum Opinion and Order.

CR3's Interim Employment

As detailed in the parties' pleadings listed above, the Court previously approved the interim employment of CR3 and its personnel, which included Dennis Gerrard ("Gerrard") as interim Chief Restructuring Officer ("CRO"), in its Agreed Second Interim Cash Collateral Order.[6] See *Agreed Second Interim Order (I) Authorizing Use of Cash Collateral, (II) Authorizing Continued Use of Existing Bank Accounts and Cash Management System, and (III) Granting Adequate Protection,* Dkt. #120. The Court continued to allow the interim employment in several subsequent cash collateral orders. In those orders, the Court granted the following powers to Gerrard, the interim CRO:

(1) Directing the operations of the Business Debtors, including without limitation, being designated as an authorized signatory for the Business Debtors to execute all documents and agreements on behalf of the Business Debtors;

(2) Reporting directly to the members, designated managers, or board of managers of the Business Debtors and taking any and all actions reasonably related thereto or in connection therewith;

(3) Directing the preparation of all financial information;

(4) Assisting with short-term cash management procedures and liquidity forecasting, including developing and maintaining cash flow forecasts and budgets delivered to UMB and the other Pre-Petition Grain Interest Holders pursuant to this Order;

(5) Approving all material cash disbursements, in coordination with the Business Debtors' obligations under this Order, in order to maximize, protect, and preserve the assets of the Business Debtors;

(6) Approving sales of assets in the ordinary course and authorizing motions and/or applications for the sale of assets outside of the ordinary course of business needing Bankruptcy Court approval in connection with the Chapter 11 Cases;

(7) Overseeing any potential sale process of Business Debtors' businesses and assets

[6] The Court notes that while the interim cash collateral orders are entitled "agreed", multiple parties have continuing objections to Express Grain's use of cash collateral and CR3's employment.

including (i) assisting the Business Debtors and their advisors with the due diligence process and discussions with potential buyers in connection therewith, and (ii) assisting the Business Debtors and their advisors with obtaining Court approval for any potential sale and closing such sale to the successful buyer;

(8) Managing the claims reconciliation process, including, without limitation, initiating and pursuing any necessary litigation involving claims filed against the Business Debtors, and approving or seeking approval, as applicable, of any settlements to be executed by the Business Debtors in connection therewith;

(9) To the extent required, attending hearings, meetings, and other events related to the Chapter 11 Cases as the Business Debtors' representative;

(10) Retaining or terminating employees, contractors and non-legal professionals employed by the Business Debtors;

(11) Directing the preparation of information, including any reports and the schedules needed for the Chapter 11 Cases, and having access to all of the Business Debtors' controlled materials necessary for such preparation;

(12) Participating in meetings with third parties and their respective representatives on all material matters related to the Business Debtors and the administration of the Chapter 11 Cases;

(13) Communicating directly with UMB and the other Pre-Petition Grain Interest Holders, and their respective professionals, with or without Debtors' counsel being present;

(14) Assisting with leadership of the Chapter 11 Cases; and

(15) Taking any and all actions necessary to fulfill the responsibilities set forth above, including executing all necessary documentation on behalf of the Business Debtors to effectuate the same.

After approving CR3's interim employment, the Court instructed Express Grain to segregate any funds that would be used to pay CR3 until such time as the Court approved final employment and/or after properly filing a motion for payment of any fees and expenses.

The Amended Application to Employ and CR3's Concessions

Shortly before the hearing on CR3's final employment, Express Grain filed its Amended Application to Employ, which contained a modified engagement letter and sought to address some

of the objecting parties' concerns. The Amended Application to Employ and the amended engagement letter contain some key provisions that lay out the scope of CR3's employment which, subject to the concessions or other parts of this Memorandum Order and Opinion, are typical terms in a restructuring firm's employment agreement. A few of the provisions in the engagement agreement and Amended Application to Employ provide the scope of CR3's services like those listed above and the compensation rates for CR3's personnel. Regarding compensation, Gerrard, the CRO, charges a $775.00 hourly rate, with a weekly cap of $25,000.00. Todd Bearup, Director, charges a $575.00 hourly rate with a weekly cap of $16,000.00. Marc Paterson, Manager, charges a $425.00 hourly rate with a weekly cap of $13,000.00. The remainder of the "Partner, Director, and Manager" titles provide hourly rates but no cap on weekly compensation.

Based on the pleadings and testimony presented at the hearing on November 30, 2021, there are at least two key differences[7] between the Application to Employ and the Amended Application to Employ. First, in Section III of the Amended Application to Employ, and as acknowledged by Gerrard in his testimony, Express Grain's board of directors not only designated Gerrard as CRO (with all the powers as listed above) but also gave him "ultimate and final decision-making authority" in the bankruptcy case. The Amended Application to Employ acknowledges, however, that the board of directors will continue to "advise and consult" and, if

[7] The Court acknowledges that there are other differences between the Application to Employ and the Amended Application to Employ and in both engagement agreements attached to those applications. For example, paragraph 11 in the amended engagement agreement now reflects a "fiduciary relationship" between Express Grain and CR3. Regardless of the nature or extent of fiduciary relationship currently listed in the amended engagement letter, this Court is imposing a fiduciary obligation, which extends to the entirety of the bankruptcy estate, as a condition of CR3's final employment.

disagreements arise regarding major decisions, the board of directors may bring those issues to the Court's attention. The CRO does not serve, however, at the direction of the board of directors.

Next, the Amended Application to Employ now seeks CR3's final employment under § 327(a), as opposed to § §105(a) and 363(b).[8] As discussed below, these Bankruptcy Code sections differ regarding the employment of professionals, but as Express Grain conceded in its Application to Employ, even if the Court based CR3's final employment under § 363, it would submit fee applications and expense reimbursements under §§ 330 and 331 and follow Bankruptcy Rule 2014 and any other applicable Mississippi Bankruptcy Local Rule or UST guideline(s). Further, at least in the Amended Application to Employ, Express Grain submitted Gerrard's Declaration as an exhibit which outlined the relationships, if any, that CR3 and Gerrard have with the Debtor, its Creditors, or any "significant" interested parties.

At the hearing, Express Grain and Gerrard made several concessions in hopes to garner the Court's approval of CR3's final employment. The Court will adopt those concessions in this Memorandum Opinion and Order. Those concessions include the following changes to the amended engagement agreement:

(1) Removal of the "success fee" paragraph under Paragraph 2, "Compensation";

(2) Removal of the administrative charge of 4% of professional fee language under Paragraph 3, "Expense Reimbursement". Any expense reimbursement will only be approved upon proper application detailing itemization of actual expenses, notice provided to all interested parties, and opportunity for hearing;

[8] In its bench ruling given on December 14, 2021, the Court approved CR3's final employment under § 363(b), which was Express Grain's original request to this Court. The Court notes that while the Amended Application to Employ on page 6 states that Express Grain is seeking CR3's final employment under § 327, including some references to § 327 in the amended engagement agreement, pages 3, 9, and 10 of the Amended Application to Employ still state that Express Grain is seeking CR3's final employment under § 363(b). The Court does recognize that Gerrard testified at the November 30, 2021 hearing in response to a question posed by the Production Lenders that he now is seeking to be employed under § 327.

(3) Removal of the "Indemnification and Related Matters" provision in Paragraph 5, which includes removal of Exhibit B to the amended engagement agreement in its entirety. Except as provided by applicable state and federal law, the amended engagement agreement will provide no indemnification provision;

(4) In Exhibit A to the amended engagement agreement, removal of language in Paragraph 1, "CRO Services" which reads, "who will report to the Company's Board of Directors";

(5) In Exhibit A to the amended engagement agreement, removal of Paragraphs 3(a) and (b) in their entirety.[9]

Gerrard's Qualifications and CR3

Gerrard provided extensive testimony at the hearing concerning his previous education and work experience and the general makeup of CR3. Specifically, Gerrard testified that he received a bachelor's degree in the late 1970s and has since worked in sales and marketing for multiple "fortune 500" companies, middle market companies, and finally as general management in several companies. As to his restructuring experience, and in addition to his role as a partner in CR3, Gerrard has previously served in positions which provided financial analysis and advice for profit improvement and workforce stability. Gerrard has also been previously employed as a CRO on 10 or more occasions, mainly in the manufacturing sector. As to CR3, Gerrard testified that it is a middle-market financial restructuring firm which employs around 15 professionals and has roughly 18 partners. While Gerrard has no previous experience in the grain manufacturing industry, several of CR3's personnel do have experience with grain storage facilities and operations, including Mark Patterson and Todd Barrett—both of whom have agreed to the weekly professional fee cap mentioned above.

[9] While not technically a concession, Express Grain has not produced any evidence of any indemnification provisions that exist in its bylaws or operating agreement.

Other Relevant Testimony

The Court heard testimony from Tammy Pearson ("Pearson"), Express Grain's comptroller. Pearson testified that since the arrival of CR3 and the CRO, the culture of Express Grain has improved, including structural improvements and better decision making at the management level. Pearson expressed concern that appointing a trustee or bringing in another restructuring group would be like "starting over", and much of the time already spent bringing CR3's personnel up to speed would have been wasted. Pearson also testified that if CR3 was replaced by a trustee or other management group, she feared for employee morale and turnover. Although in response to questions from the Farm Group's counsel, Pearson did concede that employee turnover could happen whether Express Grain was sold under CR3 or a trustee. Finally, as to Express Grain's continued operation, Pearson testified that the Debtor has a current competitive pricing advantage over other grain terminals based on Express Grain's terminal location(s).

The Farm Group called Lance Mohamed ("Mohamed"), a certified public accountant, as a witness. Apparently, Mohamed represents several farmers as clients and has some connection or relationship with other Creditors of Express Grain. The basis of his testimony (and to the extent the Court allowed his designation as an expert) concerned his review and conclusions of certain financial information i.e., the most current financial dashboard and 13-week financial projections provided by CR3 and Express Grain. To restate his testimony as simply as possible, Mohamed provided figures on what Express Grain's cost and revenue would be if the raw, prepetition grain currently in the Debtor's possession was sold on the open market versus what Express Grain's cost and revenue would be if the Debtor continued to manufacture the grain.

Positions on CR3's Final Employment[10]

The Court will summarize the arguments relating the employment of CR3, whether made in the parties' pleadings or during the hearing on November 30, 2021. The Farm Group argues that the cost to employ CR3 is cost prohibitive based on Express Grain's cash flow projections. Further, the Farm Group asserts that because the sale of the Debtor is the "ultimate result", and CR3's services do not provide for a liquidation, Express Grain has not adequately asserted the basis or need for CR3's final employment. As to the amended engagement agreement, the Farm Group complains that the while there is a proposed fee cap for several of CR3's personnel, there is no fee cap applied to all employees. Further, the Farm Group asserts that indemnification language puts the bankruptcy estate at risk of incurring a substantial administrative claim.

Farm Groups II and III similarly argue that the employment of CR3 is cost prohibitive to the bankruptcy estate considering the proposed hourly rates of CR3's employees. Farm Groups II and III also make several other arguments relating to CR3's disinterestedness. Specifically, Farm Groups II and III assert that somehow CR3 and the Debtor are in cahoots with UMB, arguably one of the Debtor's largest secured Creditors. Farm Groups II and III argue that the Debtor only brought in CR3 as a condition to have UMB's consent to use "their", i.e., UMB's, cash collateral. They further state that because of CR3's perceived loyalty issue, problems may arise when the

[10] The Court considered arguments from all pleadings, including the responses, objections, and joinders to both the Application to Employ and the Amended Application to Employ. Most of the Court's Memorandum and Opinion (at least outside of the discussion of §§ 105(a), 363(b), and 327(a)) will focus on arguments for and against the employment based on the terms as proposed in the Amended Application to Employ and CR3's concessions at the hearing on November 30, 2021. The Court will also discuss terms as proposed in the Application to Employ which are still relevant to CR3's final employment. On the other hand, the Court may not address all arguments made by the parties in this Memorandum Opinion and Order because they are no longer relevant based on the Court's bench ruling issued on December 14, 2021.

Court approves fees and expenses down the road in that the fees and expenses could have been incurred not for the benefit of the bankruptcy estate, but for the purpose of "readying UMB Bank's collateral as a turn-key prospect via a § 363 sale motion."

The UST filed its objection to the Amended Application to Employ, arguing that allowing the CRO to essentially take over the management of Express Grain, including ultimate decision making in its operational capacity, runs afoul of § 1104 of the Bankruptcy Code. Specifically, based on the terms of final employment as stated in the Amended Application to Employ, the CRO would only be accountable to the Court and would be a trustee in "all but name".

In addition to the various farmers and farming entities, the Production Lenders presented much of the substance in its pleadings and at the hearing. They agree with the UST in that employing a CRO with the type of powers requested in Express Grain's Amended Application to Employ subverts a chapter 11 trustee's role under § 1104(a). And while the Production Lenders admit that the Debtor's Amended Application seeks to remedy many of their initial objections, the Debtor's amendments do not go far enough. For example, the Production Lenders argue that while the amended engagement agreement reflects a fiduciary obligation, the fiduciary relationship is limited, i.e., it does not impose an obligation to the bankruptcy estate, nor does it provide the "protection" needed to parties in interest. The Production Lenders also argue that if the Court approves CR3's employment, it should be under § 327(a), which requires a "heightened standard" for employment of professionals.

Positions on the Appointment of a Chapter 11 Trustee

Because the Farm Group filed the Motion to Appoint a Chapter 11 Trustee, the Court will begin with their position(s). The Farm Group argues that current management cannot be trusted due to at least two checks (for postpetition deliveries) that were returned for insufficient funds.

They also make the same argument against former management, accusing the Debtor of failing to properly disclose its financial status up to the filing date of this bankruptcy case. The Farm Group further avers that, unlike a trustee, the CRO will likely not timely pursue potential claims against John Coleman, Express Grain's president. Finally, the Farm Group argues that the appointment of a trustee will be in the best interest of the Creditors in this case because: (1) the trustee would be an independent party in control and instill more confidence in the farmers to stabilize future deliveries of grain; (2) reduce administrative expenses; (3) assist with the determination of lien priority in the prepetition grain; and (4) coordinate an orderly liquidation of the Debtor's assets. Farm Group I argued at the hearing that the Debtor's violation of § 557(i) is sufficient grounds to appoint a trustee.

Next, the Production Lenders argue that numerous management deficiencies constitute cause for the appointment of a trustee. They agree with Farm Group I that the CRO's failure to implement § 557(i) and sell the raw, prepetition grain falls into the category of either cause or, at the minimum, mismanagement. Finally, the Production Lenders argue that based on financial information provided by the CRO, Express Grain cannot continue to justify the cost of CR3 just to "prop up" the Debtor to eventually sell as a going concern.

Express Grain and its secured Creditors UMB, StoneX, and Macquarie, not surprisingly, take different positions. On behalf of Express Grain, Gerrard testified that a trustee should not be appointed for several reasons. First, at this stage in the bankruptcy case, appointing a trustee would have a "chilling effect" for potential buyers because buyers would assume that "all is lost" and merely wait for the absolute lowest purchase price. Second, Gerrard testified that a trustee is not ideal from an operational standpoint considering that a trustee would not have any more operational knowledge than CR3 and would likely not do anything different than what CR3 is

already doing. Along those same lines, Gerrard testified that cost and time weigh against appointment of a trustee. Specifically, a trustee would need time to "get up to speed" with Express Grain's operation, and the Debtor cannot afford any reduction in productivity. Last, Gerrard testified appointment of a trustee would be cost prohibitive: a trustee would likely be a "nonoperational" person and need to bring in his or her own people to assist in operations, which is exactly the role that CR3 is undertaking at this stage. The trustee would also bill his or her time in addition to the rates of those operational professionals.[11]

The Debtor's Creditors make similar arguments against the appointment of a trustee to those made by Express Grain: no party has alleged fraud or gross mismanagement of the Debtor's affairs by current management, i.e., CR3. Further, as CR3 is an independent party already providing restructuring services to Express Grain, including the management and operational responsibilities, a trustee is not necessary—at least at this stage in the bankruptcy case. Finally, based on CR3's knowledge of Express Grain's operations to date, a trustee would not be in the best position to implement a process to market and sell the Debtor as a going concern and, thus, maximize the value of the bankruptcy estate for all Creditors.

Positions on Implementation of § 557(i)

The Production Lenders and other parties continue to argue that the Court should immediately implement the mandate of § 557(i) and force the sale of the raw, prepetition grain in Express Grain's possession. The Production Lenders' argument is simple: notwithstanding the ownership interest in the prepetition grain, § 557(i) is mandatory because Express Grain is a "grain

[11] As pointed out by Express Grain, under § 326, a trustee would be entitled to statutory compensation and/or commission over and above any fees and expenses incurred by bankruptcy estate professionals the trustee would likely seek to employ in this bankruptcy case.

storage facility" which holds over ten thousand bushels of a specific type of grain. As such, Express Grain should be required to immediately sell the raw, prepetition grain in its storage facilities as opposed to its current operating procedure of manufacturing the crops into byproducts through its manufacturing operation and selling the byproducts. At the hearing on November 30, 2021, counsel for the Production Lenders argued that by allowing the Debtor to continue to operate and "crush" the prepetition grain, Express Grain and, presumably, this Court, are in violation of the mandate. The Production lenders further argue the Court's failure to implement the sale requirement ignores the legislative intent of § 557(i). The Production Lenders fail to cite any case law on the issue either in oral arguments or in their pleadings.

Several of Express Grain's Creditors argue that due to the nature of the Debtor's operations as a dual-purpose facility (it stores grain but mainly manufactures or processes the grain), § 557(i) is not applicable. StoneX asserts that even if § 557(i) is applicable, Express Grain is complying with the mandate in that the Debtor is selling the prepetition grain at a set price at January futures prices plus $0.30 cents and is segregating those funds for the Court to determine ownership interests and lien priorities a later date. Express Grain similarly argues that the prepetition grain is being sold, albeit indirectly, after the manufacturing or "crushing" process. Further, Express Grain asserts that the bankruptcy estate is benefiting more than if the Debtor were forced to sell the raw, prepetition grain on the open market due to the Court's pricing mechanism at the current market price with a bonus. Express Grain also argues that forcing the sale of the raw, prepetition grain would not be free of additional costs to the estate.

III. DISCUSSSION

A. CR3 and its Personnel Meet the Requirements to be Employed as Professionals Under 11 U.S.C. §§ 105(a) and 363(b).

While there has been some debate between the parties concerning the most appropriate Bankruptcy Code provision for the Court to allow CR3's employment (if at all), the Court finds sufficient legal justification to approve CR3's final employment under §§ 105(a) and 363(b). The Court believes a more in-depth discussion is warranted to flesh out its bench ruling issued on December 14, 2021. Ordinarily, employment of professionals is governed by § 327, which provides that, with court approval, the trustee may employ professional persons that "do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties . . . ." 11 U.S.C. § 327(a). As the parties are aware, in a chapter 11 case, a debtor-in-possession is vested with the rights and powers of a trustee. 11 U.S.C. § 1107(a). As such, the terms "debtor-in-possession" and "trustee" are used interchangeably. *In re McDermott Int'l, Inc.*, 614 B.R. 244, 249 (Bankr. S.D. Tex. 2020 (internal citation omitted). To be employed under § 327, Bankruptcy Rule 2014 further requires the debtor to file an application with specific facts showing:

> the necessity for the employment, name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

Fed R. Bankr. P. 2014. In summary, the debtor-in-possession must file an application containing the above requirements under Bankruptcy Rule 2014 and show the professional person is (1) disinterested and (2) does not hold or represent an interest adverse to the bankruptcy estate. *In re American Int'l Refinery, Inc.*, 676 F.3d 455, 461 (5th Cir. 2012).

Professional employment under §§ 105(a) and 363(b), however, is different. Section 105(a) allows courts to enter any order that is necessary or appropriate to carry out provisions of the Bankruptcy Code. 11 U.S.C. § 105(a). Section 363(b) provides, in relevant part, that after notice and a hearing, the trustee (or debtor-in-possession) may "use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1). On its face, § 363(b) does not specifically address the employment of professionals, but rather the use of estate property. Nevertheless, bankruptcy courts have found that professional employment under § 363(b) is permissible. See *In re Nine West Holdings, Inc.*, 588 B.R. 678, 686-87 (Bankr. S.D.N.Y. 2018) (recognizing the "mountain of precedent" in which other courts have authorized debtors to retain professionals, including CROs, under § 363(b)). The basis for allowing professionals to be employed under § 363(b) is that a debtor-in-possession has broad discretion to use estate property when such use represents a reasonable business judgment on the part of the debtor. *In re K.G. IM, LLC*, 620 B.R. 469, 478 (Bankr. S.D.N.Y. 2020) (citing *Comm. Of Equity Sec. Holders v. Lionel Corp. (In re Lionel)*, 722 F.2d 1063, 1070 (2d Cir. 1983) (finding that a debtor must show "some articulated business justification" for using property outside the ordinary course of business under § 363(b)).

As the Production Lenders correctly point out, many of the cases cited by Express Grain in its Application to Employ do not concern the employment of professionals that were not somehow involved with or employed by a debtor prepetition.[12] The Court recognizes that §§ 105(a)

[12] Express Grain cites the following cases in its Application to Employ: *In re American Workers Insurance Services, Inc.*, Case No. 19-44208 (Bankr. N.D. Tex. Nov. 13, 2019) (Dkt. #90); *In re Mid-Cities Home Medical Equipment Co., Inc.*, Case No. 19-41232-ELM-11 (Bankr. N.D. Tex. May 17, 2019) (Dkt. #89); *In re Senior Care Centers, LLC*, Case No. 18-33967 (Bankr. N.D. Tex. Feb. 27, 2019); *In re TPP Acquisition, Inc. d/b/a The Picture People*, Case No. 16-33437 (Bankr. N.D. Tex. Nov. 21, 2016) (Dkt. #377); *In re Energy &*

and 363(b) are commonly used when the disinterestedness requirement of § 327(a) may prohibit employment of professionals who were employed prepetition in an advisory capacity or as an officer of a debtor.[13] Nevertheless, the Production Lenders fail to consider the arguments and allegations made by the various farmers and farming entities that the hiring process involved some prepetition collusion with the Debtor's secured Creditors, the Debtor, and possibly CR3. The Court must weigh those allegations against Gerrard's testimony that the hiring or selection process (to his knowledge) was fair. To alleviate any possible issues with CR3's disinterestedness or continued allegations questioning Express Grain's motives for seeking to employ CR3 as its restructuring firm (and Gerrard as its CRO), the Court believes that retention of CR3 and the CRO under §§ 105(a) and 363(b) is appropriate in this bankruptcy case.[14]

The Court is certainly aware of a more recent opinion where a bankruptcy court decided differently in the context of employment of a financial advisor. In *In re McDermott International, Inc.*, 614 B.R. 244 (Bankr. S.D. Tex. 2020), cited above for its thorough discussion on employment

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Exploration Partners, Inc., Case No. 15-44931 (Bankr. N.D. Tex. Jan. 26, 2016) (Dkt. #263); *In re Pilgrim's Pride Corporation*, Case No. 08-45664 (Bankr. N.D. Tex. Feb. 9, 2009) (Dkt. #825); *In re Mirant Corp.*, Case No. 03-46590 (DML) (Banla. N.D. Tex. Sept. 29, 2003) (Dkt. #999); *In re PRC, LLC*, Case No. 08-10239 (MG) (Banla. S.D.N.Y. Feb. 27, 2008) (Dkt. #182); *ln re Bally Total Fitness of Greater NY, Inc.*, Case No. 07-12395 (BRL) (Banla. S.D.N.Y. Aug. 1, 2007) (Dkt. #283).

[13] The Production Lenders aptly discuss the creation and development of the UST's "J. Alix Protocol" when professionals are employed under § 363(b) in their arguments to CR3's final employment. This Court, however, does not need to delve further into the UST's protocol. As Express Grain acknowledged in its Application to Employ, the Debtor will follow any UST protocol where required. The Court is also imposing certain requirements for approval of professional fees and expenses in this Memorandum Opinion and Order that follow Bankruptcy Rule 2014.

[14] Despite the Court's finding that final employment for CR3 and the CRO is warranted under §§ 105(a) and 363(b), the Court would prefer in the future for movants to request employment under § 327(a), unless there is a significant issue with disinterestedness of a professional, which may prohibit employment of a professional under § 327(a).

provisions under the Bankruptcy Code, the court was faced with whether to approve an employment application for a financial advisory firm, an affiliate of the firm, and a chief transformation officer (the "CTO") under either §§ 363(b) or 327(a). 614 B.R. at 247. The United States Trustee filed an objection to the applications, arguing that the applications should be approved under §§ 105(a) and 363(b) because the CTO provided consulting services prepetition, and therefore, the two entities in which he was affiliated did not meet the disinterested requirement. *Id.* at 253. The court primarily focused on whether the CTO's lack of disinterestedness is *per se* imputed to the two entities, and the court found the following: (1) under §§ 101(14) and (41), no *per se* rule existed, (2) the J. Alix Protocol is unnecessary based on its practical implementation, and (3) the applications would be approved under § 327(a). *Id.* at 254-55. The court, however, maintained its discretion to address an inevitable "unusual" case. *Id.* at 255.

While this Court may agree with most of the findings in *McDermott*, the Court believes this case may very well fall into the "unusual" category. While Gerrard and CR3 did not provide any services to Express Grain prepetition and imputed disinterestedness is not at issue before this Court, as the Court mentioned above, the farmers continue to allege impropriety between Express Grain, its secured Creditors, and CR3 in the selection and hiring process. The Court must weigh these allegations made by the farmers and farming entities with Gerrard's testimony and information contained in Express Grain's Amended Application to Employ and accompanying documents. Out of precaution, the Court finds that employment under §§ 105(a) and 363(b) is more appropriate, especially considering Express Grain has agreed to follow all UST protocols and disclosure requirements of Bankruptcy Rule 2014. Further, if CR3 and its personnel wish to continue to be employed by the bankruptcy estate, they must adhere to the employment requirements that are imposed in this Memorandum Opinion and Order.

Concerning the fees and expenses incurred by professionals who have been hired under § 363(b), Express Grain is correct[15] in that courts have allowed those fees and expenses to be treated as an administrative expense incurred by a debtor in the normal course of business. While the fees and expenses may be treated as administrative expenses in the normal course, the Court is requiring Express Grain to file an application for approval of fees and expenses under §§ 330 and 331 before such fees and expenses may be awarded to any professional in this bankruptcy case.

After considering the testimony presented at the hearing, the Court believes Express Grain has shown a legitimate business justification for the final employment of CR3 and its personnel, including Gerrard as CRO. Not one party presented any evidence that suggests CR3, and its personnel, are unqualified to serve in their respective roles. Despite arguments suggesting that Express Grain cannot afford to sustain the proposed compensation rates for CR3 and its personnel, the Court finds that the proposed compensation for CR3's employees, which includes weekly caps for Gerrard and at least two other professionals, is fair and reasonable.

In addition, Gerrard testified that since his arrival on site in October of 2021, he has worked to improve Express Grain's manufacturing operation, which includes reducing overhead and expenses and providing stability to its employees. Pearson also testified that CR3 and its personnel have produced positive results relating to the management and structure since their arrival. Based on the arguments presented through the parties' pleadings and evidence presented at the hearing

[15] The Court agrees with the cases cited by Express Grain, which support its position on fees and expenses: *In re TPP Acquisition, Inc. d/b/a The Picture People,* Case No. 16-33437 (Bankr. N.D. Tex. Nov. 21, 2016) (Dkt. #377); *In re 4 West Holdings, Inc.,* Case No. 18-30777 (Bankr. N.D. Tex. 2018) (Dkt. #s 132 and 263); *In re UC!, Int'!, LLC,* Case No. 16-11354 (Bankr. D. Del. Jul. 12, 2016) (Dkt. #294); *In re Juniper GTL, LLC,* Case No. 16-31959 (Bankr. S.D. Tex. May 24, 2016) (Dkt. #176); *In re HII Technologies, Inc.,* Case No. 15-60070 (DRJ) (Bankr. S.D. Tex. Sept. 22, 2015) (Dkt. #32); *In re First River Energy, LLC,* Case No. 18-50085 (Bankr. W.D. Tex. Feb. 13, 2018) (Dkt. #200).

on November 30, 2021, the Court does not see a viable alternative other than Express Grain's continued operation at this time. CR3 and its personnel give the Debtor the best chance to restructure its affairs and reorganize under the Bankruptcy Code. Even if an asset sale is Express Grain's fate, CR3 will help maintain and/or maximize the value of the bankruptcy estate for the benefit of all Creditors.

Further, subject to the final employment conditions laid out in this Memorandum Opinion and Order, and as provided in the Amended Application to Employ and CR3's amended engagement letter, the scope of the CRO's duties and powers is appropriate and not prohibited by the Bankruptcy Code. The Court cannot find any authority which might suggest that allowing the CRO ultimate operational and managerial authority conflicts with § 1104.[16] The CRO, and the Debtor for that matter, are ultimately accountable to this Court. If Express Grain's board of directors or any other interested party has concerns about the Debtor's business operation based on decisions made by the CRO, the Court has and will continue to make itself available to address those concerns.

B. Appointment of a Chapter 11 Trustee is not Warranted at this Stage in the Bankruptcy Case.

Section 1104(a) of the Bankruptcy Code provides that the court shall order the appointment of a trustee in two scenarios: (1) for cause, which includes fraud, dishonesty, incompetence, or

[16] The Court points the parties to *In re Pioneer Health Servs., Inc.*, Case No. 16-01119-NPO (Bankr. S.D. Miss. 2016) (Dkt. #552), where the court approved final employment of a CRO with, arguably, a similar role to that of Gerrard. While not a direct parallel, in that case, the UST objected to the employment of the CRO alleging that the CRO's duties conflict with those of a chapter 11 trustee. Judge Olack approved the CRO's employment over the UST's objection. The UST in this case made the same or substantially similar arguments in its oral argument before the Court on November 30, 2021, and the Court finds them unpersuasive. The scope of authority and managerial control afforded to Gerrard as CRO does not conflict with § 1104.

gross mismanagement of the debtor's affairs by current management, either before or after the commencement of the case, or (2) if the appointment is in the interest of the creditors, equity security holders, and other interest of the estate. 11 U.S.C. § 1104(a)(1)-(2). Generally, appointment of a chapter 11 trustee is an extraordinary remedy, and there is a strong presumption in favor of allowing the debtor to remain in control and possession. *In re New Orleans Paddlewheels, Inc.*, 350 B.R. 667, 691-92 (Bankr. E.D. La. 2006); *In re Tanglewood Farms, Inc. of Elizabeth City*, 2011 WL 606820 at *2 (Bankr. E.D.N.C. Feb. 10, 2011) (stating that bankruptcy courts are reluctant to displace management and control of a debtor's business unless extraordinary circumstances are present). The movant bears the burden of proof and must show gross mismanagement of the debtor or fraud by clear and convincing evidence. *In re Cajun Elec. Power Co-op., Inc.*, 69 F.3d 746, 750 (5th Cir. 1995). Courts have discretionary authority to determine whether conduct rises to the level of cause. *In re Tanglewood*, 2011 WL 606820 at *2.

As to the second scenario, determination of whether appointment of a chapter 11 trustee is in the best interests of creditors entails exercise of discretionary powers and equitable considerations. *In re New Orleans Paddlewheels, Inc*., 350 B.R. at 692. It must, therefore, be determined on a case-by-case basis and will rely heavily on the facts. *Petit v. New England Mortg. Servs., Inc. (In re Petit)*, 182 B.R. 64 (Bankr. D. Me. 1995). In making the determination, the court may consider the debtor's trustworthiness balanced against the costs of the appointment. *See Matter of Cajun Elec. Power Co-op., Inc.*, 74 F.3d 599 (5th Cir. 1996); *In re Tanglewood Farms, Inc. of Elizabeth City*, 2011 WL 606820 at *2 (finding that a trustee appointment would only burden the bankruptcy estate with additional cost and disadvantage Creditors).

After reviewing the arguments and testimony, the Court believes that the appointment of a trustee is not warranted or necessary in this bankruptcy case at this time. To begin, proponents for

the appointment of a chapter 11 trustee have not sufficiently proven fraud or gross mismanagement of Express Grain's affairs under *CR3's management*. As mentioned above, the Farm Group does argue that Express Grain issued two checks postpetition that bounced. But there is no evidence that those checks were issued under the direction and management of CR3 and the CRO. To the contrary, evidence presented to this Court indicate that those two checks were issued before CR3 and Gerrard arrived on site.

UMB aptly cites to *In re The 1031 Tax Group LLC*, 374 B.R. 78 (Bankr. S.D.N.Y. 2007) in its objection. In that case, the United States Trustee moved for the appointment of a trustee based on actions of the debtor's principal which occurred prepetition. *Id.* at 79. After the filing of the bankruptcy case, the debtor hired a CRO, who took over operational and managerial control. *Id.* The Court held that cause did not exist to appoint a trustee despite allegations of fraud and other misconduct on the part of prior management. *Id.* at 87. The Court reasoned that if current management is free from the "taint" of prior management, gross mismanagement on the part of prior management does not necessarily provide grounds for appointment of a trustee. *Id.*

The Court agrees with the Debtor and other objecting parties, that most, if not all, of the allegations of fraud, dishonesty, or gross mismanagement against Express Grain concern the actions of prior management. The Farm Group and other parties have not produced any evidence that CR3 or any of its personnel have a connection to allegations against John Coleman (the Debtor's President) or any actions taken by him which may have led to the filing of this bankruptcy case. As such, at least as to cause under § 1104(a)(1), the Farm Group and others have not met their high burden for the appointment of a trustee in this bankruptcy case.

Along the same lines, no party has shown to the Court how appointing a chapter 11 trustee at this stage in the bankruptcy case is in the best interest of the bankruptcy estate or its Creditors.

Despite arguments to the contrary, the Court is at a loss as to how a chapter 11 trustee would reduce administrative expenses to the bankruptcy estate. A trustee would need to "catch up" on all Express Grain's operations and financials, which is, to say the least, a complex manufacturing operation. As Gerrard testified at the hearing, a trustee would likely bring in his or her own operating professionals, including accountants and attorneys. Those professionals would likely duplicate much of the work already performed by CR3 and its personnel. Put simply, a chapter 11 trustee would only disrupt Express Grain's manufacturing operation and cause more unnecessary expense to the detriment of all Creditors. After considering Express Grain's trustworthiness under the management and control of CR3, the Court has not been presented with any evidence that suggests that a trustee would lower the cost and provide any additional benefit to the bankruptcy estate other than what services CR3 is currently providing.

The Court is also satisfied with the evidence presented regarding the work performed and services provided by CR3 and the CRO to Express Grain. The CRO is providing a daily dashboard containing financial information and cash flow projections to keep all parties abreast of Express Grain's operation. While some parties advocate that Express Grain should not be operating at all, the Court disagrees. As mentioned above, no party has put forward any evidence of an alternative to best optimize the assets of this bankruptcy estate if Express Grain were to cease operation. The Farm Group's own witness, Mohamad, provided his financial analysis and conclusions to this Court, which indicated that some weeks Express Grain would be more profitable selling the raw grain, while other weeks it would not. Further, based on CR3's final employment terms as approved by this Court, the CRO's expanded role in the Debtor's operation helps ensure that the manufacturing process continues uninterrupted and, if an eventual sale is in the forecast, helps maximize the Debtor's value.

In summary, Express Grain's actions under CR3's management simply do not meet the requirements under § 1104(a)(1) necessitating the appointment of a chapter 11 trustee. Further, no evidence or even rationale has been presented to the Court on a better path forward that would benefit the bankruptcy estate more than Express Grain's continued operation under CR3's management, at least based on the evidence as presented at the hearing on November 30, 2021. As addressed below in more detail, the failure to immediately implement § 557(i) is also not grounds to appoint a trustee, as the timing for implementation of this Bankruptcy Code section is within the Court's discretion under the § 557 procedures.

C. Applicability of 11 U.S.C. § 557(i)

Several parties, mainly the Production Lenders, have raised § 557(i) in their objections to the continued use of cash collateral, CR3's employment, and in support of appointing a chapter 11 trustee. The Court believes that the applicability of § 557(i) must be addressed in this Memorandum Opinion and Order due to the interrelatedness of Express Grain's continued operation under the management of the CRO and without the appointment of a chapter 11 trustee. Section 557(i) provides as follows:

> In all cases where the quantity of a specific type of grain held by a debtor operating a grain storage facility exceeds ten thousand bushels, such grain shall be sold by the trustee and the assets thereof distributed in accordance with the provisions of this section.

11 U.S.C. § 557(i). At first glance, this Bankruptcy Code provision seems straightforward: if a debtor operates as grain storage facility holding more than 10,000 bushels of grain, the bushels of grain must be sold and the proceeds distributed according to the § 557 procedures established by the Court. Several issues arise in this case that complicate the implementation of § 557(i) at this juncture—regardless of the mandatory nature of the provision. The first issue is whether Express

Grain qualifies as a grain storage facility under the Bankruptcy Code and § 557 generally.[17] Even if Express qualifies as a grain storage facility, the second issue relates to how the Court should implement § 557(i) in a bankruptcy case like this: where Express Grain operates as a dual-purpose Debtor, i.e., its survival and reorganization depends not on selling the raw grain, but on its ability to manufacture or "crush" the grain into byproducts. Last, § 557(i)'s language is unclear as to *when* the Court should require a debtor to sell its bushels of grain. Therefore, a more thorough discussion about the implementation of § 557(i) is appropriate.

1. Express Grain is a grain storage facility as defined under the Bankruptcy Code.

Despite the Debtor's manufacturing operation, the Court believes that Express Grain qualifies as a grain storage facility, and, therefore, is subject to the statutory requirements of § 557 and, more specifically, § 557(i). Section 557 only applies to a debtor that "owns or operates a grain storage facility". 11 U.S.C. § 557(a). The Bankruptcy Code defines a grain storage facility as "a site or physical structure regularly used to store grain for producers, or to store grain acquired from producers for resale." 11 U.S.C. § 557(b)(2). The first part of § 557(b)(2) implies that for § 557 to apply to a debtor, a debtor receives grain from producers and holds it in storage with the title of grain remaining in the producer.[18] *In re Mickelson*, 205 B.R. 190, 195 (Bankr. D. N.D.

[17] The Production Lenders argued at the hearing that the applicability of § 557, and by extension § 557(i), has already been determined by the entry of the Court's *Order Granting Motion Establishing Procedures Under 11 U.S.C. § 557 for Determination of Rights, Ownership Interests, Liens, Security Interests and All Other Interests in and to Grain and Proceeds of Grain* (Dkt. #1070). The Court agrees, but because at least one of the arguments raised at the hearing concerned the applicability of § 557(i) to Express Grain, the Court believes the argument should be addressed in this Memorandum Opinion and Order.

[18] The Court ordered in its previous cash collateral orders that title to any *postpetition* grain delivered to Express Grain would remain with the farmers or producers of the grain. As stated above, the Court has not decided the ownership rights to the prepetition grain, and the parties are currently briefing the issue.

1996). In other words, a debtor simply stores the grain with the intent of returning it to the producer (farmer) in the same condition. *Id.* The second part of § 557(b)(2)'s definition suggests that a debtor stores grain acquired from the farmers and resells that same grain to other customers. *Id.*

If the Court only looked to the first part of § 557(b)(2), it likely would find that Express Grain does not qualify as a grain storage facility. As the Court found after reviewing these Bankruptcy Code provisions before entering its order on § 557 procedures, the second part of § 557(b)(2) is more instructive and applicable to Express Grain. Like any grain storage facility, Express Grain receives grain from the farmers and then issues warehouse receipts or scale tickets for the grain received. While most (if not all) of the soybeans are processed and turned into byproducts, Express Grain does resale corn. In fact, the Court has previously ordered the segregation of certain corn resale proceeds. Based on the facts presented to the Court in the parties' pleadings and through witness testimony up to the date of the November 30, 2021 hearing, the Court concludes that Express Grain regularly stores corn collected from farmers and resales that corn in its same condition to third parties. As such, Express Grain meets the definition of a "grain storage facility" under § 557(b)(2), and § 557(i) is applicable to the Debtor in this bankruptcy case.

2. While the actions to be taken under § 557(i) are mandatory, the Court determines when § 557(i) should be implemented within the confines of the § 557 procedures.

The Court recognizes and does not dispute that § 557(i) is a mandatory provision. The language contained in this subsection concerning *what action* must be taken when a debtor-in-possession holds more than ten thousand bushels is not ambiguous: a trustee (or debtor-in-possession) sells those bushels and distributes the assets of those bushels in accordance with the provisions of § 557. But what is ambiguous when looking to the language of this subsection is *when* this action must be taken. In fact, § 557(i) is silent with respect to the timing of the sale of

grain and the distribution of the proceeds. The only guidance contained in § 557(i) is in the last eight words of the subsection, which read: ". . . in accordance with the provisions of this section." Therefore, to understand when § 557(i) must be implemented, the Court turns to traditional methods of statutory interpretation.

Proper interpretation of the Bankruptcy Code begins with the language of the statute itself. *Ransom v. FIA Card Servs.*, 562 U.S. 61, 69 (2011). Even when turning to the language of the statute itself, the statutory language should not be read in isolation, and the cardinal rule is that a statute should be read as a whole because the "meaning of statutory language, plain or not, depends on context." *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991). As mentioned above, the action that § 557(i) contemplates on its face is clear; however, the timing of such action is not. In following traditional methods of statutory interpretation and following § 557(i)'s reference to "the provisions of [§ 557]", the Court turns to the additional subsections of § 557 to understand when and how § 557(i) must be implemented.

As briefly mentioned above, § 557 begins with subsections (a) and (b), two subsections concerning the scope of § 557. Subsection (a) provides that § 557 only applies in a bankruptcy case concerning a debtor that owns or operates a grain storage facility and only with respect to the grain and the proceeds of that grain. 11 U.S.C. § 557(a). Subsection (b) goes on to define the phrases "grain," "grain storage facility," and "producer." 11 U.S.C. § 557(b). Subsection (c)(1) gives directives to courts concerning the expedition of the procedures for the determination of interests in and the disposition of grain and the proceeds of such grain. Section 557(c)(1) provides:

> [E]xpedite the procedures for the determination of interests in and the disposition of grain and the proceeds of grain, by shortening to the greatest extent feasible such time periods as are otherwise applicable for such procedures and by establishing, by order, a timetable having a duration of not to exceed 120 days for the completion of the applicable procedure specified in subsection (d) of this section.

11 U.S.C. § 557(c)(1). Thus, under § 557(c)(1), a court may by its own motion (and must by request of an entity claiming an interest in the grain) shorten time periods applicable for the procedures of determining interests in and the disposition of grain and its proceeds, so long as the procedures defined in § 557(d) are completed within a 120-day window. Although the word "disposition" is not defined for the purposes of § 557, disposition includes permitting owners of grain to recover their grain, granting relief from the automatic stay, abandonment of the grain by the estate, sale of the grain, and assumption or rejection of executory contracts of the estate relating to grain or the proceeds of grain. 5 *Collier on Bankruptcy* ¶ 557.04 (16th ed. 2021) (citing 11 U.S.C. § 557(i)). Subsection (d) outlines roughly 17 procedures that may be expedited under subsection (c), including a request for determination of whether such grain or the proceeds of grain is (1) property of the estate, (2) must be turned over to the estate, or (3) may be used sold, or leased; and the disposition of such grain or the proceeds of grain, before or after determination of interests in such grain or the proceeds of grain, by way of sale, abandonment, distribution, or such other methods as is equitable in the case. 11 U.S.C. §§ 557(d)(F)(i)-(iii), 557(2)(A)-(D).

Finally, § 557 contains a subsection outlining factors for a court to consider when determining the extent to which such time periods shall be shortened under § 557(c)(1). Under § 557(c)(2), the court shall determine the extent to which such time periods shall be shortened, based upon:

> (A) any need of an entity claiming an interest in such grain or the proceeds of grain for a prompt determination of such interest; (B) any need of such entity for a prompt disposition of such grain; (C) the market for such grain; (D) the conditions under which such grain is stored; (E) the costs of continued storage or disposition of such grain; (F) the orderly administration of the estate; (G) the appropriate opportunity for an entity to assert an interest in such grain; and (H) such other considerations as are relevant to the need to expedite such procedures in the case.

11 U.S.C. § 557(c)(2)(A)-(H). Therefore, while certain procedures must be expedited upon the motion of a party in interest under § 557(c)(1), courts have discretion to determine the need for and extent to which procedures should be expedited—a determination that is made by considering the above-referenced factors. 5 *Collier on Bankruptcy* ¶ 557.04[1] (16th ed. 2021).

In this case, the Production Lenders (and certain farmers and farming entities) claiming an interest in the grain or its proceeds being held and utilized by Express Grain made the request for the use of § 557. Therefore, under § 557(c)(1), the Court must expedite the procedures for the determination of such interests in and the disposition of grain by shortening (to the greatest extent feasible) the time periods applicable for these procedures. The Court determines the extent to which the procedures are expedited under § 557(c)(2) and sets out a timetable not exceeding 120 days for the completion of the applicable procedure as specified in § 557(d).

Section 557(i) calls for the mandatory disposition of grain and grain proceeds through a sale and distribution by a trustee. Not only does this section fall directly into the gambit of a "disposition" as that phrase is used by § 557(c)(1), but the action it contemplates mirrors the procedures that may be expedited under subsection (d): the disposition of such grain or the proceeds of grain by way of sale and distribution. 11 U.S.C. § 557(d). Thus, while this disposition is mandatory, the Court retains discretion in determining the extent to which the disposition may be expedited by using the factors contained in § 557(c)(2).

Further supporting this interpretation is the language of § 557(i) itself. As previously stated, this section provides for the disposition of the grain and grain proceeds to be done "in accordance with the provisions of [§ 557]." This means that these procedures are, again, still subject to the 120-day timetable contained in § 557(c)(1) as well as this Court's determination of the extent to which such time periods will be shortened using the factors contained in § 557(c)(2). When looking

to the additional subsections of § 557, it is clear to the Court that, while § 557(i) is a mandatory procedure, the extent to which such a procedure is *expedited* is left to the Court's discretion under § 557(c)(1) and (c)(2). In other words, the Court determines the extent to which any time period for a § 557 procedure is shortened under § 557(c)(2), so long as the time period for completion of procedures under § 557(d) does not exceed 120 days under § 557(c)(1).

Here, several factors contained in § 557(c)(2) are present which the Court believes weigh against expediting the disposition procedure contained in § 557(i), including the needs of the interested parties, the market for such grain, the costs of transporting the grain, and the irreparable harm that may be caused to all parties involved in the case, the employees of Express Grain, and the economy of the Mississippi Delta. To begin, the Court finds that there is no immediate need for any entity claiming an interest in grain for the prompt disposition or sale of such grain. While the Court recognizes the positions of many interested parties in this bankruptcy case, the Court is not, at this time in its implementation of the § 557 procedures, disbursing any proceeds garnered from the disposition or sale of grain held by Express Grain. In other words, even if the Court determined that a disposition or sale of the grain should take place as of the date of the hearing on November 30, 2021, or the Court's bench ruling given on December 14, 2021, no interested parties would receive their portion, if any, of the proceeds until further determinations are made under § 557 regarding the interests in such proceeds.

In addition, the current market for such grain and the costs associated with the disposition of the grain weighs against expediting the disposition procedure of § 557(i). On October 29, 2021, the Court entered the *Amended Agreed Second Interim Order (I) Authorizing Use of Cash Collateral, (II) Authorizing Continued Use of Existing Bank Accounts and Cash Management System, and (III) Granting Adequate Protection* (Dkt. #603), in which the Court established an

"Interim Established Price" to be associated with the prepetition grain used in the soybean crushing and refinement process. This price, set at a per bushel price based on the daily settle price of the January soybean futures plus $0.30, is paid by Express Grain upon the segregation of prepetition grain and grain proceeds. Based on the price fluctuations of the open market with respect to the sale of grain, the Court believes that it may be more profitable for all parties involved to allow Express Grain to continue processing the grain for the time being rather than mandating an outright and immediate sale under § 557(i). Further supporting this profitability concern are the costs associated with an outright sale of the raw, prepetition grain, including costs associated with the transportation of the grain.

The Court is also concerned with the consequences of expediting the disposition procedures of § 557(i) as those consequences relate to the employees of Express Grain and the economy of the Mississippi Delta. Expediting the disposition procedure of § 557(i) would result in the sale of all raw, prepetition grain held by Express Grain on the open market, yielding proceeds that would likely not adequately compensate those with interests in the prepetition grain and/or prepetition grain proceeds. Forcing Express Grain to sell all prepetition grain would likely force it into an immediate winding-up of its business operations and result in the termination of almost all Express Grain's employees. As Express Grain is one of the largest grain storage facilities in the state of Mississippi and has generated millions of dollars per year through the purchase, storage, and refinement of grain, the immediate shuttering of operations will send shockwaves through the Mississippi Delta and may have an adverse effect on the overall economy of Mississippi. Therefore, based on testimony given by the CRO, and the Court's previously enumerated concerns and the factors of § 557(c)(2), the Court will not expedite the disposition of grain and grain proceeds under § 557(i) at this time.

Section 557(i) is most certainly a mandatory procedure when an entity in interest makes a request for the utilization of § 557; however, the disposition procedure of § 557(i) shall go into effect at any time deemed appropriate by the Court by way of § 557(c)(2), so long as such a procedure is completed before the expiration of the 120-day timeframe contemplated by § 557(c)(1). To state it simply: a mandatory statutory provision does not equate to the immediate need for implementation of that provision.

3. The legislative history accompanying § 557 further supports that § 557(i) should not be implemented until the Court determines the ownership interests in the prepetition grain.

Although the legislative history connected to § 557 is scant, the legislative history accompanying the Omnibus Bankruptcy Improvement Acts of 1983 sheds light on the purpose of § 557 and the expedition of the determination of interests in grain assets. This legislative history further supports Congress's intentions to provide a mechanism for the distribution of grain assets being held by a grain storage facility, but places focus on the ownership of grain assets by the producers and depositors of such grain. Because Congress placed weight on the ownership of grain and grain proceeds when contemplating distributions under § 557, until such ownership interests are determined by this Court, § 557(i)'s mandatory provisions are not ripe for implementation.

The purpose of § 557 is to prevent the "forced sharing" by a producer/depositor of grain in a grain storage facility with secured lenders by addressing bailment situations where producers deposit grain with a grain storage facility for storage and/or resale with title of the grain remaining in the producers of the grain. *In re Mickelson*, 192 B.R. 516, 521 (Bankr. N. D. 1996). Arising out of the farming crisis of the 1980s, §§ 546(d), 557, and 507(a)(5) were "amelioratory changes" of the 1984 Bankruptcy Code; however, even to this day, there is "practically no legislative history specifically attributed to those 1984 Code sections 546(d), 557 and 507(a)." *In re Esbon Grain*

Co., Inc., 55 B.R. 308, 313 (Bankr. D. Kan. 1985). The court in *Esbon*, however, points out that the legislative history accompanying §§ 236, 235, and 237 of the Omnibus Bankruptcy Improvements Act of 1983 provides a useful guide for the interpretation of § 557. *Id*.

The matter brought before the court in *Esbon* arose out of the chapter 7 trustee's objection to the secured claim of The First National Bank of Smith Center (the "Bank"), the subject of which being that the "grain proceeds in storage at debtor's facility in quantity [were] insufficient to fully satisfy the claim of Bank and the claims of grain depositors." *Id*. at 309. In 1983, the debtor had executed security agreements and financing statements giving a security interest to Bank in "all grain, or contract rights now owned or hereafter acquired." *Id*. at 310. On February 28, 1985, the debtor filed for chapter 7 bankruptcy relief. The debtor was in the business of buying, selling, and storing grain and grain related supplies at a facility in Esbon, Kansas:

> Both prior and subsequent to the execution of the security agreement *debtor, in the ordinary course of business, received grain delivered by grain producers and issued scale tickets and warehouse receipts therefor*. Many of the warehouse receipts specified "open storage." That designation was commonly understood as *permitting debtor to commingle grain of that particular producer along with grain owned by debtor and/or other grain depositors*. In instances where producers desired to sell their grain outright, debtor paid the producer upon delivery and thereby acquired ownership of the deposited grain. Transactions of the latter type usually were financed with funds provided by Bank under the security agreements. As of the petition filing date the quantity of grain on hand in storage was substantially less than the total represented by outstanding receipts, scale tickets and lien pledges to Bank.

Id. (emphasis added). The court went on to recognize the issues created upon the filing for relief under the Bankruptcy Code in these situations, including the denial of a grain depositor's right to a physical redelivery of like grain in kind "because the entire amount in storage is 'property of the estate,'" and how, after the filing of a petition in bankruptcy, it "falls to the Bankruptcy Court to determine the respective grain ownership and lien rights by application of appropriate state law."

Id. (citing *In re Missouri*, 647 F.2d 768, 774 (8th Cir. 1981) (holding that while the definition of "property" under § 541 of the Bankruptcy Code is broad, the bankruptcy court must make the final determination of property interests after presentation of evidence of ownership rights through holders of documents of title under the state law)). In acknowledging that some of the decisions made under the 1978 Code "produced unfair results," the court noted that the changes made to Bankruptcy Code §§ 235, 236, and 237 of the Omnibus Bankruptcy Improvements Act of 1983—and the changes made to their "essential counterparts," §§ 546(d), 557, and 507(a)(5), in 1984—were done with the producers of grain and grain proceeds in mind. *Id*. at 310-15. In citing to an excerpt from a Report of the Committee on the Judiciary United States Senate of the Omnibus Bankruptcy Improvements Act of 1983, the court noted several problems identified by the Senate that correlate with the 1984 sections of 557, specifically:

> [] the requirements of present law which mandate that *owners of crop assets held by the debtor solely on the basis of his status as bailee* must share grain assets held by the trustee in bankruptcy on a pro rata basis with any creditor holding a security interest in assets of a similar type which are owned by the debtor, such that bailors of such storage contract crop assets have the value of their property diminished for the benefit of such creditors when there is a shortage of produce on hand; and [] the reluctance of some courts to accept warehouse receipts and scale tickets, the principle [sic] documents used in warehouse business to establish record of ownership of crop assets stored in warehouse facilities on bailment contracts, as *evidence of ownership in bankruptcy abandonment proceedings*[.]

Id. at 313 (citing S. Rep. No. 98-65, 98th Cong., 1st Sess., p. 25) (emphasis added). The court continued that the methods for solving these problems also correlate with the 1984 sections of 557, specifically:

> [] The bill would require the court to distribute the grain assets or the proceeds of such assets *first to producers* who have merely stored their grain in such a facility upon a contract of bailment; and

> [] The bill contains measures requiring the bankruptcy court to accept valid warehouse receipts and scale *tickets as proof of ownership of crop assets possessed by the debtor upon* contracts of bailment where they were issued for that purpose[.]

Id. (citing S. Rep. No. 98-65, 98th Cong., 1st Sess., p. 26) (emphasis added). The "bill" referred to in this report was later passed as the 1984 Amendments to the Bankruptcy Code. *Id*.

Finding that this legislative history was material in interpreting the 1984 Amendments to the Bankruptcy Code, the *Esbon* court concluded that the purpose of § 557 "seems to be that of allowing producer/depositors to prove up ownership and receive distribution in advance of other classes of creditors." *Id*. at 315. The expedited nature of procedures under § 557 mandates bankruptcy courts to "order distribution of the stored grain (or grain proceeds) to the producer/depositor *before* distribution to debtor's secured creditors," a mandate that places the concept of ownership at its core. *Id*. The court maintained that this interpretation is supported by Federal Rule of Bankruptcy Procedure 3001(g), which provides for the use of a "warehouse receipt, scale ticket, or similar document of the type routinely issued as evidence of title by a grain storage facility" as *prima facie* evidence of the validity and amount of a claim of ownership of a quantity of grain. *Id*. (citing Fed. R. Bankr. Proc. 3001(g)).

This Court acknowledges that § 557 provides for the expedited determination of interests in grain assets, and its subsections provide for the expedited distribution of grain assets that are being held by a debtor-in-possession. The Court also acknowledges that many entities in this case may have some type of interest in the grain and grain proceeds being held and used by Express Grain. But Congress's apparent contemplation of and concern with proof of ownership in expediting the determination of interests under § 557 leads this Court to find that ownership should be established before proceeding with the disposition and/or distribution of grain or grain proceeds under § 557(i).

The Court again wants to make clear that the requisite action contemplated under § 557(i) is mandatory. The Court is simply finding that, while implementation of § 557(i) may be inevitable in this case, its implementation (without first making grain ownership determinations) is premature. In addition, based on the factors of § 557(c)(2) as analyzed above, the Court is exercising its discretion surrounding the extent of the expedition of the § 557(i) disposition procedure. Therefore, the Court will not, at this time, implement § 557(i).[19]

IV. CONCLUSION

Considering all facts and arguments presented to the Court on November 30, 2021, and for the reasons stated above, the Court finds that the final employment of CR3 is necessary for the Debtor to continue in its operation and reorganization under §§ 105(a) and 363(b). The Court further finds that appointment of a chapter 11 trustee at this juncture would only disrupt the bankruptcy case, burden the bankruptcy estate with additional and unnecessary administrative expenses, hinder Express Grain's reorganization, and not preserve the value of the bankruptcy

[19] The Court notes that Express Grain may likely be in compliance with § 557(i) after considering the purpose and intent of § 557 and its relevant subsections. The Court agrees with the Debtor and other parties that Express Grain is paying for the use and, arguably, purchasing (if the Debtor hasn't already purchased the grain at the time of delivery) the raw, prepetition grain by segregating the proceeds received after the sale of the byproducts. The Court would find it difficult to force implementation of § 557(i) at this point in the bankruptcy case when it clearly frustrates the purpose of Chapter 11 of the Bankruptcy Code—to aid a debtor in reorganization to the benefit of all parties. Further, the Court ordered price at which Express Grain is segregating the proceeds from the sale of the byproducts is likely more than what would be received if the raw, prepetition grain were sold on the open market. Finally, based on the legislative history discussed in this Memorandum Opinion and Order, the purpose of § 557(i)'s implementation is to compensate producers of the grain, seemingly before any other creditors. Even if this Court were to force the sale of the raw, prepetition grain at this juncture, no monies would be distributed to any party before the ownership interest in and lien priority to the prepetition grain is determined. In any event, the Court declines to decide whether the Debtor is technically in compliance with § 557(i). This makes sense because the Court is not implementing § 557(i) at this stage in the § 557 procedures.

estate. Last, the Court finds that implementation of § 557(i) is premature at this stage in the § 557 procedures. It is, therefore, **ORDERED** that the *Amended Application to Approve Interim and Final Employment of CR3 Partners, LLC to (I) Provide a Chief Restructuring Officer and Additional Personnel; and (II) Designate Dennis Gerrard as the Chief Restructuring Officer filed by Express Grain* (Dkt. #1154), subject to any limitations and conditions described in this Memorandum Opinion and Order, is **APPROVED IN PART**. It is further **ORDERED** that the *Motion for Appointment of a Chapter 11 Trustee* (Dkt. #779) is **DENIED**.

##END OF ORDER##

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*289 CHAPTER 11 TRUSTEES AND EXAMINERS AFTER BAPCPA

Clifford J. White III, Walter W. Theus, Jr. [FNa1]

Business executives and corporate boards of directors know that current management generally will remain in control of business operations in most chapter 11 bankruptcy cases. Management who guided their companies into bankruptcy also ought to know that the right to remain in possession of the bankruptcy estate is not unchecked. Modern bankruptcy law has long protected stakeholder and public interests by requiring the appointment of independent trustees and examiners in cases involving egregious mismanagement, improper conduct, or other special circumstances. The recently enacted Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 [FN1] contains new provisions to help ensure better oversight of management of companies in reorganization.

The thesis of this Article is that trustees and examiners can serve creditor, shareholder, and public interests by promoting the efficiency, effectiveness, and transparency of complex chapter 11 cases. BAPCPA may expand the use of trustees and examiners in bankruptcy cases. In recent years, new and creative efforts have been employed by pre-petition management to avoid the appointment of independent trustees and neutral examiners. Eve of bankruptcy hiring of new restructuring officers is sometimes used as a shield to fend off the use of Bankruptcy Code provisions that favor independent fiduciaries and fact-finders over those controlled by extant management. Although management's proactive efforts to redress wrongdoing are to be applauded, these actions are not always sufficient to protect the diverse interests that are at stake in most large cases.

There has been increased focus in recent years on corporate mismanagement *290 and wrong-doing. Many of the business bankruptcy amendments enacted in 2005 were animated by public and Congressional concern over corporate scandals. Among other things, the law now requires that the United States Trustee seek to oust management if there are "reasonable grounds to suspect" that current management participated in fraud, dishonesty, or other criminal acts in the debtor's management or public financial reporting. [FN2] In addition, corporate debtors are under stricter time deadlines to confirm a plan of reorganization [FN3] and are restricted in their ability to pay corporate executives large bonuses while lower level employees, shareholders, and creditors face unemployment or financial loss due to bankruptcy. [FN4] These changes, coupled with other provisions of the Code, empower parties to a bankruptcy case to demand greater accountability.

Even in a corporate fraud case without the need for a trustee, the law favors the appointment of an independent examiner who has a wide-ranging mandate to report on the reasons for the corporate failure and on civil causes of actions that may be pursued for the benefit of stakeholders. If equipped with a mandate of sufficiently broad scope, an examiner may promote efficiency by navigating among the frequent multiplicity of other investigations by government authorities, boards of directors, creditors, and shareholders. The examiner may play the lead role among the players in the bankruptcy case by conducting an expansive and timely investigation that will aid parties later in pursuing monetary recoveries and other remedies. In many respects, the examiner should pre-empt the bankruptcy field by vastly reducing the need for early and duplicative discovery efforts by separate credit-

ors or committees. Examiners also advance the public interest by respecting the superior position of criminal and regulatory enforcement authorities and by providing an earlier and more definitive explanation of the corporate collapse than otherwise can be provided through ordinary civil and criminal lawsuits and prosecutions.

This Article will review the statutory history of reorganization trustees and examiners, the statutory grounds for the appointment of trustees and examiners, the powers and duties of trustees and examiners, and the impact of BAPCPA on trustee and examiner appointments. This review will show that the prudent use of these statutory tools can protect the integrity of the bankruptcy process for the benefit of all stakeholders and the public.

***291** I. LEGISLATIVE HISTORY OF REORGANIZATION TRUSTEES AND EXAMINERS

As originally enacted, the Bankruptcy Act of 1898 [FN5] contained no provisions for the reorganization or rehabilitation of businesses in financial straits. Corporate reorganizations were accomplished by means of equity receiverships, generally in federal district court. [FN6] While such a receivership was ostensibly adversarial in nature, in reality it was prearranged between the management of the debtor corporation and one or more of the corporation's creditors. Upon the filing of a complaint seeking a receiver, the defendant corporation would immediately file an answer consenting to the relief sought. Related proceedings would be brought in all jurisdictions where the corporation had assets, thereby forestalling any individual creditors from enforcing their rights in those jurisdictions. While the district court would appoint a receiver for the corporation's assets, in reality, given the collusive nature of the proceeding, management of the corporation would remain in control of the proceeding, subject only to the insufficient oversight of the district court and unofficially constituted "protective committees" of creditors. [FN7]

In response to apparent inability of equity receiverships to handle the business failures resulting from the Great Depression, Congress amended the Bankruptcy Act in 1933 by adopting section 77 to add a new chapter VIII. [FN8] The following year, Congress added section 77B to cover general corporate reorganizations. [FN9] Under section 77B, corporations were permitted to file voluntary petitions for reorganization, and were generally permitted to remain in control of their affairs.

After several more years of hearings and of intense lobbying by various constituencies, Congress adopted the Chandler Act in 1938. [FN10] The Chandler Act represented the first comprehensive revision of the Bankruptcy Act since 1898, and it substantially rewrote the provisions related to business reorganizations, principally through the adoption of chapters X and XI. Chapter X resulted from consultations between the Securities and Exchange Commission ("the SEC"), under the leadership of William O. Douglas, and the National***292** Bankruptcy Conference, an association of reorganization attorneys. While the National Bankruptcy Conference had sought only minor changes in reorganizations under section 77B, the SEC believed that reorganizations under that section continued to suffer from many of the infirmities and abuses of equity receiverships. The SEC's efforts culminated in a reorganization statute which furnished much needed protection and shifted control of the reorganization process away from management and the reorganizers. This was accomplished by requiring a disinterested trustee in most cases; generally allowing all interested parties to participate in the formulations of a plan, with the disinterested trustee as the focal point; providing a source of independent advice, the Securities and Exchange Commission; and the establishment of fiduciary concepts applicable to reorganizations. [FN11]

In a reorganization under chapter X, the district court was required to appoint "on its own initiative" a disinterested trustee if the corporation's liquidated, noncontingent, debts exceeded $250,000. [FN12] If the debts did not rise to this amount, the court had discretion to appoint a trustee; no standard was given for when such an appointment was appropriate. [FN13] Chapter X also provided for

the appointment of an examiner, but such appointments were rare given the mandatory nature of trustee appointments in cases of any significant size. If the debtor remained in possession, the court was empowered to appoint a disinterested examiner to perform all or any of certain enumerated duties of a trustee in lieu of the debtor. [FN14]

In addition to chapter X, the Chandler Act added to the Bankruptcy Act a new chapter XI, which was designed for the expeditious and cost-effective rehabilitation of small businesses. While a plan of reorganization under chapter X could affect the rights of secured creditors and equity security holders, an arrangement under chapter XI could affect only the rights of unsecured creditors.

Under chapter XI, the debtor generally remained in possession of its property and had all of the rights and powers of a trustee, subject to such limitations as the court might impose. [FN15] Chapter XI further provided that the court "may, upon the application of any party in interest, appoint, if necessary, a receiver of the property of the debtor, or if a trustee in bankruptcy has previously been appointed, shall continue such trustee in possession." [FN16] ***293** Receiver appointments were rare under chapter XI.

Despite the major differences between chapters X and XI, the Bankruptcy Act did not establish a clear line for the eligibility of debtors under each chapter. Chapter X provided that a case should be administered under chapter XI if adequate relief could be obtained under that chapter. [FN17] Similarly, either the SEC or a party in interest could seek a determination that a chapter XI petition should have been brought under chapter X. [FN18] Given the relaxed requirements of chapter XI and the almost unfettered right of management to remain in control, bankruptcy professionals sought to use chapter XI whenever possible. An early Supreme Court case seemed to hold that publicly-held corporations could not use chapter XI. [FN19] A later decision, however, indicated that the fact that a corporation had publicly held securities did not mandate the use of chapter X; rather, the choice of a chapter was to be decided based upon the "needs to be served." [FN20] This decision ran counter to the SEC's long-espoused position that only chapter X was available for public companies. The SEC sought without success to have legislation adopted that would have expressly limited the eligibility of chapter XI for public companies. [FN21]

The use of chapter XI to the near exclusion of chapter X continued unabated through the 1960s. For that reason, reorganization trustees were quite rare. This trend culminated in the chapter XI filing of W.T. Grant Company, a New York Stock Exchange listed public corporation with over a billion dollars in debt.

In 1970, in response to many calls for a general overhaul of the bankruptcy laws, Congress enacted legislation establishing a Commission on the Bankruptcy Laws of the United States. [FN22] After a comprehensive study, the Commission submitted its report to Congress in 1973. [FN23] The Commission Report exhaustively examined the history of the bankruptcy laws, including the tension between chapters X and chapter XI. The Commission made these observations about why chapter XI had grown in favor:

> 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***294** 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. [FN24]

The Commission concluded that only by combining the existing reorganization chapters into one chapter 11 could the disparate procedures be eliminated and the potential abuses of chapter XI be addressed. [FN25]

The Commission studied the role of disinterested trustees in reorganization cases, and acknowledged views ranging from complete antipathy to trustees to support for the general use of trustees. [FN26] The Commission concluded:

> The Commission believes that the concept of the independent trustee is sound, but the Commission also recognizes that it has disadvantages. Much of the disadvantage stems from the blunt approach to utilization of the independent trustee: Not only is the independent trustee to investigate, advise, and formulate a plan, but he also is to operate the business. In many cases it is sufficient to require an independent investigation and formulation of a plan, without the ouster of existing management. The presence of an administrative***295** agency as a watch dog over the reorganization process will make this approach feasible in more cases.
>
> The Commission, therefore, recommends that the appointment of an independent trustee be discretionary, but that the need for such an appointment be presumptive where indebtedness exceeds $ 1,000,000 and there are 300 or more security holders. The ouster of management and the appointment of an independent trustee may be urged by any party in interest, including the administrator, and the determination shall be made by the court, after notice and hearing. If an independent trustee is not appointed, the administrator or any party in interest may request that the court appoint an independent person to investigate or formulate a plan, even though existing management is not ousted. [FN27]

The Commission's recommendations were incorporated into a bill, which was later introduced in the House of Representatives. The National Conference of Bankruptcy Judges, which had been excluded from the Commission's proceedings, drafted its own bill, which was itself introduced in the House. [FN28] Work continued in the House on bankruptcy legislation until 1977, when House Bill 8200 [FN29] was ultimately introduced.

H.R. 8200 took a very flexible approach to the appointment of a trustee or examiner. The court was called upon to decide if the protection of a trustee or examiner was needed and to weigh that protection against the costs and expenses of a trustee and examiner. [FN30] The House Report for H.R. 8200 ***296** stated that "[a] trustee would not necessarily be needed to investigate misconduct of former management of the debtor, because an examiner appointed under this section might well be able to serve that function adequately without displacing the current management." [FN31]

The SEC strongly opposed H.R. 8200 for failing to protect the investing public. [FN32] The SEC instead favored chapter 11 of the Senate bill, S. 2266, [FN33] which required the appointment of a trustee for all cases involving a "public company," which was defined as a debtor with liabilities other than for goods, services, or taxes exceeding $5,000,000, and with not fewer than 1,000 equity security holders. [FN34] The Report accompanying S. 2266 said that the mandatory trustee for public cases was "designed to counteract the natural tendency of a debtor in distress to pacify large creditors,

with whom the debtor would expect to do business, at the expense of small or scattered investors." [FN35]

The differences between the House and Senate bills, including those relating to trustees and examiner were reconciled by a compromise which was enacted as the Bankruptcy Reform Act of 1978. [FN36] The requirement that a trustee be appointed for all public companies was eliminated. The permissive ***297** aspects of the House bill were eliminated; section 1104 as enacted provides that the court "shall" order the appointment of a trustee if cause exists or if such an appointment is in the interests of creditors and interest holders. "Cause" was defined to include "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor ...." The compromise also envisioned a broader role for examiners. Section 1104(b) (now (c)) required the court, after the request of a party in interest, to appoint an examiner to perform an investigation if such an appointment is in the interest of creditors and others interested in the estate. [FN37] Importantly, §1104(b)(2) (now (c)(2)) of the Bankruptcy Code contained a new mandate that an examiner be appointed upon the request of a party in interest in cases with more than $5,000,000 in unsecured debts other than for goods, services, or taxes. [FN38] The Joint Explanatory Statements of the House and Senate leaders explained that the mandatory examiner appointment in these cases "should adequately represent the needs of public security holders in most cases" and alleviate the need for a trustee. [FN39]

While the substantive requirements of § 1104 remained unchanged until 2005, it was modified twice in the interim. In 1986, § 1104 was amended to reflect the role of the United States Trustee in making trustee and examiner appointments. [FN40] In 1994, the statute was further amended to provide for the election of a chapter 11 trustee upon the request of a party in interest. [FN41]

The 2005 changes to § 1104, which will be explored in other sections of this Article, were more significant. First, § 1104(a)(3) was added to provide that the court, after determining that grounds for conversion or dismissal of the case exist under § 1112 of the Bankruptcy Code, shall instead appoint a trustee if the court determines that the appointment of a trustee is in the best interests of creditors and the estate. [FN42] Second, § 1104(e) was added to require that the United States Trustee move for the appointment of a trustee if there are reasonable grounds to believe that the debtor's management has participated in actual fraud, dishonesty, or criminal conduct in management or financial accounting. [FN43] These changes suggest that chapter 11 trustees ***298** should be appointed more frequently in the future.

II. GROUNDS FOR THE APPOINTMENT OF TRUSTEES AND EXAMINERS

A. TRUSTEE

Under § 1104(a) of the Code, a party in interest may request the appointment of a chapter 11 trustee "[a]t any time after the commencement of the case but before confirmation of a plan." The use of the term "commencement of the case" makes it clear that, in an appropriate case, a chapter 11 trustee could be appointed after the filing of an involuntary petition but before the entry of an order for relief. [FN44] If grounds for the appointment of a trustee are established, the statute mandates that the court "shall" order such an appointment. [FN45]

1. *For cause*

The first ground for the appointment of a trustee is cause. The court shall order the appointment of a trustee:

> for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not in-

> cluding the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor .... [FN46]

Several aspects of this statute are noteworthy. First, the use of the word "including" indicates that the list of items constituting cause is not exhaustive. [FN47] The phrase "or similar cause" could, however, be construed to focus the attention of the court on the nature of the listed examples of cause to ensure that the conduct complained of is similar in nature to fraud, dishonesty, incompetence or gross mismanagement.

Second, § 1104(a)(1) specifically prohibits courts from basing a determination of cause on the amount of the debtor's assets or liabilities or on the number of equity security holders. This prohibition was intended to ensure that courts did not reinstitute the "public company" trustee requirement of chapter X by finding cause based on one or more of these factors. Instead, as is discussed elsewhere in this Article, mandatory examiners are to provide ***299** necessary protections in cases with sufficient public debt. [FN48]

Third, the examples given of cause all relate to conduct by "current management" of the debtor. Legislative history supports the proposition that when the fraud, dishonesty, incompetence, or gross mismanagement took place under former management, a trustee might not be necessary to investigate that misconduct; an examiner could instead serve that function without displacing management. [FN49] What is not clear, however, is who or what constitutes "former management."

While much of the focus in recent scandals has been on chief executive officers, chief financial officers, and other top officers of corporations, the fact remains that real management authority of a corporation rests with its board of directors. For instance, under Delaware law, the board of directors is responsible for management of a corporation's affairs: "The business of every corporation organized under this chapter shall be managed by or under the direction of a board of directors ...." [FN50] The officers of a corporation are agents of the board, but the board is ultimately responsible for their actions. [FN51]

Because a corporate officer is merely an agent of the board of directors exercising management powers delegated by the board of directors, the principles of agency law apply to the relationship between the officer and the board. A fundamental principle of agency law is that the principal at all times retains the power to revoke the authority of the agent. [FN52] A corporate board at all times retains the right to terminate the corporation's officers or to limit the officers' authority. Furthermore, as a general proposition, when a debtor is in possession, bankruptcy courts are not to involve themselves in issues of corporate governance absent evidence of clear abuse. [FN53]

In the prototypical case of the early 2000s involving a large corporation beset by serious allegations of pre-petition fraud, the corporation's top officers have generally been relieved of their responsibilities before the filing of the case, and the board of directors has named new officers to take their place. Generally speaking, most directors who were not also serving as officers retain their seats on the board, at least for some period of time. Whether the replacement of officers who are alleged to have committed fraud without a simultaneous replacement of the directors on whose watch that fraud occurred suffices to insulate the debtor in possession from a motion for ***300** the appointment of a chapter 11 trustee is open to serious question. [FN54]

2. *Interests of creditors, equity security holders, and others*

The second express ground for the appointment of a chapter 11 trustee is if such an appointment "is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor of the amount of assets or liabilities of the debtor ...." [FN55] Very limited legislative history exists to aid in the construction of this provision, and it did not appear as a standalone ground in any

proposed version of § 1104 until the compromise version that was adopted. The Senate bill had proposed a similar standard for the appointment of a trustee in a nonpublic company - the court was to appoint a trustee if the interests of the estate and its security holders would be served thereby. [FN56] The language of the statute provides little guidance. It is clear, however, that the court is called upon to weigh the interests of all constituencies in the case, and not just those of creditors. "Where the debtor's business effects such a large segment of the general public, consideration of the 'public interest' becomes a greater factor in deciding whether to order the appointment of a trustee" under subsection (a)(2)." [FN57] In weighing the myriad interests, courts have considered factors such as the trustworthiness of the debtor, its past and present performance and prospects for rehabilitation, and the confidence (or lack thereof) of the business community and creditors in present management. [FN58] In a liquidating chapter 11 case, however, "there is no need to balance the appointment of a trustee [under section 1104(a)(2)] with the present management's ability to run the company." [FN59] The existence of significant causes of action against insiders, especially when combined with the absence of ongoing business operations requiring the presence of current management, has been held to warrant a trustee appointment under (a)(2). [FN60] The question to ask in these instances is whether management is in a position to exercise undivided loyalty to the rights of all interested parties, and the debtor's goal of rehabilitation. [FN61] A high level of acrimony between a debtor's management and its creditors can lead to a trustee appointment under (a)(2), ***301** particularly if that acrimony is hampering the prospects of rehabilitation. [FN62] A debtor in possession's inability to sue its insiders or others has been held to justify appointment of a chapter 11 trustee. [FN63] Commentators have suggested that, given the non-exclusive definition of "cause" in subsection (a)(1), few instances will arise where a court would order the appointment of a trustee under subsection (a)(2) where the appointment could not also find cause under subsection (a)(1). [FN64]

3. *Alternative to Conversion or Dismissal*

The third ground for the appointment of a trustee was added by BAPCPA. The court is to order the appointment of a chapter 11 trustee "if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate." [FN65] BAPCPA amended § 1112 of the Bankruptcy Code to make conversion or dismissal of chapter 11 cases mandatory if the court determines that "cause" exists. "Cause" is now defined to include a substantial number of acts and failures to act by a debtor. [FN66] If, for instance, a debtor in possession fails to timely pay post-petition taxes, [FN67] the court *must* order the conversion or dismissal of the case unless the debtor in possession or another party establishes that there is a reasonable likelihood that a plan will be timely confirmed and that the failure to pay taxes was reasonably justified and will be cured within a reasonable period of time fixed by the court. [FN68]

New § 1104(a)(3) seems to have been included in BAPCPA to provide the courts with additional flexibility in cases that otherwise would be subject to conversion or dismissal. The court may determine that the appointment of a trustee is in the best interests of creditors and the estate and order such an appointment in lieu of converting or dismissing the case. This section does, however, give rise to a procedural issue. If a court, at the conclusion of a hearing on a motion to convert or dismiss, decides that a trustee appointment is appropriate under § 1104(a)(3), may the court direct the appointment immediately or must additional notice be given to parties in interest? Sections 1104 and 1112 both require "notice and a hearing," Under the Bankruptcy Code, "after notice and a hearing" means "after such notice as is appropriate ***302** in the particular circumstances and such opportunity for a hearing as is appropriate in the particular circumstances ...." [FN69] Under the Bankruptcy Rules, the debtor, all creditors, and indenture trustees must be given at least 20 days notice of the hearing on a motion to convert or dismiss a chapter 11 case. [FN70] This

notice could arguably be sufficient to alert parties in interest to the possibility that the court might order a trustee appointment in lieu of converting or dismissing the case. [FN71] Any question about the adequacy of notice could be resolved, however, by including a reference to a trustee appointment as an alternative remedy in the prescribed form of notice.

B. EXAMINER

Section 1104(c) [FN72] of the Bankruptcy Code governs the appointment of examiners. There are two express grounds for the appointment of an examiner "to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor ...." [FN73] As will be discussed below, there now appears to be a third ground for the appointment of an examiner that is not readily ascertainable upon a quick perusal of the statute. An examiner cannot be appointed if the court has ordered the appointment of a chapter 11 trustee, and an examiner appointment must predate the confirmation of a plan. [FN74]

1. *Interests of creditors, equity security holders, and others*

Under § 1104(c)(1), the court "shall" order the appointment of an examiner if "such appointment is in the interests of creditors, any equity security holders, and other interests of the estate." [FN75] This language is identical to the second ground for the appointment of a trustee. While the statute uses the mandatory "shall," as a practical matter courts have broad discretion to determine whether the facts and circumstances of a particular case warrant the appointment of an examiner. In fact, no district court or court of appeals decision has been reported that reversed a decision by a bankruptcy court either appointing or declining to appoint an examiner under subsection (c)(1).

***303** Courts often order appointments under subsection (c)(1) as a less drastic remedy in response to a motion seeking the appointment of a chapter 11 trustee. Certainly, an examiner appointed under these circumstances could appropriately investigate and advise the court whether the appointment of a trustee was warranted. Furthermore, as is discussed below, courts have been imaginative in fashioning roles for examiners to alleviate concerns over management practices while leaving the debtor in possession. [FN76]

2. *Mandatory appointment of examiner*

Under 11 U.S.C. § 1104(c)(2), the court "shall" order the appointment of an examiner if "the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000." [FN77] As was discussed above, this subsection was a last minute compromise to provide some mandatory protection to parties in interest in public cases. [FN78]

While the use of specific debt levels to establish entitlement to a mandatory examiner might seem an odd way to identify public cases, this mechanism seems to have worked well. Only one reported decision discusses whether a particular debtor's obligations were fixed, liquidated, unsecured debts other than debts for goods, services, or taxes, and the court in that case had no difficulty deciding the issue. [FN79] Virtually all other cases appear to have involved debentures and unsecured bank debt about which there can be little controversy.

Rather than contend over whether the debt threshold has been met in a case, parties and courts have frequently contended over whether an examiner appointment under § 1104(c)(2) is in fact mandatory, or whether the court retains the discretion to decline to appoint an examiner. While there has been a split of authority on the issue, [FN80] the better reasoned decisions give ***304** effect to the mandatory "shall" and the legislative history and direct the appointment of an examiner where the proponent of the appointment establishes that the debt threshold is met.

3. *Alternative to Conversion or Dismissal*

While § 1104(c) has only two subsections, it appears that BAPCPA was intended to provide an additional ground for the appointment of an examiner. As was discussed above, [FN81] BAPCPA added a new § 1104(a)(3) to provide for the appointment of a trustee "if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee *or an examiner* is in the best interests of creditors and the estate." [FN82] As drafted, the statute could lead to an anomalous result - the court might determine that an examiner should be appointed in lieu of conversion or dismissal, but the statute directs the court to appoint a trustee instead. That Congress intended to provide for the appointment of an examiner under these circumstances is clear from the legislative history:

> Section 442(b) [of BAPCPA] creates an additional ground for the appointment of a chapter 11 trustee or examiner under section 1104(a) [*sic*]. It provides that should the bankruptcy court determine cause exists to convert or dismiss a chapter 11 case, it may appoint a trustee or examiner if it is in the best interests of creditors and the bankruptcy estate. [FN83]

Accordingly, one may construe the BAPCPA amendment to give the courts discretion to appoint either a trustee or examiner under § 1104(a)(3) based upon the facts and circumstances of each particular case.

III. DUTIES AND POWERS OF CHAPTER 11 TRUSTEES AND EXAMINERS

A. DUTIES AND POWERS OF A CHAPTER 11 TRUSTEE

Section 1106(a) of the Bankruptcy Code defines the principal duties of a trustee under chapter 11. [FN84] Additional trustee duties are sprinkled throughout***305** the Bankruptcy Code. [FN85] In addition to these duties, the chapter 11 trustee has broad powers under numerous other sections of the Code. Among these powers are: the power to avoid certain transfers under §§ 544 - 550; the power to assume or reject executory contracts under § 365; the power to obtain credit under § 364; the power to use, sell, or lease property of the estate under § 363; the power to retain professionals under § 327; and the authority to operate the debtor's business under § 1108.

While a trustee's exercise of many of these powers is subject to court approval, only two provisions of the Bankruptcy Code enable the court to limit the authority of a chapter 11 trustee. First, § 1106(a)(3) requires that a trustee perform a broad investigation of the debtor "except to the extent that the court orders otherwise." [FN86] This gives the court the discretion to limit the trustee's investigation as is appropriate under the facts of a particular case. If, for instance, a trustee is appointed on the heels of an examiner's report finding that the debtor's management had engaged in substantial fraud, it would ***306** certainly make sense for the court to order the trustee not to conduct a duplicative investigation. [FN87] Second, the court may order, on request of a party in interest and after notice and a hearing, that the trustee not operate the debtor's business. [FN88] An order that a chapter 11 trustee not operate a debtor's business would not restore the operation of the business to the debtor's management; instead it would simply close down the business. The trustee would retain all other rights and prerogatives of a trustee under chapter 11.

Notwithstanding the Bankruptcy Code's broad devolution of powers, rights, and duties to chapter 11 trustees, some courts have authorized the appointment of "trustees with limited powers." [FN89] These decisions have typically arisen in cases where the success of the debtor corporation's business was entirely bound up in the talents of one individual who for some reason cannot be trusted to exercise the fiduciary duties of a debtor in possession. For instance, the principal of the debtor in *Nartron* [FN90] was by all accounts a highly talented engineer who led his company in the development and production of innovative high-end auto-

motive accessories. The court found that the engineer had been as litigious as he was talented. The court's opinion exhaustively recounted the events underlying a number of lawsuits, and expressly found that the behavior of the engineer in connection with that litigation and his failure to comply with the duties imposed upon a debtor in possession constituted cause for the appointment of a trustee under § 1104(a)(1). [FN91] Having reached this conclusion, however, the court decided to grant the trustee only limited powers. It based this decision on its conclusion that the complete ouster of the engineer would be detrimental to creditors and that his continued cooperation in and management of the debtor's day-to-day business operations were important to the debtor's survival. [FN92] The court therefore ordered the appointment of a trustee to be responsible for:

> all matter such as financial management and accountability, expenditure of estate assets, and ongoing payments, if any, to insiders, and the investigation and litigation of all estate causes of action against insiders or third parties, resolution of ***307** [a major creditor's] pre-petition unliquidated claim, and if feasible, the filing of a Disclosure Statement and Plan of Reorganization. [FN93]

While the concerns of the courts in *Nartron* and similar cases are certainly understandable, the limitation of the powers of a trustee is neither appropriate under the law nor necessary to assure the continued involvement of insiders in the operation of the debtor's business. Most decisions authorizing the appointment of a trustee with limited powers have done so without analysis. In recent years, however, the courts in *Nartron* and *Intercat* [FN94] have set forth identical analyses to support their decision to limit the trustee's powers. First, the decisions point out that § 1107 gives the debtor in possession the rights and powers of a trustee "subject to such limitations or conditions as the court prescribes." The decisions then cite to § 1108 for the proposition that "unless the court orders otherwise" the trustee may operate the debtor's business. They point out that the debtor in possession has this same right. Finally, both decisions conclude that these two statutes "grant the court broad authority to tailor and define the rights of a debtor-in-possession or a trustee if one is appointed to operate the debtor's business." [FN95]

This reasoning appears to be a misreading of the Bankruptcy Code. Section 1108 does not give courts the authority to micromanage the operation of the debtor's business. It is best viewed as an "on-off" switch. Section 721 requires that the court specifically authorize a chapter 7 trustee to operate the debtor's business. The switch therefore defaults to off in chapter 7, but the court may turn it on. On the other hand, in chapter 11, § 1108 provides that the switch defaults to on, but that the court may turn it off. Nothing in § 1108 provides for a limitation on a trustee or debtor in possession's operation of the business other than an outright prohibition. [FN96]

Under § 1107(a)(1), however, a court may limit the authority of a debtor in possession to operate the business or to perform other duties or exercise other rights. Of course, § 1107(a)(1) by its terms applies only to debtors in possession, and not to trustees. If a court does limit the debtor in possession's ***308** duties or powers, the proper officer upon whom to devolve those powers is not a trustee. It is an examiner. Section 1106(b) states: "An examiner appointed under section 1104(d) of this title shall perform the duties specified in paragraphs (3) and (4) of subsection (a) of this section, and, except to the extent that the court orders otherwise, *any other duties of the trustee that the court orders the debtor in possession not to perform*." [FN97] It is therefore clear that a court may order an examiner to perform certain trustee duties that it does not believe should be performed by the debtor in possession. But nothing in this analysis leads to the conclusion that a chapter 11 case can simultaneously have both a trustee and a debtor in possession. Furthermore, nothing lends credence to the idea that the court may limit the authority of a trustee except to the extent explicitly provided in the Bankruptcy Code.

Furthermore, while the appointment of a chapter 11 trustee divests a debtor's management of all authority and control over the debtor's estate, the appointment need not result in the complete displacement of a debtor's day-to-day management. The person appointed to serve as trustee should have the knowledge and qualifications to allow him or her to exercise sound business judgment in deciding whether and on what terms to hire any members of former management. A trustee is given a limited briefing about the case before his or her selection and a detailed briefing afterwards to provide the trustee with necessary information to make these and other decisions. While the insider might view a lesser role in the company as a bitter pill to swallow, the insider would nevertheless have the incentive to stay on the job if the trustee so desires. The insider's financial well-being would likely rise or fall with the success of the debtor.

B. DUTIES OF AN EXAMINER

Section 1106(b) prescribes an examiner's primary duties:

> An examiner appointed under section 1104(d) of this title shall perform the duties specified in paragraphs (3) and (4) of subsection (a) of this section, and, except to the extent that the court orders otherwise, any other duties of the trustee that the court orders the debtor in possession not to perform. [FN98]

Because of its multiple explicit and implicit cross-references, this subsection obviously tells the reader next to nothing standing alone. Section 1104(a)(3) requires the examiner "except to the extent that the court orders otherwise, [to] investigate the acts, conduct, assets, liabilities, and financial condition of ***309** 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." [FN99] A broader scope of investigation can hardly be imagined. While the court can, pursuant to the terms of the statute, limit the investigation to some extent by "ordering otherwise," both the statutory language and the legislative history establish that an examiner's primary duty is to investigate the debtor. [FN100] A court would abuse its discretion if it were to order the appointment of an examiner but then enter an order restricting the examiner from performing a meaningful investigation of the debtor and its affairs.

Under § 1106(a)(4), an examiner, having performed an investigation, is to "file a statement" of the investigation and to provide a copy or summary of that statement to official committees serving in the case, to any indenture trustee, and to any other entity designated by the court. [FN101] An examiner's statement, which is commonly denominated a "report," must include "any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor ...." [FN102] This statutory mandate is closely linked to § 1104. Section 1104(c) states that an examiner is to perform "such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor ...." [FN103] Furthermore, the specifications of what constitutes "cause" for the appointment of a trustee under § 1104(a)(1) include "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management ...." [FN104]

The examiner's duty to report on fraud and similar conduct is independent of any limitations that the court places on the scope of the examiner's investigation under § 1106(a)(3). If an examiner uncovers wrongdoing by a debtor's management while conducting an investigation, that wrongdoing must be disclosed in the examiner's report. If the wrongdoing is by current management, the report could serve as the basis for a motion seeking the appointment of a chapter 11 trustee under § 1104(a)(1).

An examiner's report must also disclose facts related to "a cause of action available to the estate...." [FN105] Again, this obligation is independ-

ent of the ***310** scope of the examiner's investigation. If an examiner's report discloses a cause of action that is not being pursued by the debtor in possession, the creditors' committee or some other entity may seek permission to pursue that action on behalf of the estate.

In addition to the explicit duties to investigate and report, an examiner may have additional duties arising from limitations placed by the court on a debtor in possession. Section 1107(a) of the Bankruptcy Code prescribes the rights, powers, and duties of a debtor in possession:

> (a) Subject to any limitations on a trustee serving in a case under this chapter, *and to such limitations or conditions as the court prescribes*, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106 (a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter. [FN106]

Section 1106(b) provides that, unless the court provides otherwise, an examiner is to perform "any other duties of the trustee that the court orders the debtor in possession not to perform." [FN107] Based upon this statute, many courts have vested examiners with a wide variety of powers. In the face of this statutory scheme, courts have paradoxically shown a reluctance to permit examiners to exercise their explicit investigatory powers while fashioning innovative roles for examiners. The attempts to limit the examiner's investigatory role are discussed below. [FN108] Among the expanded powers which courts have granted to examiners have been: prosecutor of estate causes of action; [FN109] corporate manager; [FN110] mediator; [FN111] and, interestingly, "special master." [FN112] ***311** Other courts have thrown caution to the wind and granted an examiner powers so broad that the examiner became a quasi-trustee. [FN113]

This aggressive creativity in fashioning non-investigatory roles for examiners may be attributable to two related factors. The first is the reluctance of some courts to order the appointment of a chapter 11 trustee. It would seem that the refusal of a debtor in possession to pursue a valuable cause of action on behalf of its estate might well constitute cause for the appointment of a trustee, but the visceral antipathy of some courts to trustee appointments leads them to explore what they view as less intrusive alternatives, such as allowing an examiner to pursue the cause of action in the debtor's stead.

The second factor that seems to underlie these decisions arises from the understandable desire of courts to make cases "work." A lot can ride on the outcome of a chapter 11 case. Under the Bankruptcy Code courts are not permitted to become involved in the day-to-day operation of cases, but bankruptcy judges are sometimes among the persons best situated to spot ongoing problems. By directing the appointment of examiners to perform discrete roles, such as to serve as a plan facilitator or mediator, a court seeks to assure the success of cases before it. This is a laudable goal, and not necessarily inappropriate. Fact specific determinations must be made in each case over what duties an examiner should be granted, and there is a continuum ranging from an examiner who does nothing but investigate to one who is for all intents and purposes a trustee. But it must be recognized that there is a line on that continuum that should not be crossed, because examiners vested with extremely broad non-investigatory roles may in many ways be quite like special masters, the appointment of which is prohibited in bankruptcy cases. [FN114]

We do not suggest that examiners should never do anything other than investigate and report. Indeed, § 1106(b) by its terms countenances a flexibility in allocating trustee duties between an examiner and a debtor in possession. We do believe, however, that both the language of the statute and the legislative history dictate that the primary role of an examiner should be investigative, and that a properly conducted independent examiner's investigation can aid immeasurably in the administration of a chapter 11 case.

***312** IV. TRUSTEES AND EXAMINERS AFTER BAPCPA

While BAPCPA's most sweeping changes to the Bankruptcy Code affected consumer cases, the changes it made to chapter 11 were not insignificant. Several of the changes appear to reflect dissatisfaction with certain aspects of chapter 11 practice as it has developed under the Bankruptcy Code. For instance, new limits were placed on the time within which debtors in possession have the exclusive right to file a plan. The exclusivity period for debtors in possession other than "small business debtors" can no longer be extended beyond a date that is eighteen months after the date of the chapter 11 order for relief. [FN115] The ability of the debtor to obtain unlimited extensions of exclusivity had been identified as a source of significant leverage against creditors in the plan negotiation process. [FN116] To address concerns that corporate debtors have not expeditiously rehabilitated under chapter 11, § 1112(b) of the Code was amended to restrict the discretion of bankruptcy courts to excuse debtors' failure to comply with their requirements under the Code. Conversion or dismissal of a case is now mandatory upon a finding by the court of cause, [FN117] and the list of what constitutes "cause" was substantially lengthened. [FN118] As was discussed above, [FN119] § 1104 was amended to provide that, as an alternative to conversion or dismissal, the court may order the appointment of a chapter 11 trustee or examiner if that relief is in the best interests of creditors and the estate. [FN120]

BAPCPA was amended in committee less than two months before its final passage to reflect additional Congressional concerns about management abuses in chapter 11. [FN121] In one amendment, Congress substantially limited the increasingly-prevalent practice whereby debtors adopted "key employee retention plans," or KERPs, that provided healthy bonuses to top management in exchange for their agreement to stay on the job. [FN122] Before BAPCPA, ***313** courts routinely approved such retention plans under the "business judgment" rule governing the debtor's use of estate property under § 363 of the Code. [FN123] Section 503(c) of the Code, added by BAPCPA, severely limits KERPs and severance packages for insiders of debtors. Observers accurately predicted that debtors' counsel would seek to avoid these limitations by recasting KERPs as performance-based awards. [FN124] In a recent decision, a bankruptcy court concluded that an alleged incentive bonus for top management was a disguised KERP because the management goals were set so low that all the managers had to do to earn the bonuses was to stay on the job. [FN125]

The second late amendment to BAPCPA dealing with corporate management was the addition of § 1104(e). It provides:

> The United States trustee shall move for the appointment of a trustee under subsection (a) if there are reasonable grounds to suspect that current members of the governing body of the debtor, the debtor's chief executive or chief financial officer, or members of the governing body who selected the debtor's chief executive or chief financial officer, participated in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor's public financial accounting. [FN126]

This provision appears to have been added in response to major corporate fraud scandals that resulted in chapter 11 filings, such as those involving Enron, WorldCom, and Adelphia. [FN127] Trustees were not appointed in any of these cases despite overwhelming evidence of financial fraud by prepetition management. Commentators have been very critical of what they view as machinations designed to avoid the appointment of trustees in such cases. [FN128] While some of these criticisms have themselves been the source of significant controversy, [FN129] they seem to have resonated with Congress and may have resulted in the adoption of § 1104(e). The importance Congress assigned to ***314** § 1104(e) is highlighted by the fact that, unlike almost all of BAPCPA, it became effective upon enactment or on April 20, 2006. [FN130]

A. THE APPOINTMENT OF CHAPTER 11

TRUSTEES AFTER BAPCPA

How the adoption of § 1104(e) might change the status quo related to chapter 11 trustee appointments can be considered only in light of how case law developed after the adoption of the Bankruptcy Code. In the years immediately following the enactment of the Code, courts rendered opinions that arguably interpreted the compromise language in § 1104(a) as if the House bill, with its emphasis on cost/benefit analysis and court discretion, had passed unchanged. As early as 1980, a bankruptcy court asserted that the appointment of a trustee pursuant to § 1104(a)(1) was an "extraordinary remedy" and, instead of determining if cause existed for the appointment of a trustee, analyzed whether the appointment of a trustee pursuant to that subsection was in the best interests of creditors. [FN131] Another court noted that there is a presumption under the Bankruptcy Code that the debtor will remain in possession. [FN132] From this rather unremarkable proposition other courts derived the principle that there is a "strong presumption" that a debtor should remain in possession. [FN133] Finally, other courts derived, apparently without supporting authority, the principle that "cause" under § 1104(a)(1) must be demonstrated by "clear and convincing" evidence. [FN134] So by the late 1990s it was considered settled law that the appointment of a chapter 11 trustee for cause was an extraordinary remedy against which there was a strong presumption; the proponent of such an appointment was required to establish cause by clear and convincing evidence. [FN135]

To further complicate the burden for a party in interest seeking the appointment of a trustee under § 1104(a)(1), the principle developed in some quarters that the appointment of a trustee under that subsection was not as ***315** mandatory as would appear from the statutory requirement that "the court *shall* order the appointment of a trustee ... for cause ...." [FN136] For instance, the court in *General Oil Distributors*, [FN137] while acknowledging that its discretion was more circumscribed under subsection (a)(1) than it was under subsection (a)(2), nevertheless engaged in a backdoor weighing of costs versus benefits in determining if cause existed for the appointment of a trustee. [FN138] In a similar decision, the court in *William A. Smith Constr.* [FN139] stated that a trustee should be appointed "only when the protection afforded by a trustee is needed and the costs and expenses of a trustee would not be disproportionately higher than the value of the protection afforded." [FN140]

The distaste for chapter 11 trustee appointments shown by many bankruptcy courts early in the development of the case law under the Code was perhaps to be expected, given their experience in presiding over chapter XI cases under the Bankruptcy Act. Trustee appointments under that chapter were quite rare, and experienced bankruptcy judges had gained their experience in a system where the appointment of a chapter X trustee was considered a major impediment to the rehabilitation of a business. Even though the compromise language in the Bankruptcy Code clearly contemplated that trustee appointments would be forthcoming in cases where there is substantial evidence of fraud or gross mismanagement, these early decisions have served as the backbone for a trustee jurisprudence that has often made it very difficult to obtain the appointment of a chapter 11 trustee in a case where such an appointment would seem warranted. By enacting § 1104(e) in 2005, Congress must at a minimum be seen having reaffirmed its determination to assure that trustees are appointed in cases that result from substantial fraud.

Section 1104(e) mandates that the U.S. Trustee file a motion seeking the appointment of a trustee if reasonable grounds exist to suspect that current members of management or the debtor's governing body have participated in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor's public financial reporting. [FN141] Section 1104(e) clearly does not establish a new ground for the appointment of a trustee; the U.S. Trustee must allege and prove a ground for the appointment of a trustee under ***316** § 1104(a). It therefore makes little sense for Congress to have required the U.S. Trustee to file a motion under § 1104(a) based only upon "reasonable grounds to

suspect" fraud or other dishonest conduct if the motion may be granted by the court only if the U.S. Trustee is able to produce clear and convincing evidence in support of the motion. The adoption of § 1104(e) therefore calls for a reexamination of the case law that established this heightened level of proof.

There was never a basis in the Bankruptcy Code or in legislative history for the conclusion that the appointment of a chapter 11 trustee is an extraordinary remedy against which there is a strong presumption and which can be granted only on the basis of clear and convincing evidence. There is certainly a presumption inherent in the Bankruptcy Code that a debtor will remain in possession, because a movant seeking a trustee under § 1104(a) has the burden of proof. If, however, the proper burden of proof is the preponderance of the evidence instead of clear and convincing, then this presumption is no stronger than the presumption enjoyed by every civil litigant who does not have the burden of proof. It appears that the clear and convincing burden was created by courts in response to earlier decisions that took the ordinary presumption and made it "strong" based on no real authority. In other words, they seem to have reasoned that, because the presumption is stronger than usual, more than the usual amount of evidence would be required to overcome the presumption. [FN142] Because there is no basis for a stronger presumption, there is no basis for a heightened burden of proof.

A recent decision directly held that the proper burden of proof for the appointment of a chapter 11 trustee is preponderance of the evidence and not clear and convincing evidence. In *Tradex*, [FN143] the district court, in considering an appeal from an order authorizing the appointment of a trustee, found that Supreme Court precedent "suggests that the reflexive endorsement of a demanding 'clear and convincing' evidentiary burden regarding trustee appointment under § 1104 is anomalous." [FN144] The court relied heavily on the Supreme Court's decision in *Grogan v. Garner*. [FN145] In *Grogan*, the Supreme Court unanimously held that a creditor seeking to except its claim from discharge for false pretenses or fraud pursuant to 11 U.S.C. § 523(a)(2)(A) need only establish its right to the exception by a preponderance of the evidence. The Court concluded that the absence of anything in the statute or the legislative history mandating a higher burden of proof "is inconsistent with the ***317** view that Congress intended to require a special, heightened standard of proof." [FN146] The Court went on to presume that the preponderance of the evidence standard is applicable in civil actions between private litigants unless particularly important individual interests or rights are at stake. [FN147] The *Tradex* court concluded that no such interests were at stake in a motion seeking the appointment of a chapter 11 trustee, and accordingly concluded that the preponderance of the evidence standard was appropriate for § 1104 motions. [FN148]

The appellant in *Tradex* sought to distinguish trustee motions from exceptions to discharge by citing to case law discussing the "strong presumption" that a debtor should remain in possession. The court made short shrift of this argument:

> Turning back to the implied foundation of the "presumption" that current management can best run the debtor's business and its implications for a "clear-and-convincing" standard in the lower court case law, it must be recognized that if what is ordinarily true is equated with a strong presumption, then a presumption is triggered in almost all civil contexts. People are not normally negligent, and one could say it is "extraordinary" when individuals are "grossly" negligent, but that has not warranted a heightening of the burden of proof in civil cases. [FN149]

Tradex appears to have been the first decision to fully and critically examine the "received wisdom" surrounding trustee appointments that developed after the adoption of the Bankruptcy Code. [FN150] In light of the enactment of § 1104(e), further reexamination of the statutory underpinnings of the case law under § 1104(a) is likely to occur in the upcoming years. Section 1104(e) focuses attention not only on corporate officers who committed

fraud, but also on the "governing body" who selected those officers; therefore, the common practice whereby a board of directors on whose watch fraud occurred replaces management with a restructuring professional immediately before filing in an effort to avoid a trustee appointment will likely come under scrutiny. A board of directors may plead ignorance of the fraud, but such a situation is generally an indication that, at a minimum, the board failed to exercise effective oversight over management. Whether a restructuring professional***318** retained by such a board will feel free to investigate fully the involvement of the board in fraud is subject to real doubt. [FN151]

If the enactment of § 1104(e) leads to an increase in motions seeking the appointment of chapter 11 trustees, parties opposing these motions are likely to advance several common arguments. One such argument is that the appointment of a trustee will add an additional layer of cost that will burden the bankruptcy estate. Courts have frequently recited cost as a factor militating against a trustee appointment. [FN152] The concern over cost is both legally irrelevant and overstated. While H.R. 8200 required an explicit cost-benefit analysis for all trustee appointments, that weighing test disappeared from the compromise version of § 1104 enacted in 1978. [FN153] While the discretionary standard for appointment under subsection (a)(2) is certainly broad enough to enable a court to consider cost, the proper analysis under subsection (a)(1) should be limited to whether cause exists. Cost should not factor into the equation. [FN154]

Even if cost is to be considered, it appears that concerns over additional cost are somewhat exaggerated. There is nothing cheap about a major chapter 11 case in today's legal environment. The modern paradigm involves the retention by the debtor, either immediately before or immediately after filing, of a highly-compensated chief restructuring officer. That officer will often arrive on the scene with a team of professionals billing at substantial hourly rates who will either supplant or supplement the debtor's pre-petition management. A chapter 11 trustee will, at a minimum, replace a senior officer of the debtor. So the cost of the trustee must be balanced against the compensation***319** of that officer. In deciding whom to appoint as trustee, the U.S. Trustee consults with creditors and others about the role the trustee should play in a case. If the debtor is actively operating its business, the U.S. Trustee will often appoint a person with the business acumen to oversee the rehabilitation of the business. If, on the other hand, the case is a liquidation in which a substantial amount of litigation is anticipated, a trustee with investigative and litigation experience might well be appointed. In either case, however, the trustee will bring real value to the case that must be balanced against any additional costs the trustee's appointment might engender. In addition to providing value to the estate, the appointment of a trustee can result in the lowering of other administrative costs. A creditors' committee certainly will not need to be as aggressive in pursuing investigations, as an independent trustee does not require the same degree of oversight as a debtor in possession. Furthermore, the trustee will be able to pursue all estate causes of action without regard to who the defendant is, eliminating the need to divide litigation responsibilities between the estate representative and the committee. In any event, the compensation of a trustee is subject to review for reasonableness under the standards enunciated in 11 U.S.C. § 330(a)(3). [FN155]

A second concern frequently expressed over the appointment of a chapter 11 trustee is that it will cause inefficiency in the administration of the estate. Of course, if cause exists for the appointment of a trustee under § 1104(a)(1), any inefficiency that such an appointment might cause is simply a consequence of the application of the law. But a trustee appointment need not cause major disruptions in case administration. In liquidation cases, parties frequently plead that an early motion to appoint a trustee will disrupt asset sales under § 363; if the motion is delayed until such sales are closed, parties then argue that new management and professionals are so invested in the case that their replacement will harm creditors. If, however, a motion seeking the appointment of a trustee is filed soon after filing of case and considered expedi-

tiously, this inefficiency should be minimal, assuming that the professionals being replaced are willing to work with the trustee on the transition. The trustee should be able to retain the debtors' professionals for a period of time ***320** to share information with the trustee and the trustee's professionals and to close transactions like asset sales that are underway. [FN156] In a case with an ongoing business, a trustee may avoid inefficiencies by retaining key employees after assuring that they are not implicated in the misconduct that led to the trustee's appointment.

A final concern often expressed by both parties and courts is that the appointment of a chapter 11 trustee will result in the premature termination of the debtor's exclusive right to file a plan. When presented with a motion to appoint a chapter 11 trustee, some bankruptcy courts have noted that such relief would terminate the debtor's exclusive periods under 11 U.S.C. § 1121. [FN157] Courts that deny motions to appoint chapter 11 trustees because such relief would terminate the debtor's exclusivity put the proverbial cart before the horse. Exclusivity is a privilege enjoyed by honest management that diligently moves the reorganization process towards its intended goal - a chapter 11 plan that maximizes and passes value to stakeholders. Under 11 U.S.C. § 1121(c)(1), Congress has clearly indicated that exclusivity has no value when it is decoupled from effective management; after a chapter 11 trustee is appointed, exclusivity terminates. Accordingly, the argument that questionable management should be left in place to keep the plan process moving in some direction is a *non sequitur*.

In any event, recent legislative efforts to limit exclusivity demonstrate a concern that cases are not moved expeditiously and costs are multiplied because parties have less incentive to quickly reach an accommodation. Furthermore, it is questionable whether the debtor in possession should retain an exclusive right to file a plan in a liquidation/litigation case where pre-petition management has been ousted because of the specter of fraud or serious mismanagement. Under these circumstances, new management should have no greater claim to the enhanced bargaining power given the debtor in possession by the exclusive period than a trustee would.

***321** B. THE APPOINTMENT OF EXAMINERS UNDER BAPCPA

While no provision of BAPCPA expressly changed the Bankruptcy Code with respect to examiners (with the implied exception of § 1104(a)(3) [FN158]), the intent of Congress to require close independent scrutiny of the chapter 11 process, as evidenced in §§ 1104(e) and 503(c)(1), should cause a reevaluation of the proper role of chapter 11 examiners. Examiners have been appointed in a number of major chapter 11 cases since 2000, and they have played major roles in investigating pre-petition misconduct that led to the filing of some of the most notorious cases arising from corporate fraud, such as those of Enron and WorldCom. Congress was certainly aware of the vital role examiners played in these cases; indeed, the WorldCom examiner testified about his investigation at a Senate Judiciary Committee hearing. [FN159] Nevertheless, as with trustees, some courts have been reluctant to order the appointment of an examiner, particularly one with a broad scope of investigation. Because the appointment of an examiner under § 1104(c)(1) is inherently within the courts' discretion, one is not likely to find a case where the court finds grounds for an examiner appointment under that subsection but then circumscribes the examiner's duties. Accordingly, the real conflicts over the proper role of an examiner have occurred in cases where an examiner appointment was sought pursuant to § 1104(c)(2).

While some courts have held that the appointment of an examiner under § 1104(c)(2) is not mandatory, [FN160] generally courts will obey the statutory mandate. A number of courts, however, have asserted that they have broad discretion to severely limit the scope of the required examination. These cases follow a common fact pattern. A party seeks the appointment of an examiner under § 1104(c)(2) for an arguably improper purpose, typically very

late in the case. [FN161] The request for an examiner will often appear to be a litigation tactic. The decisions use broad language about the court's discretion to tailor the scope and cost of the examination, based upon the language in § 1104(c) that the court shall order the examiner to conduct "such an investigation of the debtor as is appropriate ...." While some limitation of ***322** the scope of the examination might be appropriate in cases such as these, the decisions are frequently cited by parties seeking to limit an examiner's investigation in other cases where there is no doubt that a full examination of the type envisioned by Congress is appropriate.

The imposition of strict limitations on the scope of an examination in a case where the appointment of an examiner is required under § 1104(c)(2) runs counter to the intent and structure of the Bankruptcy Code. Professors Warren and Westbrook recently analyzed how courts have set the scope of examinations and concluded that it does not comport with either the language of the statute or the legislative intent:

> The history and structure of [§§ 1104(c) and 1106(b)] make it clear that the examiner is not like the plumber or carpenter who is called in to check for a leak or a rotten board, but an engineer charged with examining the entire structure and making recommendations about what to do about it. The courts have dealt with this provision as if the examiner were a sort of special counsel appointed to do some discrete job rather than to provide a replacement for the investigation and recommendations of a trustee in an appropriate case. The court's job in smaller cases is to determine whether the case is appropriate for that treatment. In a case with more than $5 million in debt, its job is to order appointment of the examiner. In both instances, the court has the further discretion to exclude certain of the examiner's duties under § 1106(a)(3)-(4) or to expand them under § 1107(b), but that is very far from defining those duties starting at zero - an approach that has been typical up to now. [FN162]

A broad scope of examination is particularly appropriate when an examiner is appointed under § 1104(c)(2) in a case involving substantial allegations of pre-petition fraud. Under the plain meaning of the statute a court's discretion to remove from the scope of an examiner's investigation credible allegations of pre-petition or post-petition fraud by the debtor is quite limited. The statute commands that an examiner perform an appropriate investigation and singles out allegations of fraud and abuse as an example of the type of examination that is appropriate. Furthermore, any report filed by an examiner must include "any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor ...." [FN163] If, therefore, a party in interest requests the ***323** appointment of an examiner under §1104(c)(2) and points to substantial evidence of debtor fraud or misconduct, a court must permit the examiner to look into those allegations.

The presence of an active creditors' committee in a case should not be used as a reason to limit the scope of the investigation of an examiner appointed under § 1104(c)(2). The creation of a "zero-sum game" where such an examiner would investigate only what the committee was not investigating would give rise to a paradox. In § 1104(c)(2), Congress mandated the appointment of an examiner in a case with large amounts of public debt. Yet it is precisely in such a case that a creditors' committee is most likely to be aggressive in pursuing its discretionary investigatory prerogatives under § 1103(c)(2). Congress clearly did not intend to require the appointment of an examiner who would do nothing simply because the creditors' committee was very active. If anything, legislative history supports the proposition that concerns over undue influence by major creditors in large reorganization cases underlay efforts by the SEC and others to assure that some meaningful independent investigation took place in such cases. [FN164] The examiner can relieve the committee of some of its investigatory responsibilities, particularly those related to litigation against third parties, so it can focus on ne-

gotiations toward the formulation of a consensual plan of reorganization.

Parties opposing an independent investigation frequently assert that an examiner's investigation will add no value to the estate. The delegation of the investigatory function to a party other than one who may pursue causes of action uncovered by the investigation is seen as inefficient. These arguments completely miss the point of having an independent examination. Unlike either the debtor or the committee, the examiner has no bias, and his duties do not run to any particular constituency. The examiner's report can be a road map for future litigation while serving as a brake against the expensive pursuit of fruitless causes of action. As one court stated:

> The benefit of appointing an independent examiner is that he or she will act as an objective nonadversarial party who will review the pertinent transactions and documents, thereby allowing the parties to make an informed determination as to their substantive rights. Often, the information that an examiner provides in his or her report serves as a road map for parties in interest as they evaluate and pursue their substantive rights.... In essence, an examiner's report paints a picture, his or her image of what happened in the case, and ends with that expert's opinion of what that story means, in legal ***324** terms. The report puts the story on paper and provides a context for debate. [FN165]

Finally, the argument that an examiner's report adds no value to the estate also discounts the value of a very public explanation of what happened in the case. Even in a public case that does not apparently involve fraud, disappointed investors are entitled to a clear, unbiased narrative of why the company ended up in chapter 11.

A number of issues can arise from the need for an examiner to coordinate the examiner's investigation with other investigations, both civil and criminal. These issues arose, to varying degrees, in connection with the examinations in the Enron and WorldCom cases. As examiner appointments become more common in cases arising from criminal conduct and securities violations, it is worthwhile to consider how these issues can be addressed to assure that an examiner's investigation can proceed without unduly hampering other investigations.

The issue of the timing of a mandatory examiner appointment under § 1104(c)(2) may arise. A party in interest or the U.S. Trustee may request an appointment very early in proceedings or instead let the dust from filing settle somewhat. The timing of the appointment can have an impact on both the coordination of investigations and the ability of an examiner to fulfill his or her statutory obligations. An early appointment has certain advantages. An examiner will have the maximum amount of time to investigate estate causes of action before statutes of limitations force a decision on whether they should be pursued. [FN166] Witnesses' recollection of events will be fresher, and evidence can be preserved. The ground rules for coordination of civil and criminal investigations can be set early to avoid any confusion that might later give rise to conflict. The examiner can quickly evaluate the pre-petition and post-petition conduct of current management to assure that grounds for the appointment of a trustee do not exist.

Certain advantages might also inhere in a later appointment. The examiner could take advantage of investigative efforts of others by using information developed by them. Such an appointment may reduce concerns about the disclosure of information that might compromise law enforcement investigations. On balance, however, it seems that the advantages of an early appointment will usually outweigh those of a later appointment.

In public company cases involving significant pre-petition fraud, law enforcement***325** and regulatory authorities are likely to be investigating the debtor before a chapter 11 petition is filed. It is important for the examiner to avoid interference with these investigations. A recent article discussed at length the interplay of investigations by the exam-

iner, the Department of Justice, and the S.E.C. in connection with the WorldCom fraud, and detailed the efforts of the Office of the Deputy Attorney General to coordinate those investigations in a manner that enabled each investigating entity to complete its task. [FN167] The selection of the proper person for appointment as examiner in a case such as WorldCom is vitally important. To ensure that proper lines of communication are established between prosecutors and the examiner, it is generally important that the examiner or someone on the examiner's staff be experienced in working with law enforcement authorities on criminal matters.

The early issuance by an examiner of interim reports might hamper prosecutions. The examiner is tasked with "telling the story," but "opening the door too fast" could adversely affect a criminal investigation. The examiner can avoid these problems by working with prosecutors by issuing sequential smaller reports on discrete issues that will not implicate criminal law enforcement concerns. Such sequential reports could address, for instance, causes of action for which a statute of limitations might be about to expire. Witnesses might be more willing to cooperate with the examiner because they would have less fear that their testimony would touch on subjects currently under criminal investigation. The examiner might also allow prosecutors and regulators to preview reports and to identify any material that might compromise ongoing investigations. If such a procedure is contemplated, the U.S. Trustee will carefully review the proposed order authorizing the appointment of the examiner to assure that the deadlines for reports do not make such sharing impracticable. Any procedure calling for the sharing of information between the examiner and prosecutors must be carefully tailored to avoid the violation of confidentiality provisions in document production orders and to avoid claims by criminal defendants that the examiner was working as a agent for the prosecutor by engaging in improper criminal discovery.

The examiner should establish early in the investigation a working relationship with the creditors' committee to avoid undue duplication. Ideally, the creditors committee should "stand down" any investigations of matters unless they are time-sensitive, such as litigation that must be brought before assets are placed beyond the reach of the court or issues that must be resolved before the development of a consensual plan of reorganization may proceed. The examiner can make appropriate arrangements to share the results***326** of document production requests and witness interviews with the creditors' committee, subject to constraints related to law enforcement activities.

CONCLUSION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 added important features to the law to correct imbalances in chapter 11 practice that evolved over the past quarter century since the last comprehensive bankruptcy reform law was enacted. These imbalances favored incumbent management at the expense of creditors and the public interest.

The new reform law increased management accountability through several provisions related to matters ranging from executive compensation to the exclusivity period for filing a plan of reorganization. As necessary adjuncts to achieve this objective of enhanced accountability, the law enhanced the ability of outside parties to seek trustees or examiners. In response to the 1938 Chandler Act's strong preference for a trustee over a debtor in possession, the 1978 Bankruptcy Code struck a balance so that debtor's management remained in control unless special circumstances warranted their ouster. Courts were required to order the appointment of examiners with a broad mandate upon request in larger cases. Over time, the pendulum of case law swung from the 1938 law's extreme bias against management to a bias in favor of incumbent management. Among other things, case law in many jurisdictions became results-oriented rather than statute-driven, imposed a heightened burden of proof on those seeking trustees, and altered the traditional roles of trustees and examiners.

By restoring the balance, the reform law should

help reestablish the trustee's and examiner's expansive mandates and independent character that were vitiated over the past 25 years. In turn, corporate debtors should be more responsive to constituencies in the case and the public interest. Robust use of trustees and examiners may lead to greater transparency in the bankruptcy process, more effective case administration, speedier and more comprehensive investigations of the financial condition of the debtor, and more expeditious resolution of the case.

Time will tell whether case law will reflect the new statutory reality or if practitioners will construct new and creative devices to work around the reforms. Almost assuredly, new imbalances will creep into the system as they have before each previous major reform law in modern bankruptcy history. But, in the meantime, the new bankruptcy reform law provides opportunities for improved chapter 11 case administration for the benefit of all stakeholders - including creditors, shareholders, and the general public.

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[FN1]. Pub. L. No. 109-8, 119 Stat. 23 (2005) ("BAPCPA").

[FN2]. 11 U.S.C. § 1104(e).

[FN3]. 11 U.S.C. § 1121(d)(2).

[FN4]. 11 U.S.C. § 503(c).

[FN5]. Act of July 2, 1898, 30 Stat. 544 ("the Bankruptcy Act") (repealed 1978).

[FN6]. For a full explanation of the development of equity receiverships from railroad insolvencies of the late 19th century, see Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 160-166 (2004); *see also* DAVID A. SKEEL, JR., DEBT'S DOMINION, 48-70 (2001).

[FN7]. SECURITIES AND EXCHANGE COMMISSION, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES: PART I, STRATEGY AND TECHNIQUES OF PROTECTIVE AND REORGANIZATION COMMITTEES (1937) (available at http://www.sechistorical.org/collection/papers/1930/1937_0510_SEC_003.pdf)

[FN8]. Act of March 3, 1933, 48 Stat. 1467.

[FN9]. Act of June 7, 1934, 48 Stat. 911.

[FN10]. Act of June 22, 1938, 52 Stat. 840.

[FN11]. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. No. 137, 93rd Cong., 1st Sess., 243-44 (1973) [hereinafter *Commission Report*].

[FN12]. Chapter X Rule 10-202(a).

[FN13]. *Id.*

[FN14]. Chapter X Rule 10-208(b).

[FN15]. Bankruptcy Act § 342 (repealed 1978).

[FN16]. Bankruptcy Act § 332 (repealed 1978). The requirement that a trustee remain in possession took effect only if the debtor had previously been adjudicated a bankrupt under another chapter of the Act and a trustee had been appointed under that chapter.

[FN17]. Bankruptcy Act §§ 146(2), 147 (repealed 1978).

[FN18]. Bankruptcy Act § 328 (repealed 1978).

[FN19]. SEC v. U.S. Realty & Improvement Co., 310 U.S. 434 (1940).

[FN20]. General Stores Corp. v. Shlensky, 350 U.S. 462 (1956).

[FN21]. *Commission Report, supra* note 7, at 246.

[FN22]. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468 (1970).

[FN23]. *Commission Report, supra* note 7.

[FN24]. *Commission Report, supra* note 7, at 247-48 (footnote omitted).

[FN25]. *Id*. at 248.

[FN26]. *Id*. at 251-53.

[FN27]. *Id*. at 253. The reference to "the administrator" relates to the Commission's proposal that an administrative agency be established to remove the court from many aspects of bankruptcy administration. This proposal ultimately lead to the creation of the United States Trustee Program.

[FN28]. *See* Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47, 68-70 (1997).

[FN29]. H.R. 8200, 95 Cong., 1 Sess. (1977) ("H.R. 8200").

[FN30]. H.R. 8200 § 101 (proposed § 1104):

> (a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court may order the appointment of a trustee only if- -
>
> (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.
>
> (b) If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court may order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, or gross mismanagement of the debtor of or by current or former management of the debtor, if- -
>
> (1) the protection afforded by an examiner is needed; and
>
> (2) the costs and expenses of an examiner would not be disproportionately higher than the value of the protection afforded.

[FN31]. H.R. Rep. No. 595, 95 Cong., 1 Sess. (1977) at 402.

[FN32]. *See* Leonard J. Gumport, *The Bankruptcy Examiner*, 20 CAL. BANKR. J. 71, 88-89 (1992).

[FN33]. S. 2266, 95 Cong., 2d Sess. (1978) ("S. 2266").

[FN34]. S. 2266 § 101 (proposed §§ 1101(3), 1104). Proposed § 1104 provided, in relevant part:

> (a) In the case of a public company, the court, within ten days after the entry of an order for relief under this chapter, shall appoint a disinterested trustee. In the event of a vacancy a successor shall be appointed by the court as soon as practicable. Section 1105 shall not apply to an appointment under this subsection.
>
> (b) In the case of a nonpublic company, at any time after the commencement of the case but before confirmation of a plan, on request of a party in interest and after notice and a hearing the court for cause shown may order the election or if the creditors do not elect a trustee the court may appoint a trustee. The court shall order the election, or if the creditors do not elect, the appointment of a trustee if such appointment would be in the

> interests of the estate and security holders. The creditor election permitted by this subsection shall be in the manner prescribed by and subject to the provisions of sections 702(a), 702(b), and 702(c) of this title.
>
> (c) If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest and after notice and a hearing, the court for cause shown may order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, or gross mismanagement of the debtor of or by current or former management of the debtor. The court shall order the appointment of an examiner if such appointment would serve the interests of the estate and security holders.

[FN35]. S. Rep. No. 989, 95 Cong., 2d Sess. (1978) at 10.

[FN36]. Pub. L. No. 95-598, 92 Stat. 2549 (1978) (the "Bankruptcy Code").

[FN37]. 11 U.S.C. § 1104(c)(1) (formerly § 1104(b)(1)).

[FN38]. 11 U.S.C. § 1104(c)(2) (formerly § 1104(b)(2)).

[FN39]. 124 Cong. Rec. S17417 (daily ed. October 6, 1978).

[FN40]. Bankruptcy Judges, U.S. Trustees, & Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088, § 222.

[FN41]. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106, § 211.

[FN42]. 11 U.S.C. § 1104(a)(3).

[FN43]. 11 U.S.C. § 1104(e).

[FN44]. 11 U.S.C. § 303(b) (an involuntary case is commenced by the filing of a petition).

[FN45]. *See* Escoe v. Zerbst, 295 U.S. 490, 493 (1935) ("shall" is the language of command; its use in a statute indicates intent that the statute should be mandatory).

[FN46]. 11 U.S.C. § 1104(a)(1).

[FN47]. 11 U.S.C. § 102(3). *See also* In re Savino Oil & Heating Co., Inc., 99 B.R. 518 (Bankr. E.D.N.Y. 1989).

[FN48]. *See infra* text accompanying notes 77-83.

[FN49]. H.R. Rep. No. 595, 95 Cong. 1st Sess. (1977) at 402.

[FN50]. 8 De.C. § 141(a).

[FN51]. Joseph Greenspon's Sons Iron & Steel Co. v. Pecos Valley Gas Co., 34 Del. 567, 156 A. 350 (1931).

[FN52]. *RESTATEMENT (SECOND) OF AGENCY* § 118. Even if the principal and agent have entered into a contract under which certain authority is delegated to the agent, the principal may revoke that authority at will, subject only to the right of the agent to seek damages for breach of contract. *Id*.

[FN53]. *In re* Johns-Manville Corp., 801 F.2d 60 (2nd Cir. 1986).

[FN54]. *See infra* text accompanying note 151.

[FN55]. 11 U.S.C. § 1104(a)(2).

[FN56]. S. 2266 § 101 (proposed § 1104(b)).

[FN57]. *In re* Ionosphere Clubs, Inc., 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990) (ordering appointment of chapter 11 trustee).

[FN58]. *Id*. at 168.

[FN59]. *In re* PRS Ins. Group, Inc., 274 B.R. 381, 388 (Bankr. D. Del. 2001).

[FN60]. *Id*. at 388-89.

[FN61]. *In re* Cohoes Ind. Terminal, Inc., 65 B.R. 918, 923 (Bankr. S.D.N.Y. 1986) (ordering appointment of chapter 11 trustee where debtor's principal attempted to function in conflicting capacities); *In re* Concord Coal Corp., 11 B.R. 552, 554 (Bankr. S.D. W.Va. 1981) (ordering appointment under section 1104(a)(2) where debtor's manager had competing business interests).

[FN62]. *In re* Marvel Entm't Group, Inc., 140 F.3d 463, 474 (3rd Cir. 1998).

[FN63]. PRS Ins. Group, 274 B.R. at 388-91. *See also In re* Oklahoma Refining Co., 838 F.2d 113, 1135-36 (10th Cir. 1988) (affirming appointment of trustee where chapter 11 debtor would have to sue affiliates for unpaid receivables).

[FN64]. *See, e.g.* COLLIER ON BANKRUPTCY ¶ 1104.02[d][iii] (15th ed. rev. 2006).

[FN65]. 11 U.S.C. § 1104(a)(3).

[FN66]. 11 U.S.C. § 1112(b)(4).

[FN67]. 11 U.S.C. § 1112(b)(4)(I).

[FN68]. 11 U.S.C. § 1112(b)(2).

[FN69]. 11 U.S.C. § 102(1).

[FN70]. Fed. R. Bankr. P. 2002(a)(4).

[FN71]. The Bankruptcy Rules do not require that notice of a motion seeking the appointment of a chapter 11 trustee be served on all parties in interest, and they do not specify a minimum notice period for a hearing on such a motion. This is understandable; in a truly egregious case of debtor misconduct, the delay occasioned by an extended notice period could enable a debtor's management to continue to misappropriate assets or to engage in other misconduct.

[FN72]. Before the Bankruptcy Reform Act of 1994, § 1104(c) was § 1104(b).

[FN73]. 11 U.S.C. § 1104(c).

[FN74]. *Id.*

[FN75]. 11 U.S.C. § 1104(c)(1).

[FN76]. *See infra* text accompanying notes 109-114.

[FN77]. 11 U.S.C. § 1104(c)(2).

[FN78]. *See supra* text accompanying notes 36-39.

[FN79]. *In re* Keene Corp., 164 B.R. 844 (Bankr. S.D.N.Y. 1994). In *Keene*, the court was faced with an unusual motion by a debtor seeking the appointment of an examiner in its own case. The debtor proffered evidence that it was a judgment debtor on a number of non-final judgments exceeding $11 million. The bankruptcy court found that this evidence was contradicted by the debtor's schedules that characterized these unbonded judgments as "contingent." Because the debtor was unable to explain this inconsistency, the court concluded that it could not find that the appointment of an examiner was mandatory under then § 1104(b)(2). *Id.* at 856.

[FN80]. *Compare In re* Revco D.S. Inc., 898 F.2d 498 (6th Cir. 1990) (appointment is mandatory under Section 1104(c)(2)); *In re* Loral Space & Communications, Ltd., 2004 WL 2979785 (S.D.N.Y., December 23, 2004) (same, reversing 313 B.R. 577 (Bankr. S.D.N.Y 2004); *In re* UAL Corp., 307 B.R. 80 (Bankr. N.D. Ill. 2004); *In re* Mechem Financial of Ohio, Inc., 92 B.R. 760 (Bankr. N.D. Ohio 1988) (same); *In re* The Bible Speaks, 74 B.R. 511 (Bankr. D. Mass.1987) (same); *In re* 1243 20th Street, Inc., 6 B.R. 683 (Bankr. D.D.C.1980) (same); *In re* Lenihan, 4 B.R. 209 (Bankr. D.R.I.1980) (same) *with In re* Rutenberg, 158 B.R. 230 (Bankr. N.D. Fla.1993) (examiner not mandatory where appointment would delay the administration of the case); and *In re* GHR Companies, Inc., 43 B.R. 165 (Bankr. D. Mass. 1984) (examiner not mandatory and not necessary as case did not involve public company). *See also In re* Bradlees Stores, Inc., 209 B.R. 36 (Bankr. S.D.N.Y. 1997), where the court held that creditors had waived their right to seek an examiner under 11 U.S.C. § 1104(c)(2); the creditors were fully aware that the

debtor was conducting a thorough and costly investigation and nevertheless waited until just before the expiration of a statute of limitations before seeking an examiner. *Id.* at 39.

[FN81]. *See supra* text accompanying notes 65-71.

[FN82]. 11 U.S.C. § 1104(a)(3).

[FN83]. H.R. REP. NO. 109-31, pt. 1, at 95 (2005).

[FN84]. (a) A trustee shall -

(1) perform the duties of a trustee specified in paragraphs (2), (5), (7), (8), (9), (10), (11), and (12) of section 704;

(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 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; and

(8) if with respect to the debtor there is a claim for a domestic sup9ort obligation, provide the applicable notice specified in subsection (c) [of section 1106].

The references in subsection (a)(1) to the paragraphs in § 704 should be read to refer to subparagraphs of § 704(a) as amended by BAPCPA.

[FN85]. For example, the trustee is the representative of the estate (11 U.S.C. § 323), must invest moneys of the estate appropriately (11 U.S.C. § 345), must file tax returns (11 U.S.C. § 346), and must meet with committees (11 U.S.C. § 1103(d)).

[FN86]. 11 U.S.C. § 1106(a)(3).

[FN87]. COLLIER ON BANKRUPTCY ¶ 1106.03[10][a] (15th ed. rev. 2006).

[FN88]. 11 U.S.C. § 1108.

[FN89]. *See In re* Nartron Corp, 330 B.R. 573 (Bankr. W.D. Mich. 2005); *In re* Intercat, Inc., 247 B.R. 911 (Bankr. S.D. Ga. 2000); *In re* G & G Transport, Inc., 1998 WL 898835 (Bankr. E.D. Pa., December 22, 1998); *In re* North American Comm., Inc., 138 B.R. 175 (Bankr. W.D. Pa. 1992); and *In re* Madison Management Group, Inc., 137 B.R. 275 (Bankr. N.D. Ill. 1992).

[FN90]. 330 B.R. 573 (Bankr. W.D. Mich 2005).

[FN91]. *Id.* at 583 - 592.

[FN92]. *Id.* at 594.

[FN93]. *Id.*

[FN94]. *In re* Intercat, 247 B.R. 911 (Bankr. S.D. Ga. 2000).

[FN95]. *Nartron*, 330 B.R. at 594; *Intercat*, 247 B.R. at 924.

[FN96]. This interpretation of § 1108 is supported by legislative history. Under the Bankruptcy Act, a receiver, trustee, or debtor in possession could operate the debtor's business in Chapter X or Chapter XI only upon authorization of the court. COLLIER ON BANKRUPTCY ¶ 1108.LH (15th ed. rev. 2006). Both the House and Senate reports, explaining § 1108, stated: "This section permits the debtor's business to continue to be operated, unless the court orders otherwise. Thus, in a reorganization case, operation of the business will be the rule, and it will not be necessary to go to the court to obtain an order authorizing operation." H.R. Rep. 95-595, 95th Cong., 1st Sess. 404 (1977); S. Rep. 95-989, 95th Cong., 2d Sess. 116 (1978). Section 1108 is therefore best read as simply reversing the presumption of chapter 7 and of prior law that the debtor's business should not be operated.

[FN97]. 11 U.S.C. § 1106(b).

[FN98]. 11 U.S.C. § 1106(b).

[FN99]. 11 U.S.C. § 1106(a)(3).

[FN100]. *See supra* text accompanying notes 36-39.

[FN101]. 11 U.S.C. § 1106(a)(4).

[FN102]. *Id.*

[FN103]. 11 U.S.C. § 1104(c).

[FN104]. 11 U.S.C. § 1104(a)(1).

[FN105]. 11 U.S.C. § 1106(a)(4).

[FN106]. 11 U.S.C. § 1107(a) (emphasis added).

[FN107]. 11 U.S.C. § 1106(b).

[FN108]. *See infra* at p.

[FN109]. Patton's Busy Bee Disposal Service, Inc. v. Robert A. Sweeney Agency, Inc. (*In re* Patton's Busy Bee Disposal Service, Inc.), 182 B.R. 681, 686 (Bankr. W.D.N.Y. 1995); Williamson v. Roppollo, 114 B.R. 127, 129(W.D. La. 1990); *But see In re* Cybergenics Corp., 330 F.3d 548, 577-78 (3rd Cir. 2003) (*en banc*) (appointment of examiner with authority to sue not consistent with examiner's general role as an independent investigator).

[FN110]. *In re* Liberal Market, Inc., 11 B.R. 742 (Bankr. S.D. Ohio 1981) (examiner given authority to supervise/control operation of debtor's businesses).

[FN111]. *In re* Big Rivers Electric Corporation, 355 F.3d 415, 422 (6th Cir. 2004) (examiner ordered to "[w]ork with Big Rivers and its creditors in ... resolving various disputes with creditors, ... and [ ] if feasible, attempt to negotiate a global settlement of the disputes in this case and the development of a consensual plan of reorganization") (*In re* Public Service Co. of New Hampshire, 99 B.R. 177 (Bankr. D.N.H. 1989) (appointment of examiner appropriate to mediate parties' efforts to achieve consensual plan after exclusivity was terminated); *In re* UNR Industries, Inc., 72 B.R. 789 (Bankr. N.D. Ill. 1987) (examiner appointed to "determine whether negotiations toward a consensual plan of reorganization are at an impasse.").

[FN112]. *In re* Landscaping Services, Inc., 39 B.R. 588 (Bankr. E.D.N.C. 1984) (examiner appointed to determine whether confirmation requirements had been met; case did not have active creditors' committee/United States trustee to serve as check on debtor in possession).

[FN113]. *See, e.g., In re* John Peterson Motors, Inc., 47 B.R. 551, 553 (Bankr. D. Minn. 1985) (contending that 11 U.S.C. § 1106(b) authorizes bankruptcy court to order the appointment of "a trustee albeit with the title of examiner"); *But see In re* International Distribution Centers, 74 B.R. 221, 223-24 (S.D.N.Y. 1987) (bankruptcy court order granting powers of trustee to examiner overly broad; the bankruptcy court does not have the dis-

cretion to "render the examiner a pseudo-trustee.").

[FN114]. FED. R. BANKR. P. 9031. Masters Not Authorized: "Rule 53 F.R. Civ. P. does not apply in cases under the Code."

[FN115]. 11 U.S.C. § 1121(d)(2). While the initial exclusivity period for small business debtors was extended from 120 days to 180 days, but to obtain an extension of this period, such a debtor must show that it is more likely than not that the court will confirm a plan within a reasonable period of time. 11 U.S.C. § 1121(e)(1), (3). Furthermore, small business debtors are subject to a 300 day deadline for filing a plan and disclosure statement. 11 U.S.C. § 1121(b)(2). The failure by a debtor in possession to file a plan within that deadline would constitute cause for conversion or dismissal under § 1112(b) of the Code.

[FN116]. *See, e.g.*, Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 693-94 (1993).

[FN117]. 11 U.S.C. § 1112(b)(1). A debtor is afforded some opportunity to avoid conversion or dismissal, but it must establish that it has a reasonable likelihood of rehabilitation and that its failure to comply with requirements was excusable and can be cured. 11 U.S.C. § 1112(b)(2).

[FN118]. 11 U.S.C. § 1112(b)(4).

[FN119]. *See supra* text accompanying notes 65 - 71.

[FN120]. 11 U.S.C. § 1104(a)(3).

[FN121]. Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485, 563 (2005).

[FN122]. 11 U.S.C. § 503(c).

[FN123]. *See, e.g.*, Dai-Ichi Kangyo Bank v. Montgomery Ward Holding Corp. (*In re* Montgomery Ward Holding Corp.), 242 B.R. 147 (D. Del. 1999).

[FN124]. Karen Cordry & Zachary Mosner, *Challenging the "Lake Woebegon Syndrome": What Hath Congress Wrought with Kerps*, AM. BANKR. INST. J., June 2006, at 12, 61.

[FN125]. *In re* Dana Corp., 351 B.R. 96 (Bankr. S.D.N.Y. 2006). The court concluded that "this compensation scheme walks, talks and is a retention bonus." *Id.* at 102.

[FN126]. 11 U.S.C. § 1104(e).

[FN127]. Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603, 618 (2005).

[FN128]. *See, e.g.*, Lynn M. LoPucki, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS 145-57 (2005).

[FN129]. Thomas J. Salerno, *Courting Failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts*, AM. BANKR. INST. J., February 2005, at 46 (book review).

[FN130]. BAPCPA, § 1406.

[FN131]. *In re* Hotel Associates, Inc., 3 B.R. 343, 345 (Bankr. E.D. Pa. 1980) ("Courts eschew rigid absolutes and look to the practical realities and necessities inescapably involved in reconciling competing interests").

[FN132]. *In re* Eichorn, 5 B.R. 755, 757 (Bankr. D. Mass. 1980). The court in *Eichorn* correctly noted that the House and Senate reports should not be relied upon as legislative history for § 1104, as they described versions of that section that were not enacted. *Id*. The statement that a presumption in favor of the debtor remaining in possession is simply a recognition that a trustee will be appointed only after the filing of a proper motion under § 1104 by a party that meets the burden of proof.

[FN133]. The first reported decision to use the "strong presumption" formulation was *In re* Sea

Queen Kontaratos Lines, Ltd., 10 B.R. 609 (Bankr. D. Me. 1981). It has been repeated innumerable times since, apparently without much analysis.

[FN134]. The first reported decision to require clear and convincing evidence under § 1104(a)(1) was *In re* L.S. Good & Co., 8 B.R. 312, 314 (Bankr. N.D. W. Va. 1980). The court cited no authority to support the application of this burden of proof. In *In re* Tyler, 18 B.R. 574 (Bankr. S.D. Fla. 1982), the court stated that because the appointment of a trustee is an extraordinary remedy, the evidence to support such an appointment must be clear and convincing. *Id.* at 577.

[FN135]. *In re* Marvel Entertainment Group, Inc., 140 F.3d 463, 471 (3rd Cir. 1998).

[FN136]. 11 U.S.C. § 1104(a)(1).

[FN137]. In re General Oil Distributors, Inc., 42 B.R. 402 (Bankr. E.D.N.Y. 1984).

[FN138]. *Id.* at 409.

[FN139]. *In re* William A. Smith Constr. Co., Inc., 77 B.R. 124 (Bankr. N.D. Ohio 1987).

[FN140]. *Id.* at 126. The court relied exclusively on both the House and Senate reports as support for its conclusion that costs and benefits were to be weighed under § 1104(a)(1). *Id.* The court showed no awareness that § 1104 as enacted differed radically from both the House and Senate bills described by those reports. *See supra* text accompanying notes 36-39. *See also In re* F.A. Potts & Co., Inc., 20 B.R. 3, 4 (Bankr. E.D. Pa. 1981) (relying on House report for proposition that costs and expenses of a trustee should be weighed against the value of the protection afforded by a trustee).

[FN141]. 11 U.S.C. § 1104(e).

[FN142]. *See In re* Tyler, 18 B.R. 574 (Bankr. S.D. Fla. 1982).

[FN143]. Tradex Corp. v. Morse (*In re* Tradex Corp.), 339 B.R. 823 (D. Mass. 2006). *Tradex* was decided after the effective date of § 1104(e), but the amendment was not applicable because the chapter 11 petition was filed before the April 20, 2005 effective date of § 1104(e).

[FN144]. *Id.* at 830.

[FN145]. Grogan v. Garner, 498 U.S. 279 (1991).

[FN146]. *Id.* at 286.

[FN147]. *Id.*

[FN148]. 339 B.R. at 830.

[FN149]. *Id.* at 831.

[FN150]. *But see also* In re Altman, 230 B.R. 6, 16-17 (Bankr. D. Conn. 1999), *vacated in part*, 254 B.R. 509 (D. Conn. 2000) (standard is preponderance of the evidence after *Grogan*).

[FN151]. The pre-petition replacement of management is even less likely to be effectual in cases of closely-held limited liability companies. Because the members of LLCs are most frequently the managers, if management of an LLC committed fraud, an effort to replace management with a new chief restructuring officer to avoid a trustee appointment should be unavailing. The members of the LLC, who are the tainted management, are likely to retain the right to replace the CRO at any time.

[FN152]. *See, e.g.*, Committee of Dalkon Shield Claimants v. A.H. Robins Co., 828 F.2d 239, 240-41 (4th Cir. 1987) (concluding that bankruptcy court has some level of discretion to determine if "cause" exists to appoint a chapter 11 trustee under § 1104(a)(1); bankruptcy court properly took cost into account in determining the existence of cause); *In re* Coral Springs Medical Center Assocs., 99 B.R. 112, 113 (Bankr. S.D. Fla. 1989) (contending, without any empirical support, that chapter 11 trustee appointment would cost debtor "between 5% and 10% of gross receipts"); *In re* Century Glove, Inc., 73 B.R. 528, 536 (Bankr. D. Del. 1987) ("The appointment of a trustee imposes substantial financial burdens on a debtor's estate which can preclude the possibility of reorganization.") (internal citation omitted); *In re* Macon Prestressed Concrete Co., 61

B.R. 432, 439 (Bankr. M.D. Ga. 1986) ("... the appointment of a trustee would impose a substantial financial burden on a debtor's estate, thus precluding an effective reorganization due to increased administrative expenses.").

[FN153]. *See supra* text accompanying notes 36-39.

[FN154]. *See In re* V. Savino Oil & Heating Co., 99 B.R. 518, 528 (Bankr. E.D.N.Y. 1989) (recognizing that version of § 1104(a) contained in H.R. 8200, which would have allowed for discretionary trustee appointment in all instances, was not enacted into law; bankruptcy court need only decide whether requisite "cause" has been demonstrated).

[FN155]. BAPCPA amended § 330 to provide that "[i]n determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326." 11 U.S.C. § 330(a)(7). While this provision is not limited by its terms to chapter 7 trustees, it appears to conflict with § 330(a)(3), which was amended by BAPCPA specifically to require that, in determining reasonable compensation for a chapter 11 trustee, the court consider the nature, extent, and the value of the trustee's services, taking into account all relevant factors. This apparent internal inconsistency can best be resolved by recognizing that Congress intended that chapter 11 trustees, whose maximum compensation under 11 U.S.C. § 326 is likely to be very high, file traditional fee applications demonstrating an entitlement to reasonable compensation not based on any percentage of disbursements. Otherwise the trustee's compensation would reflect the size of the business being reorganized instead of the value provided to stakeholders by the trustee.

[FN156]. *See* 11 U.S.C. § 327(e).

[FN157]. *See, e.g., In re* Allsun Juices, Inc., 34 B.R. 162 (Bankr. M.D. Fla. 1983) (noting that debtor's exclusivity will not expire for several months). In commenting on *Allsun Juices*, the United States Bankruptcy Court for the District of Colorado rejected the idea that resolution of the trustee motion would have to wait until the debtor's exclusivity periods expired:

> As a preliminary matter, the Court is not persuaded by Colorado-Ute's reliance upon cases which find motions to appoint a trustee filed within the original exclusive period to be premature. Those cases involved situations where the courts first found that there was not cause to appoint a trustee and that such appointment was not in the best interests of creditors. Then, the courts discussed the timing and the propriety of the motions. *Thus, if the facts and circumstances warrant the appointment of a trustee, it is not appropriate to wait to file the motion until the termination of the exclusive period. Such a deferral will only further delay the progress toward the effective rehabilitation and reorganization of the debtor.*

In re Colorado-Ute Elec. Assoc., Inc., 120 B.R. 164, 175 (Bankr. D. Col. 1990) (emphasis added).

[FN158]. *See supra* text accompanying note 82.

[FN159]. *The WorldCom case: Looking at Bankruptcy and Competition Issues Before the S. Comm. on the Judiciary*, 108th Cong. 2 - 9 (2003) (statement of Richard Thornburgh, bankruptcy examiner).

[FN160]. *See, e.g., In re* Loral Space & Commc'ns, Ltd., 313 B.R. 577 (Bankr. S.D.N.Y. 2004), *rev'd* 2004 WL 2979785; *In re* Rutenberg, 158 B.R. 230 (Bankr. M.D. Fla., 1993); *In re* GHR Cos., Inc., 43 B.R. 165 (Bankr. D. Mass. 1984).

[FN161]. *See, e.g., In re* Revco D.S., Inc., 898 F.2d 498 (6th Cir. 1990) (examiner was sought only to investigate pre-petition leveraged buyout); *In re* Bradlees Stores, Inc., 209 B.R. 36 (Bankr. S.D.N.Y. 1997) (examiner was sought only to bring claim on inter-company transfer); *In re* UAL Corp., 307 B.R. 80 (Bankr. N.D. Ill. 2004) (examiner was sought only to investigate timing of debtor's decision to seek modification of its retiree benefits); *In re* Loral Space & Comm., Ltd., 2004 WL 2979785 (S.D.N.Y. 2004) (examiner was sought only to appraise the debtors' assets and liabilities).

[FN162]. Elizabeth Warren & Jay L. Westbrook, *Examining the Examiner*, AM. BANKR. INST. J., May 2005, at 34, 74.

[FN163]. 11 U.S.C. § 1106(a)(4)(A).

[FN164]. *See supra* at p. 296 and text accompanying notes 32-35.

[FN165]. *In re* Fibermark, 339 B.R. 321, 325 (Bankr. D. Vt. 2006) (citations omitted).

[FN166]. *See* 11 U.S.C. §§ 546(a)(1) (right to commence avoidance power actions expires after the later of two years after the entry of the order for relief or one year after the appointment of a chapter 11 trustee, if the trustee is appointed before the expiration of the two year period); and 108(a)(1) (non-bankruptcy limitations period extended by a maximum of two years after the order for relief).

[FN167]. H. Slayton Dabney Jr., Andrew C. Hruska & Samuel S. Kohn, *The Government's Approach to Fraud-Induced Bankruptcies of Large Public Companies*, AM. BANKR. INST. J., February 2006, at 12.
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