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PRACTICE EMPHASIS

John Melko is a partner in the Financial Services Group, with a broad based practice including financial and business restructurings, complex bankruptcies, and acquisition and sale transactions involving media properties, primarily radio stations. His restructuring and bankruptcy clients have been involved in the oil and gas, manufacturing, retail, financial services, airline, and electric utility industries. He has represented borrowers and debtors in possession, creditors and creditors' committees, trustees, investors, and buyers of assets and businesses in and out of restructuring or bankruptcy settings. For over two years, served as general counsel of a media company with extensive activity buying, upgrading and selling radio stations in all parts of the country. He was a member of the bar committee that worked with the bankruptcy judges on the complex Chapter 11 cases procedure for the Southern District.

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Presented:

PRIVILEGED CHARACTERS

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PRIVILEGED CHARACTERS

Introduction

The filing of a petition in bankruptcy creates an "estate". Like a corporation, an estate is a legal creation or fiction, yet it must be managed: it has statutorily described attributes, responsibilities, and obligations, and it may own assets, enter into contracts and generally conduct business. Those responsibilities and obligations must be carried out by real people. The people who manage an estate go by different names depending on the specific type of estate, but their responsibilities are similar in that they all act as fiduciaries for a defined group of beneficiaries. Because they are acting on behalf of others, so long as they discharge their duties in accordance with governing law, including standards of care and diligence, they will not be held personally accountable for liabilities arising out of those acts, thereby enjoying a type of judicial immunity or privilege from lawsuits – thus the somewhat whimsical title.

However, where an estate representative acts to benefit himself rather than his or her constituency, or when the standard of care required by a position is not met, personal liability will generally be imposed on that representative. Unlike a corporate director, broad indemnifications are not available to estate representatives, with rare exception.

This presentation will generally describe the fiduciaries duties of estate representatives and the nature of immunity or privilege enjoyed by each. Without examples, such a description would consist of little more than recitations of statues or general rules, and thus cases where estate representatives have been sued, or frequently, had their fees challenged by way of imposition of liability for misdeeds, will be examined.

The estate representatives whose roles will be examined are: management of Debtors in Possession, Trustees, Examiners, and Committees. Where appropriate, professionals for the various representatives will be thrown in for good measure.

I.
DEBTOR IN POSSESSION MANAGEMENT

Bankruptcy Code §1101(1) defines "debtor in possession" as the "debtor except when a person that has qualified under section 322 of this title is serving as trustee in the case". Code § 1107(a) states that, subject to limitations, "a debtor in possession shall have all of the rights … 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." The excepted duties deal mainly with investigation of and reporting on acts of the debtor.

Thus, where pre-petition management of a corporate or partnership debtor has not been displaced by a trustee, that management remains in place during the pendency of the bankruptcy case, subject to normal corporate and partnership governance procedures. What flows from this is an ongoing responsibility to manage the business subject to the statutory requirements of the Bankruptcy Code and the standard of care, loyalty and diligence required by the state laws under which the entity that is the debtor was formed.

Much has been written about the fiduciary duties of officers and directors of corporations and how those duties change upon nearing insolvency. That area is surveyed below, largely by way of review. The law is sufficiently developed such that there is general understanding that officers' and directors' duties can expand to include creditors, and that if it becomes settled at some point that the equity owners are "out of the money" the duty shifts to be owed solely to creditors. What may be less clear is the extent of the additional duties and responsibilities assumed by management of a Chapter 11 debtor particularly given the ad hoc nature of some of the jurisprudence defining those duties.

A. Pre–Bankruptcy; Fiduciary Duties Owed to Solvent Corporations

1. Duty owed to Shareholders. The "management" of a solvent corporation consists of it officers and directors. Directors are generally elected by the shareholders, whereas the officers are appointed by the board of directors. Management of a healthy, or solvent, company owes it allegiance to the shareholders only and stands as their fiduciaries. *See* Simons v. Cogan, 549 A.2d 300, 302-04 (Del. 1998).

The shareholders or owners of the company have invested their capital in a venture to be managed by others, the officers and directors, and in which the shareholders are to be passive. Having entrusted their funds to these professional managers, it is of no surprise that those managers are held to the high standards of a fiduciary, that is, a person charged with certain standards of care, and precluded from self dealing. *SEE* RESTATEMENT (SECOND) OF TRUSTS §2 cmt. b (1959). Over time, the standard of care has been refined. The 1998 revision to The Model Business Corporation Act §8.30: The Standards of Conduct, provides very general standards of care and diligence of directors in their individual capacities and when acting as part of a Committee. 2 MODEL BUS. CORP. ACT ANN. §8.30.

The level of care and diligence expected of a director is perhaps better understood from §8.31. Standards of Liability For Directors (the "Standards of Liability"). 2 MODEL BUS. CORP. ACT ANN. §8.31. Id. §8.31. The Standards of Liability provide that, unless otherwise excused by exculpatory articles, parties seeking to recover against a director (by definition the corporation or its shareholders) may prevail if they can demonstrate that the director filed in any number of ways, including a lack of good faith, reasonable inquiry, inattention to the business and affairs of the corporation, failure to devote timely attention to specific matters of concern, or by having a financial interest in the outcome, among other things. *Id.*

The Official Comments to the 1998 revisions set forth an excellent description of the Standards of Conduct:

> *This mandate governs all aspects of directors' duties: the duty of care, the duty to become informed, the duty of inquiry, the duty of informed judgment, the duty of attention, the duty of loyalty, the duty of fair dealing and, finally, the broad concept of fiduciary duty that the courts often use as a frame of reference when evaluating a director's conduct, These duties do not necessarily compartmentalize and, in fact, tend to overlap. For example, the duties of care, inquiry, becoming informed, attention and informed judgment all relate to the board's decision-making function, whereas the duties of attention, becoming informed and inquiry relate to the board's oversight function.*

Id. §8.30 Official Commentary at 8-164 to 8-165. For an excellent discussion of the duties of directors, *see* R. Franklin Balotti and Joseph Hinsey IV, *Director Care, Conduct, and Liability: The Model Business Corporation Act Solution*, 56 Bus. Law. 35 (2000).

Of course most states, and the Model Act, have provided exculpatory provisions protecting directors from simple negligence and providing broad indemnification rights. As will be seen in following sections, however, these savings clauses may have little or no effect against suits of creditors of insolvent companies.

2. <u>No Duty Owed to Creditors</u>. Management of a solvent corporation owes no special duty of care to creditors. Creditors are owed the benefit of the respective bargains they have negotiated with the borrower/customer entity. Absent some fraud or special set of circumstances imposing a trust relationship, they stand, essentially, as adverse parties, with each bound only to the terms of the agreement, and liable only in contract in the event of a breach. *See* <u>In re Ben Franklin Retail Stores, Inc.</u>, 225 B.R. 646, 653 (Bankr. N.D. Ill. 1998), aff'd in relevant part, 1999 WL 982963 (N.D. Ill. Oct. 26, 1999) (N.D. 97C6043, 97C7934), amended and superseded by 2000 WL 28266 (N.D. Ill. Jan. 12, 2000).

In <u>C-T of Virginia, Inc. v. Barrett</u>, 124 B.R. 689 (W.D. Va. 1990), the Unsecured Creditors Committee of C-T of Virginia, Inc. ("C-T") brought suit on behalf of the Debtor against certain former officers and directors of the Debtor over a merger which creditors maintain was not in the best interests of the Company. After reviewing the applicable law, the Court found that the directors' duties were limited to gaining the highest possible price for its shareholders and that duty did not extend to the interests of current or future unsecured creditors of the Company. *Id*. pp. at 692-93.

In a case arising from the RJR Nabisco leveraged buy-out of its shareholders, bondholders who alleged that the value of their previously issued bonds had been diminished by the buy-out sued the Company, RJR Nabisco, Inc. and its chairman, F. Ross Johnson. Among other things, the plaintiffs alleged a breach of fiduciary duty by the Company and its chairman to them as creditors of Nabisco. Metropolitan Life Ins. Co. v. RJR Nabisco, Inc., 716 F.Supp. 1504 (S.D.N.Y. 1989). As an initial matter, there was a dispute as to whether the law of Delaware or New York would apply. The defendants sought to rely on Delaware law because Simons v. Cogan, 549 A.2d 300, 303 (Del. 1988), a then recent Delaware supreme court case, clearly held that a corporate bond "represents a contractual entitlement to the repayment of a debt and does not present an equitable interest in the issuing corporation necessary for the imposition of a trust relationship with concomitant fiduciary duties."

While not clear from the Nabisco opinion, it appears that the Court found that New York law, not Delaware, would apply but nonetheless found the Simons opinion persuasive and held that the plaintiffs which it described as "sophisticated investors who are unsecured creditors" were not owed a fiduciary duty and thus not entitled to protections owed to such beneficiaries. 716 F.Supp. 1504, 1524-25.

Similarly, the Third Circuit Court of Appeals in Lorenz v. CSX Corp., 1 F.3d 1406 (3d Cir. 1993) found that bondholders were not owed a fiduciary duty and upheld the dismissal of the plaintiffs' claims.

B. Nearing Bankruptcy; Changing of Fiduciary Duties

1. Change in Fiduciary Duty. Cases described differently the role of directors when a corporation becomes insolvent, or is near insolvency changes. The cases have been less than uniform in describing the change. The difference in language appears to be more fact-driven than based on legal significance. In Pepper v. Litton, 308 U.S. 295, 60 S. Ct. 238, 84 L.Ed. 281, the Court, in discussing the standard of review for an equitable remedy of setting aside a transaction, made clear that "in the event of bankruptcy of the corporation, [the remedy is] enforceable by the trustee for that standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation - creditors as well as stockholders. Id., 307 (citations omitted). Thus, the Litton Court held that the fiduciary duties expanded to cover not just shareholders but creditors as well. So, too, Geyer v. Ingersoll Publications Co., 621 A.2d 784 (Del. Ch. 1992), the Delaware Chancery Court held that, at the moment of insolvency, the fiduciary duties of directors covered the "entire corporate enterprise" and that "shareholders' wishes should not be the director's only concern." Id. at 789. A well known case which not only provides for a broadening of fiduciary duties when a company is insolvent to cover both shareholders and creditors is Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., 1991, WL 277613 (Del. Ch. Dec. 30, 1991). Credit Lyonnais arose out of a leveraged buy-out of MGM Studios followed soon thereafter by a bankruptcy, a corporate reorganization and a reorganized MGM with a significant amount of debt. The controlling shareholder demanded that the board approve sales of assets to pay down the debt. The lender, Credit Lyonnais, had certain contractual rights with respect to management of the company, providing debt remained above a certain level, and objected to the sale of assets for the reorganized, yet nearly insolvent, MGM on the grounds that it would not be in the best interest of the Company. A board fight and litigation ensued, and the Delaware Chancery Court, in what is now a famous footnote, provided in business casebook form a sensitivity analysis analyzing the

correct risk adjusted sales price of assets of a corporation with significant debt, and some equity. *Id*. n.55.

Other cases and to speak in terms of the fiduciary duties of the directors "shifting" to creditors when a company becomes insolvent. *See* FDIC v. Sea Pines Co., 692 F.2d 973, 976-77 (4th Cir. 1982), cert. den., 461 U.S. 928 (1983). The distinguishing factor would appear to be the degree of insolvency. At some point, when it becomes clear that there is simply no value available to existing equity, the fiduciary duties of the corporation's directors is owed entirely to the creditors of the estate.

Because there is not complete agreement on the definition of solvency for purposes of measuring fiduciary duties, nor can one be precise as to when a corporation becomes insolvent, courts have recognized that the expansion of directors' fiduciary duties begins when the company is "in the vicinity of insolvency" Credit Lyonnais, 1991 WL 277613 at *34, n.55; or "approaching insolvency", In re Healthco Int.'l, Inc., 208 B.R. 288, 300 (Bankr. D. Mass. 1997).

C. Chapter 11 Management; Fully Expanded Duties

1. Obligation includes Officers and Directors. Bankruptcy Code §1107(a) makes clear that the debtor in possession has the same fiduciary duties and liabilities as a trustee. Who then is the debtor in possession? In the cases of partnership or corporate debtors, where no trustee is appointed, the management of the pre petition debtor will remain in place. Thus, the officers and directors who managed the debtor pre petition remain incumbent and in addition to the expanded obligations to creditors discussed above, also take on the additional responsibilities of complying with the provisions of the Bankruptcy Code.

In the fiduciary cases cited above, the defendants were the companies and the directors for the most part. But corporate officers are not immune from suit, particularly when there are allegations of fraud or financial mismanagement. *See Id*. Looking no further than the daily newspapers will supply a portfolio-full of reports of corporate officers from the likes Worldcom, Enron, Adelphia, etc. being sued by investors and creditors, as well as being pursued, in some instances, by criminal prosecutors.

When the debtor is a corporation, corporate officers and directors are considered to be fiduciaries both to the corporate debtor in possession and to the creditors. In re Anchorage Nautical Tours, Inc., 145 B.R. 637 (9th Cir. B.A.P. 1992), citing In re Crouse Group, Inc., 75 B.R. 553, 557-558 (Bankr. E.D. Pa. 1987); In re Clu Dev. & Management Corp., 27 B.R. 610, 612 (9th Cir. B.A.P. 1982); *see* also FED. R. BANK. P. 9001(5) (including in the definition of "Debtor" corporate officers, directors, and controlling shareholders for corporations, and any and all general partners for a partnership).

In a case involving a "Chapter 22", i.e., a second chapter 11 filing for the same albeit, "reorganized" company, the creditors' committee prevailed in its suit against insider officers and directors for making less than arms lengths related party loans to the detriment of the debtor, and two of the directors were found liable for secretly acquiring creditors' claims in the first bankruptcy case. *See*, In re Toy King Distributors, Inc., 256 B.R. 1 (Bankr. N.D. Fla. 2000).

2. The removal of the DIP. Bankruptcy Code §1104 provides for appointment of a trustee:

> (a) For cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the Debtor by current management, either before or after commencement of the case, or similar cause, but not including the number of holders of securities of the Debtor or the amount of assets or liabilities of the Debtor; or
>
> (b) If such 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 or the amount of assets or liabilities of the Debtor.

BANKR. CODE §1104(a).

Although the Bankruptcy Code supplies a number of causes for which the debtor in possession may be displaced by a trustee, the cases make clear that appointment of a trustee is an extreme remedy. In re G-I Holdings, Inc., 295 B.R. 502 (D. N.J. 2003), In re Tahkenitch Tree Farm Partnership, 156 B.R. 525 (Bankr. E.D. La. 1993), In re Heck's Properties, Inc., 151 B.R. 739 (S.D. W.Va. 1992). Nonetheless, there is no shortage of reported opinions where trustees have been appointed. Additionally, the examples of "cause" which will give rise to appointment of a trustee are not limited to those set forth in the code. *See* In re Cajun Elec. Power Coop, Inc. 191 B.R. 659 (M.D. La. 1995), vacated 69 F.3d 746, opinion withdrawn in part on re-hearing, 74 F.3d 599, Reh'g and suggestion for Rehenbancden. 83 F.3d 421, cert. den. 117 S.CT. 51, 519 U.S. 808, 136 L. Ed 2d 15.

A trustee was appointed in the Cajun Electric case because of an inherent, structural conflict. As an electric cooperative, Cajun was comprised of local, rural utility companies. Cajun's bankruptcy was precipitated largely by an investment in a failed nuclear generating power plant, and the rate adjustment over that failed or stranded investment was being litigated with the various rate-making agencies. Cajun was attempting to have a higher rate or price of electricity approved. The member co-ops, in turn owned by the customers, actually preferred a lower rate, but those rates would not enable Cajun to repay its creditors, including the Rural Utility Service. This structural conflict gave rise to the appointment of a trustee, without finding any wrongdoing on behalf of the member utilities or Cajun's management. Similarly, In re matter of Tahkenitch Treefarm Partnership, 156 B.R. 525 (Bankr. E.D. La. 1993) held that .a deadlock among the board of directors constituted sufficient cause to appoint a trustee as being in the best interest of the estate.

Chapter 11 management has been replaced for failure to file operating reports in violation of cash collateral orders. In re AG Service Centers, L.C., 239 B.R. 545 (Bankr. W.D. Mo. 1999), using accountants not retained and paying them out of estate assets; In re Nautilus of New Mexico, 83 B.R. 784 (Bankr. D. N.M. 1988), inability to formulate a plan of reorganization; In re Ionosphere Clubs, 13 B.R. 164 (Bankr. S.D.N.Y. 1990); and not surprisingly for diversion of assets, In re PRS Insurance Group, Inc., 274 B.R. 381 (Bankr. D. Del. 2001).

Another risk or a potential exposure by DIP Management is for suits arising out of post-petition acts which are alleged to violate state law. The automatic stay of Bankruptcy Code §362 operates as a stay of acts to collect pre-petition debts, or which would affect property of the estate. However, with regard to establishing liability for post-petition acts which are alleged to violate state law, DIP Management (and trustees) may be sued without leave from the Bankruptcy Court, but subject to that court's general equitable power:

28 U.S. C. §959 provides as follows:

> (a) trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury,
>
> (b) except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

While debtors in possession and trustees can be sued in state courts for their post-petition acts, those defendants frequently turn for protection to the Bankruptcy Court, alleging that the State Court of Litigation will interfere with the administration of the bankruptcy case. *See* Carter v. Rogers, 220 F.3d 1249 (11th Cir. 2000), *cert. den.* 121 S. Ct. 775, 531 U.S. 1077, 148 L.Ed.2d 673; In re Lehal Realty Assoc., 101 F.3d 272 (2nd Cir. 1996); In re DeLorean Motor Co., 991 F.2d 1236 (6th Cir. Mich. 1993) *reh. den.* (June 17, 1993).

3. Of Ordinary Course of Business and Cheap Insurance. Bankruptcy Code §363 provides that the DIP (and trustee) may conduct post petition operations in the ordinary course of business. Transactions not in the ordinary course of the Debtor's business may be effected only after notice and hearing, and with bankruptcy court approval. Several tests have emerged for determining what is in the "ordinary course". Frequently, there will be business exigencies prompting management to conduct a transaction that may or may not be in the ordinary course without the niceties of court approval. If such an emergency arises and there is a functioning Creditors' Committee, at a minimum, Committee consent should be sought.

However, absent such an emergency, it is difficult to imagine forging ahead on anything that might be later questioned as to ordinary course without seeking court approval. Obtaining court approval will virtually always protect management from later challenges. The process itself requires notice to interested parties, affords an opportunity to object, and results in a court order. A later collateral challenge to the transaction or against management for breach of duty should fail under notions of collateral estoppel and res judicata, absent a showing of active fraud on the part of the movant.

Two tests have emerged analyzing whether a transaction was in the ordinary course. *See* In re Lavigne, 114 F.3d 379, 385 (2nd Cir. 1997). Lavigne was a case involving holding that cancellation of medical malpractice insurance policy by proctologist specializing in high-risk laser surgery was beyond the ordinary course of business and required notice under §363(b)(1). The Court found that the term "ordinary course of business" has been accepted "to embrace the reasonable expectations of interest parties of the nature of transactions that the debtor would likely enter in the course of its normal, daily business." *Id.* at 384 (citing In re Watford, 159 B.R. 597, 599 (M.D. Ga. 1993), *aff'd without opinion*, 61 F.3d 30 (11th Cir. 1995). In re Roth American, 975 F.2d 949, 952-53 (3rd Cir. 1992); In re Dant & Russell, 853 F.2d 700, 704-05 (9th Cir. 1988); In re Coordinated Apparel, 179 B.R. 40, 43 (Bankr. S.D.N.Y. 1995); In re The Leslie Fay Companies, 168 B.R. 294, 304 (Bankr. S.D.N.Y. 1994); In re the Drexel Burnham Lambert Group, 157 B.R. 532, 537-38 (S.D.N.Y. 1993).

The first test has been described as the "creditor's expectation test" a/k/a the "vertical test" whereby the court "views the disputed transaction from the vantage point of a hypothetical creditor and inquires whether the transaction subjects a creditor to economic risks of a nature different from those he accepted when he decided to" enter into a contract with the debtor. *Id.*, 385, *citing* Dant, 853 F.2d at 705 (internal quotations omitted); Leslie Fay, 168 B.R. at 304.

The second test has been called the "industry-wide test" a/k/a the "horizontal test" employing "an industry-wide perspective in which the debtor's business is compared to other like businesses. In this comparison, the test is whether the post-petition transaction is of a type that other similar businesses would engage in as ordinary businesses." Citing, Dant, 853 F.2d at 704; Leslie Fay, 168 B.R. at 304. Not surprisingly, the cancellation of the malpractice policy failed both tests.

Other cases finding activities outside the ordinary course:

In re Geothermal Resources International, Inc., 93 F.3d 648 (9th Cir. 1996). 5-year employment contracts for two board members (i) increasing salaries, (ii) providing "Bonus Guaranty Accounts" of $1,000,000 and $625,000 to fund prospective bonus payments, (iii) provided that they could only be terminated without cause "clearly were not made in the ordinary course of business."

In re Crystal Apparel, Inc., 220 B.R. 816 (Bankr. S.D.N.Y. 1998). Post-petition administrative claims to two former executives of $729,567.66 and $675,238.69 based on employment agreements providing for a "change of control" payment ("golden parachute" payments) failed horizontal and vertical tests.

In re Unoil, 948 F.2d 678 (10th Cir. 1991). Assignment of debtor's interests in oil and gas properties to various affiliated limited partnerships was outside the ordinary course of business.

In re Buyer's Club Markets, Inc., 150 B.R. 787 (D. Colo 1993), *aff'd* 5 F.3d 455 (10th Cir. 1993). Severance payment policy to all pre-petition employees that became effective only upon conversion to Chapter 7 and was radical departure from pre-petition severance pay policy failed vertical test.

In re Anchorage Nautical Tours, Inc., 145 B.R. 637 (9th Cir. B.A.P. 1992). Debtor's surrender of vessel to debtor's president to use in profitable cleanup of Exxon Valdez oil spill not within ordinary course of business.

In re Continental Holdings, Inc., 170 B.R. 919 (Bankr. N.D. Ohio 1994). Debtor's conveyance of bond to stay execution of judgment against debtor and debtor's principal were either "transfer" or "use" of estate property that was not in the ordinary course of business.

In re Consolidated Auto Recyclers, Inc., 123 B.R. 130 (Bankr. D. Me. 1991). Parent corporation's trustee's voting of subsidiary's stock to seek approval to file chapter 11 petition was outside the ordinary course of business.

In re Berkley Multi-Units, Inc., 88 B.R. 394 (Bankr. M.D. Fla. 1988). Although the term "ordinary course of business" is to be broadly interpreted, debtor was not in the business of purchasing and selling apartment buildings, thus disbursement of escrow funds in connection with debtor's purchase of apartment complex was outside of the ordinary course of business.

In re Continental Airlines, Inc., 61 B.R. 758 (S.D.Tex 1986). Continental's use of funds in post-petition attempt to take over Air Micronesia, Inc. was not in the ordinary course of business.

In re Waterfront Companies, Inc. v. Johnson, 56 B.R. 31 (Bankr. D. Minn. 1985). Debtor's entering into indemnity agreement indemnifying majority shareholder and affiliated entities was not in the ordinary course of business.

The common sense rule to be derived is that if a transaction recurs in the debtor's business on a frequent and routine business, and on terms and in a similar dollar magnitude to the proposed transaction, it is most likely ordinary course. If the proposed transaction has never been done by the debtor or is a rare occurrence that, absent a bankruptcy, would require board and/or shareholder approval , it is not ordinary course. And for the many transactions falling in a gradation of gray between the two extremes set forth above, seek input from the Committee, but even with Committee consent, file a motion if at all possible.

4. Hiding Behind the Bankruptcy. One of the "benefits" of being management of the DIP is that suits arising out of pre-petition conduct may either be enjoined or compromised as part of a Plan of Reorganization. With the limited exception of the Johns-Mannsville procedure pertaining to third party releases codified in Bankruptcy Code §524(g), neither practice is entirely proper and both are used (or at least attempted) regularly.

(a) Injunctions against suit. Some Chapter 11 estates have sought to enjoin actions against individuals and entities associated with the estate on the grounds that continuation of such actions would unduly impair reorganization, where, for example, the party is essential to the formulation of a plan of reorganization. *COLLIER ON BANKRUPTCY*, ¶105.03(2).

In Wysko Investment Co. v. Great Am. Bank, 131 B.R. 146, 148 (D. Ariz. 1991), the Court enjoined paying on letter of credit where drawing on letter of credit would have impaired reorganization. Some courts have used injunctions where there are "special" or "unusual" circumstances. *COLLIER ON BANKRUPTCY*, ¶105.03(b). In A. H. Robins Co. v. Piccinin (In re A. H. Robins Co.), 788 F.2d 994 (4th Cir. 1986), the debtor Robins was a co-defendant in over 5,000 lawsuits for selling the Dalkon Shield intrauterine contraceptive device. The debtor sought an injunction to stay suits against co-defendants. The Court ruled that §362(a)(1) stays actions where "there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor." Robins, 788 F.2d at 999-1000. §362(a)(3) stays actions, *whether against the debtor or otherwise*, to obtain possession or to exercise control over property of the debtor. The debtor's insurance policies were "property"; accordingly proceedings against the debtor's insurer were stayed. *Id*. at 1001.

A motion under §105 may support a stay under the following circumstances: "the Bankruptcy Court may use its injunctive authority to 'protect the integrity of a bankrupt's estate and the Bankruptcy Court's custody thereof and to preserve to that Court the ability to exercise the authority delegated to it by Congress [citation to In re Northern Boneless Meat Corp, 9 B.R. 27, 29 (S.D.N.Y. 1981) omitted]. Pursuant to the exercise of that authority the Court may issue or extend stays to enjoin a variety of proceedings [including discovery against the debtor or its officers and employees] which will have an adverse impact on the Debtor's ability to formulate a Chapter 11 plan." In re Johns-Manville Corp., 40 B.R. 219, 226 (D.C. Cir. 1984). The holding found that suits may be enjoined because irreparable harm would be suffered by the debtor because successful suits against co-defendants would reduce and diminish the insurance fund pool. This would outweigh any contrary hardship to the plaintiffs.

Field v. Zale Corp. (In re Zale Corp.), 62 F.3d 746 (5th Cir. 1995). Permanent injunction against third-party tort claims effectively discharged debts of nondebtor, unfairly impacted third parties and did not effect property of the estate, and were denied as beyond the authority of bankruptcy court. The same decision upheld injunctions against third parties bringing contract claims because those claims would have an effect on property of the estate.

Lomas Fin. Corp. v. Northern Trust Co. (In re Lomas Fin. Corp), 117 B.R. 64 (S.D.N.Y. 1990). The Court enjoined action against officers of debtor that alleged fraudulent misrepresentations causing advances to be made to the debtor. The "unusual circumstances" standard was met because the corporate charter obligated the debtor to indemnify the officers.

North Star Contracting Corp. v. McSpedon, 125 B.R. 368 (S.D.N.Y. 1991). Citing Lomas, the Court held that the automatic stay applied to an action against the president of the debtor for misrepresentation.

American Film Tech., Inc. v. Taritero (In re American Film Tech., Inc.), 175 B.R. 847 (Bankr. D. Del. 1994). Complaint against twenty-eight current and former directors of the debtor who were covered by indemnification provisions of the debtor's charter was enjoined. The Court adopted the reasoning of A.H. Robins and rejected In re Metal Center, Inc., 31 B.R. 458 (Bankr. D. Conn. 1983).

Thus, while generally frowned upon, injunctions which have the effect of protecting officers, directors and other third parties – frequently for long periods of time – can occasionally be gotten in a Chapter 11 case.

5. Third Party Releases and Permanent Injunctions. §524 sets forth the effect of a discharge in bankruptcy. Leaving aside the special provisions for asbestos cases contained at §524(g), and community property and related claims applying to individual debtors, "a discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." BANKR. CODE §524(e). However, if a debt is discharged, then the permanent injunctions against collection of §524(a)(3) against the debtor and its property apply. Additionally, §1141(d) provide additional discharge and provisions applicable under confirmed plans of reorganization.

By their specific language, §§524 and 1141, with narrow exceptions, do not and cannot protect third parties. However, relying on the court's broad "related to" jurisdiction, injunctions under §105 issued in connection with motions to compromise controversy pursuant to Bankruptcy Rule 9019, and the contractual feature of plans of reorganization, officers and directors frequently are able to resolve claims against them through the debtor's reorganization.

II.
TRUSTEES

A. Appointment of Trustee.

In business cases, trustees are appointed automatically by the Office of the United States Trustee in Chapter 7 cases pursuant to Bankruptcy Code §§701 and 703; or elected under §702. The duties of a trustee are set forth in Bankruptcy Code §704. In Chapter 11 cases, trustees are only appointed for cause or in the best interest of the constituents of the estate, pursuant to Bankruptcy Code §1104(a)(1) (or (2). Chapter 11 trustees are also appointed by the United States Trustee or may be elected by the creditors.

Regardless of whether a trustee is elected or directly appointed by the United States Trustee, the person serving as trustee must qualify by, among other things, posting a bond pursuant to Bankruptcy Code §322(a). Also *see* Granderson v. Carpenter (In re Granderson), 252 B.R. 1, 5 (B.A.P. 1st Cir. 2000). As set forth in Bankruptcy Rule 2010(a), the bond is to ensure the "faithful performance of official duties by the trustee." Bankruptcy Rule 2010(b) sets forth who may proceed against the trustee's bond. While the rule provides that any action must be brought in the name of the United States, a failure to name the United States as a party plaintiff will not be fatal. In re Traffic Safety Company, Inc., 21 B.R. at 669. With respect to a trustee's bond, there is a statute of limitations set forth in Bankruptcy Code §322(d). However, in a Chapter 11 case, parties should also be mindful that any claims should be considered with respect to the final fee application of the trustee, if special compensation arrangements had been approved by the Court and the United States Trustee for the trustee's fees.

B. Duties of Trustees.

Various duties of a trustee in either a Chapter 7 or Chapter 11 case are set forth at Bankruptcy Code §§704 and 1106, respectively. Those duties cover a wide range of activity, but essentially consist of collecting and accounting for assets and liabilities of the estate, investigating potential causes of action of the estate, wrapping up the business affairs of the Debtor, and making appropriate distribution to creditors, and, if any residual remains, to the Debtor. Occasionally, in a Chapter 7 case the trustee must operate the business for a short period of time and provision for that is made in Bankruptcy Code §721. In a Chapter 11 case, it is presumed that the trustee will operate the Debtor's business, unless the Court, on request of a party in interest and after notice and hearing, orders the trustee otherwise. Bankruptcy Code §1108.

Stated generally, a trustee has the fiduciary duty to conserve assets of the estate and maximize distributions. United States v. Aldrich (In re Rigden) 795 F.2d 727, 730 (9th Cir. 1986). Trustees have the fiduciary duty to exercise care and diligence as an ordinarily prudent person facing similar circumstances. In re Cochise College Park, Inc., 703 F.2d 1339, 1357 (9th Cir. 1983). And as the Supreme Court has made clear, in appropriate circumstances, a trustee has a fiduciary duty to shareholders of the estate. Commodity Futures Trading Comn'n v. Weintraub, 471 U.S. 343, 355.

C. Limited Immunity of Trustees.

As is the case with other appointed representatives in a bankruptcy case, Chapter 7 and Chapter 11 trustees enjoy a broad limited immunity while acting in the course and scope of their appointed duties. In a Chapter 7 case, the Fifth Circuit has held that bankruptcy trustees should not be subjected to personal liability for damages to the estate unless they are found to have acted with gross negligence. In re Smyth, 207 F.3d 758 (Cir. 5 2000), rehearing denied. Similarly a Chapter 7 trustee was found to be immune from liability for alleged negligence and breach of fiduciary duty. In re Mailman Steam Carpet Cleaning Corp., 196 F.3d 1 (1st Cir. Mass. 1999) cert. denied, 120 S. Ct. 2661, 530 U.S. 1230, 147 L.Ed.2d cert. 275. As always, in questionable circumstances, seeking court authorization is always the safest bet. In re San Juan Hotel Corp., 847 F.2d 931 (1st Cir. Puerto Rico 1988). In Chapter 11 cases, the same standards of broad immunity apply. *See* Bennett v. Williams, 892 F.2d 822 (9th Cir. Cal. 1989). Weissnan v. Hassett, 47 B.R. 462 (S.D.N.Y. 1985) held that board of trustees' acts consisted solely of investigation into the Debtor and report thereon and was unrelated to ongoing operations, the trustee would be absolutely immune from suits arising out of that investigation and report.

As set forth above in the discussion of debtors in possession, trustees can be sued for post-petition matters that transgress state law. 28 U.S.C. §959. The suits may be filed "without leave of the court appointing [trustee]" 28 U.S.C. §959(a). However, pursuant to §959(b) of that statute, the Court may enjoin the litigants if the state court litigation is found to interfere with the administration of the bankruptcy case. *See* Carter v. Roger, 220 F.3d 1249 (11th Cir. Ala. 2000) cert. den. 121 S. Ct. 775, 531 U.S. 1077, 148 L.Ed.2d 673, In re DeLorean Motor Co., 991 F.2d 1236 (6th Cir. Mich. 1993) rehearing denied.

However, one set of suits that adds an extraordinary circumstances will not be enjoined or stayed are environmental suits. In re Grace Co., 155 B.R. 5; also *see* In re H.L.S. Energy Co., Inc., 151 F.3d 434 (Cir. 5 1998).

D. Removal and Liability of Trustees

Despite the broad protection afforded to trustees, they can and will be held liable for missed dates. Where serious matters have arisen, trustees have been removed "for cause" pursuant to Bankruptcy Code §324(a). The next section of the statute is mandatory that whenever the court removes a trustee or examiner under subsection (a), that person "shall thereby be removed in all other cases under [Title 11] in which such trustee or examiner is then serving unless the court orders otherwise." In re Drinkwater, 178 B.R. 590 (Bankr. Mass. 1995) holds that causes for removal include a trustee's incompetence or unwillingness to perform his duties. Where a trustee is not disinterested or holds an interest adverse to the estate, removal is appropriate. In re Paolino, 80 B.R. 341, 345 (Bankr. E.D. Pa. 1987). Where a trustee has been found to have violated his fiduciary duty to the estate, he or she will be removed. In re Vega, 102 B.R. 552 (Bankr. N.D. Tex. 1989).

However, courts will generally not remove a trustee absent actual fraud or actual injury. In re Martin, 817 F.2d 175, 181-83 (1st Cir. 1987). Nor will a trustee be removed for good faith mistakes in judgment where the trustee's decision was both discretionary and reasonable under the circumstances. *See* In re Olympia Holding Corp., 305 B.R. 586, 591 (Bankr. N.D. Fla. 2004).

In a Chapter 11 case, if it appears that the Debtor should be restored to debtor in possession status, the trustee's appointment will be terminated. Bankruptcy Code §1105. Termination of the trustee's appointment is, of course, different than removal for cause. Frequently, a trustee will be "liable" or penalized by denial of compensation for misconduct. *See* In re Unclaimed Freight of Monroe, Inc., 244 B.R. 358 (Bankr. W.D. La. 1999). In re El San Juan Hotel Corp., 239 B.R. 635, affirmed 230 F.3d 1347 (1st Cir. BAP (P.R.) 1999). In cases where trustees have been removed for cause, the liability appears fairly clear. *See* In re Vega, 102 B.R. 552 (Bankr. N.D. Tx. 1989), In re BH&P, Inc., 949 F.2d 1300 (3rd Cir.) N.J. (1991).

III.
EXAMINERS & OTHERS

Certainly one of the most notable changes in Chapter 11 practice in recent years is the increased use of examiners. The role of the examiner is generally described by statute, and may be defined by the court on a case by case basis to focus on a narrow set of issues or to be as expansive as that of a trustee. Perhaps the most interesting aspect of the examiner's lot in life is the special and protected relationship the examiner has with the court.

A. Appointment of Examiner.

Examiners are creatures of Chapter 11 solely. Bankruptcy Code §1104 provides for the appointment of an examiner 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 shall 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, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if—

(1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or

(2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.

Thus, if the appointment of a trustee has been requested but the Court is not convinced that the high burden of proof for appointment of a trustee has been met but there is some cause for concern, an Examiner will be appointed. Alternatively, parties in interest may not want the drastic remedy of a trustee but may request the appointment of an Examiner. Such an appointment must be made pursuant to 1104(c)(1) if there is no trustee, and the Court finds that it would be in the best interests of the estate, or if it has been requested and the Debtor has uncontested non-trade claims in excess of $5 million. §1104(c)(2). Examiners must be disinterested neutrals, and are prohibited from writing themselves into other roles in the case. Bankruptcy Code § 321(b) provides that: "A person that has served as an examiner in the case may not serve as trustee in the case." Similarly, the examiner is later precluded from serving as an advisor in the case: "The trustee may not employ a person that has served as an examiner in the case." 11 U.S.C. §327(f).

It is important for Examiners to have a clearly defined role and an understanding of what it is they are supposed to do. Statutorily, an Examiner's duties are set forth at 1106(b). Normally, these duties consist of an investigation into the acts of the Debtor, pre- or post-petition, and the filing of a report to the Court. In the typical appointment, the Examiner is considered to be operating as an independent reporter to the Court, and thus the fiduciary duty of the Examiner is generally understood to be that of an unbiased fact finder for the Court, though the Examiner's report is a filed, public document.

B. Duties and Responsibilities of Examiner.

Bankruptcy Code §1106(b) requires examiners to perform an investigation, which means they must "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." BANKR. CODE §1106(a)(3)

Examiners must file a report, which means they must identify and memorialize "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. §1106(a)(4)(A).

In addition to these mandatory duties, a bankruptcy court may order an examiner to perform "any other duties of the trustee that the court orders the debtor in possession not to perform." BANKR. CODE §1106(b).

The examiner has three general duties flowing from the Code, the Federal Rules of Bankruptcy Procedure and the common law: (i) he may not have a "material adverse" interest to any party to the bankruptcy "for any … reason," either at the time of appointment or during the course of the bankruptcy; (ii) he has several disclosure obligations; and (iii) he owes the creditors and shareholders a duty of loyalty. In re Big Rivers Elec. Corp., 355 F.3d at 433-34.

Given the (generally) circumscribed grant of authority and duties of examiners, and the scrutiny which led to the appointment in the first instance, it would seem unlikely that examiners would have much opportunity to breach their fiduciary duties. As discussed below, while rare, it does happen on occasion.

C. Limited Immunity of Examiner.

Like Committees and trustees, examiners operating within the scope of their authority will enjoy limited immunity from suits arising out of acts undertaken as examiner. Kovalesky v. United Health Care Organization, Inc., 1997 WL 630144 (S.D.N.Y. 1997). In a case of first impression, the court analyzed whether the doctrine of judicial immunity could extend to finding that an Examiner appointed by a bankruptcy court to conduct an investigation of the debtor's affairs and to report the findings of that investigation is absolutely immune from claims of negligence based on his findings and conclusions. Kovalesky, 1997 WL 630144 at 3. Citing Baldwin and In the Matter of Hamiel & Sons, 20 B.R. 830, 832 (Bankr. S.D. Ohio 1982) ("…the…examiner then constitutes a court fiduciary and is amenable to no other purpose or interested party"), the court held that a "limited powers examiner", i.e. one appointed solely to conduct an investigation of the debtor's affairs, to evaluate the validity of certain claims and to report his findings, is absolutely immune from negligence claims. The outcome might have been different if the examiner had been an "expanded powers examiner."

D. Examiner with Expanded Powers.

However, §1106(b) also provides that the role of an Examiner can be expanded to encompass "any other duties of the trustee that the court orders…." In a number of cases, the role of the Examiner has been subject to "mission creep". The "Examiner with Expanded Powers" is not a new cartoon superhero, and in fact may be coming to case near you. These cases may be found all over the but are also well represented in 5th Circuit bankruptcy cases.

In the Northern District of Texas, in the Mirant case an examiner was appointed and his role expanded to address issues in the case unanticipated at his initial appointment. The Third Amended and Restated Order Defining Role of Examiner shows that the Examiner's role is extremely broad, and appears to fulfill a necessary role in a series of cases spanning 83 debtors, many with ongoing intercompany transactions and without separate committees. The Examiner's duties include the standard investigations typical of examiner appointments, monitoring and if requested, analyzing ongoing transactions that have an inter-debtor effect and reporting to the court and parties in interest, monitoring, but not participating in, negotiations among the parties to the case, facilitating communications among the parties if it appears necessary, and holding monthly status conferences open to all parties in interest to monitor and discuss progress in the cases. The recordings of such meetings shall be available to all parties , other than the court, which because the status conferences may contain settlement discussion, has ordered that they not be disclosed to the court. The orders also contain immunity form discovery for the examiner. These provisions are contained in a series of orders dated July 7, July 30, September 1 and September 15, 2004. *See*, In re Mirant Corporation et al. USBC, N.D. Tx., Fort Worth Div., Case No. 03-46590.

In the Western District of Texas, an examiner with expanded powers was appointed in the El Paso Refinery case, [case no. 94-300051, W. Dist. Tx., El Paso Division], where as the examiner's investigation expanded, he was empowered to take on traditional trustee-type tasks, including negotiating sales of estate property.

In the Enron cases, there were two examiners appointed, one for Enron Corp, and one for Enron North America ("ENA"). Much of the tension in the case, and a significant reason for the ENA examiner, was the concern of the ENA creditors that they would be diluted in a joint or consolidated plan of reorganization.

While there is little case law in the area, it seems a safe bet that where an examiner is charged with the responsibilities of liquidating assets, collecting money, making distributions, that person would be exposed to the same sort of claims that a trustee would.

E. "Other" Appointed Persons.

In a number of cases, courts have appointed persons to roles for which no firm statutory underpinning appears, but whose job was to aid the court in the reorganization process. An example of such a case where the appointment went extremely badly is the group of Owens Corning asbestos cases. See, In re Kensington International Limited et al., 3687 F. 3d 289 (3d Cir. 2004). These are actually 5 related asbestos cases which had been consolidated for some purposes and all of which were being handled by a senior United States District Judge, by special assignment. The judge appointed five consultants or advisors to "advise the Court and to undertake such responsibilities, including … mediation of disputes, holding case management conferences, and consultation with counsel, as the Court may delegate to them individually." *Id.* at 297. Over the next 2 years the judge met repeatedly with the advisors and sometimes with parties repeatedly, totaling at least 325 hours, and the meetings included the exchange of extra-judicial information. *Id*. Creditors in the cases moved to recuse the judge. He denied the motions, up they went by way of mandamus petitions, ultimately resulting in the judge being disqualified in three of the five cases.

The underlying facts are surprising enough. Truly shocking, however, was the follow up. The judge took retirement and within a matter of a few months (at most) took a job at the firm of one of the advisors, who was representing plaintiffs in another asbestos case simultaneously with his "neutral" role as advisor in some of the largest asbestos bankruptcy cases pending. *See* Wall Street Journal Online, p. A8, August 6, 2004.

F. Miscellaneous Examiner Issues.

1. Ex Parte Conferences. Bankruptcy Rule 9003, *Prohibition of Ex Parte Contacts*, in relevant part, provides:

> *Except as otherwise permitted by applicable law, any examiner, any party in interest, and any attorney, accountant, or employee of a party in interest shall refrain from ex parte meetings and communications with the court concerning matters affecting a particular case or proceeding.* FED. BANKR. 9003(a).

There are few reported cases under Bankruptcy Rule 9003, and none apposite to this discussion. Perhaps given the clarity of the rule, that should not be surprising. But it must also be considered in its historical context. Consider the following legislative history:

> *When litigation does arise, there are substantial reasons for not entrusting its determination to bankruptcy judges involved in the prior administration of these litigated estates. It is necessary and important that the adversaries have confidence that their controversy will be determined by evidence adduced to them and presented to the trier of the law and the facts. The Commission is convinced that the referees' participation in administrative aspects of bankruptcy proceedings tends to impair the litigants' confidence in the impartiality of the tribunal's decision. In particular, adversaries of the trustee in bankruptcy tend to doubt that the referee who appointed the trustee can insulate himself from at least a suspicion of impartiality….*

H.R. REP. NO. 93-137, pts. 1 and 2 (1973), Collier's Legislative History – 1978 Act, App. Pt. 4-247.

Thus, while the role of an examiner as an independent officer reporting to the court may mean that the examiner's role be to inform the court as to underlying case dynamics, the only permissible method of communication is through the examiner's report, as required by Bankruptcy Code §1106(a) and Bankruptcy Rule 9003(a). The risk to the case and to the judicial system of any other communication is simply too great, as demonstrated by Kensington.

2. Examiner Protective Orders. Starting late last year and culminating only weeks ago, the press has had a great deal of fun with the Enron Corp. Examiner, Neal Batson's request that, (as reported) having finished his voluminous reports, and having been paid, through his firm, some $95 million, he now wishes to make an end of it, and be done once and for all with Enron, including not having to answer questions concerning his report or keep all of those pesky documents. In fact, Batson's reasons are both sound and in keeping with well established precedent. Batson's main points (here greatly simplified) are that the documents are copies of things gotten from other parties, except for attorney client and attorney work product between him and his firm, and were he to be available for every investigative body and plaintiff seeking to sue over an Enron related transaction, it would only be as a shortcut to their own research and he and the members of his firm would virtually never be finished.

After numerous hearings, the court granted a protective order providing for maintenance of many of the Enron documents, destruction of some others (copies) and extremely limited future access to Batson. As in the Mirant case discussed above, these protections evolved through a series of orders. The relevant orders are dated December 17, 2003, December 18, 2003, February 18, 2004 and October 5, 2004. *See* In re Enron Corp et al., USBC, S.D.N.Y. Case No. 01-16034.

The following cases support Batson's request and the court's order:

> *Matter of* Baldwin *United Corp*., 46 B.R. 314, 316 (Bankr. S.D. Ohio 1985). "An Examiner's legal status is unlike that of any other court-appointed officer which comes to mind. He is first and foremost disinterested and nonadversarial. The benefits of his investigative efforts flow solely to the debtor and to its creditors and shareholders, but he answers solely to the Court." Although the issue of disclosure of the Examiner's investigative materials was not before the court, the court expressed disapproval with the idea that an Examiner could be required by third-party litigants to produce his investigative materials. *Id*. at 317 ("If Examiners in other cases are to perform…[their] functions effectively, and if their nonadversarial role is to be maintained, they and the subjects of their investigation must be unhampered by the threat that any information that comes into the Examiner's hands will be fair game for a plethora of anxious litigants.")

> In re Ionosphere Clubs, Inc., 156 B.R. 414, 432 (S.D.N.Y. 1993), *aff'd* 17 F.3d 600. In denying the lifting of a protective order, the court observed that "[a]ny record compiled by the Examiner is not a judicial record, but simply a source of information designed for the purpose of identifying the assets of the estate for the eventual benefit of the debtor and its creditors. That some of the parties to the proceedings will assert substantive rights to the assets, once collected, does not make the identification of these assets an adjudicatory determination of "substantive rights."

> Vietnam Veterans Foundation v. Erdman, No. 84-0940, 1987 WL 9033 (D. D.C.). Granting (in part) a motion to disqualify the examiner as an expert witness, the court observed that the examiner "constitutes a Court fiduciary" (*Hamiel*) and has been likened to a "civil grand jury" (*Baldwin*). In addition, "[t]he integrity of the judicial process is directly threatened when litigators are allowed to question directly a court officer about the reasoning behind his official actions…" *Id*. at 2. The court held that the examiner's court-appointed powers could not serve as the basis for his proffered testimony. "A contrary rule would allow the parties to short-cut and would only invite further demands on such officers, potentially leading to substantial encroachments on judicial integrity and efficiency." *Id*. The court permitted the examiner to testify only as to matters outside his investigation or report.

Thus, given the neutral role the Code envisions for examiners and the legal precedent, protective orders for examiners appear entirely proper.

IV.
COMMITTEES

Bankruptcy Code §1102 requires the United States trustee to "appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate." BANKR. CODE §1102(a)(1). The section further provides for appointment of additional committees "if necessary to assure adequate representation of creditors or of equity security holders". BANKR. CODE §1102(a)(2). Thus, committees are comprised of representatives of specific constituencies and are charged with the responsibility to represent those constituencies. Pursuant to Bankruptcy

Code §1103(a), they hire "one or more attorneys, accountants, or other agents, to represent or perform services for such committee."

A. The Fiduciary Duties of Committees, and Members and their Counsel.

It is well settled that official committees serve as fiduciaries for the classes of claims or interests they represent. "Creditors' committees play a pivotal role in the Chapter 11 process. Like debtors, they also serve as fiduciaries and are required to act in a manner to serve the best interest of the estate and its creditors." Bankruptcy Code §1103(c)(5). As such, committees and their counsel do not act in the best interests of their individual members but must serve to protect the interests of all creditors. In re National Liquidators, Inc., 171 B.R. 819 (Bankr. S.D. Ohio 1994), *affirmed in part*, *reversed in part* 182 B.R. 186, quoting In re Mesta Machine Company, 67 B.R. 151, 156-158 (Bankr. W.D. Pa. 1986).

The same rule applies with respect to equity committees, and in fact any other committee appointed in a Chapter 11 case. In re Drexel Burnham Lambert Group, Inc., 138 B.R. 717 (Bankr. S.D.N.Y. 1992), *affirmed* 140 B.R. 347.

An individual committee member is a fiduciary to those whom it represents. It is not a fiduciary to the Debtor or to the bankruptcy state in general. In re SPM Manufacturing Corp., 984 F.2d 1305, 1315 (1st Cir. 1993).

B. Limited Immunity For Committees and Counsel.

As noted above, under Bankruptcy Code §1103 there is a grant of authority for committees to represent their constituencies. That carries with it a charge of fiduciary duties, but also a right of limited immunity while acting within the scope of the granted authority. This was perhaps best said in In re Tucker Freight Lines, Inc., 62 B.R. 213 (Bankr. W.D. Mich. 1986). The Court held that "however, implied in this grant of authority must also be a concurrent fiduciary duty to all unsecured creditors. At a minimum, this fiduciary duty requires that the committee's determination must be honestly arrived at, and, to the greatest degree possible, also accurate and correct. For Creditors' Committee to urge rejection of the plan for reasons they knew, or would have known but for recklessness, to be false would violate this duty and deprive them of any limited immunity they might otherwise hold under §1103(c)(3). *Id*. at 216. As a regular part of many plans of reorganization, committees, their members and counsel seek and receive general releases for their duties within the case. Occasionally, these releases become a matter of some controversy, particularly where a committee member or member of the class represented by the committee has voted against and/or objected to the confirmation of the plan and believes that the committee member and/or the committee awards counsel bridged its fiduciary duty to him.

In PWS Holding Corp., 228 F.3d 224 (3d Cir. 2000), the holders of subordinated debt instruments objected to the plan on several bases, including that it contain releases for the unsecured creditors committee and its counsel. Those objections were overruled. Similarly, in a case where a member of the equity committee objected to a plan because of alleged breaches of fiduciary duty by the equity committee and its counsel by advocating a plan which the objecting member did not like, the Court found that the equity committee with its grant of authority also had fiduciary duties owed to the class as a whole and not to individual members and a limited right or grant of immunity with respect to its acts. In re Drexel Burnham Lambert Group, Inc., 138 B.R. 717, 772 (Bankr. S.D.N.Y. 1992), affirmed 140 B.R. 347.

C. Committees (and Members) Behaving Badly.

The protections and immunity protecting committees, their members and counsel in the execution of their respective duties is broad but appropriately limited to those acts taken within the bounds of the bankruptcy code and case law which recognizes common sense standards borrowed from other areas of the law. A committee member was held to have breached its fiduciary duty to the creditors by usurping a government grant that had been enjoyed by the Debtor. The case originally went up to the Third Circuit on whether the grant was recoverable from the committee member as property of the estate. The third circuit held that the grant, issued by the federal government, was not property of the Debtor's estate but did find that the member had breached its fiduciary duty and thus would be liable to the estate and remanded the case on that basis. In re Life Service Systems, Inc., 279 B.R. 504 (Bankr. W.D. Pa. 2002).

A creditors committee was held to have exceeded its authority and it and its counsel were held liable for violating the automatic stay where the committee filed an adversary proceeding for a cause of action belonging to the Debtor without prior bankruptcy court approval. The Court found that the committee had violated the requirements of Louisiana World Exposition v. Fed. Ins. Co., 858 F.2d, 233 (5^{th} Cir. 1988) and thus the committee's actually outside of its limited immunity. The individual committee members were held personally liable and their counsel's fees were cut. Official unsecured creditors committee of General Homes Corp. v. American Savings & Loan Ass'n. of Florida (In re General Homes Corp.), 181 B.R. 870 (Bankr. S.D. Tex. 1994). Also *see* Robert S. Blanc, putting a limit on unlimited creditors' committee liability, 13 Bankr. Dev. J. 359 (Spring 1997).

In an early, but important, case regarding the fiduciary duties of creditors committees, it was held that where the creditors committee urged rejection of the plan of reorganization for reasons the committee knew, or should have known but for their own recklessness were false, the committee violated its fiduciary duties to the creditor body. In re Tucker Freight Lines, Inc., 62 B.R. 213 (Bankr. W.D. Mich. 1986).

In a case that speaks directly to the growing phenomena of trading in debt instruments of debtors, a venture fund (which was not a committee member but appeared to have been working with the committee in some fashion) was held to have breached its fiduciary duty where the fund was a significant shareholder in the Debtor's parent company and, based on information it obtained as an insider, purchased at discount approximately 40% of the outstanding notes of the Debtor, thus making it the largest unsecured creditor. It secretly acquired the notes without disclosing its purchases to the board of the debtor corporation (Paper Craft), its parent company or the Committee that it was doing so. The creditor's claim was equitably subordinated to an amount not greater than what it had actually paid for the notes, and the case was remanded for further findings as to whether further subordination would be appropriate. Citi Corp. Venture Capital, Ltd. v. Committee of Creditors Holding Unsecured Claims, 160 F.3d, 982 (3^{rd} Cir. 1998).

D. Members May Protect Self Interest.

The above cases do not mean that a committee member may not act in its own self interest. Rather, the rule is that the member may not use inside information or its position as a committee member to its own benefit and to the detriment of its constituency as a whole. Thus, a committee member which was sued by the trustee for alleged breach of fiduciary duties was held to be not liable where the bankruptcy court reasoned that the committee member, while having a responsibility to represent its constituency, was also entitled to take steps to protect its own interest. Krafsur v. UOP (In re El Paso Refinery, L.P.), 196 B.R. 58, 74 (Bankr. W.D. Tex. 1996).

E. Counsel Acting Against Constituents' Vote.

Interesting conflicts arise where the unsecured creditor body as a whole, they like to accept the plan that the Committee counsel has objected to. In re EBP, Inc., 171 B.R. 601 (Bankr. N.D. Ohio 1994), the Debtor filed a motion to strike the objection of the unsecured creditors committee because the creditor body as a whole voted to accept the plan. After an evidentiary hearing, the Court found that, absent a factual showing that the committee counsel had actually exceeded its authority, the objection would not be stricken. The particular facts of this case show that only 9 out of 72 creditors voted at all, but that each vote cast was in favor of confirmation. The amount of claims voted in favor of the plan was higher than the percentage voting, but included one significant claim of an insider. Nonetheless, the standards for confirmation had been met. The unasked question was whether the creditors committee as a whole was carrying out its duty where no creditor voted against the plan, including the committee chairman.