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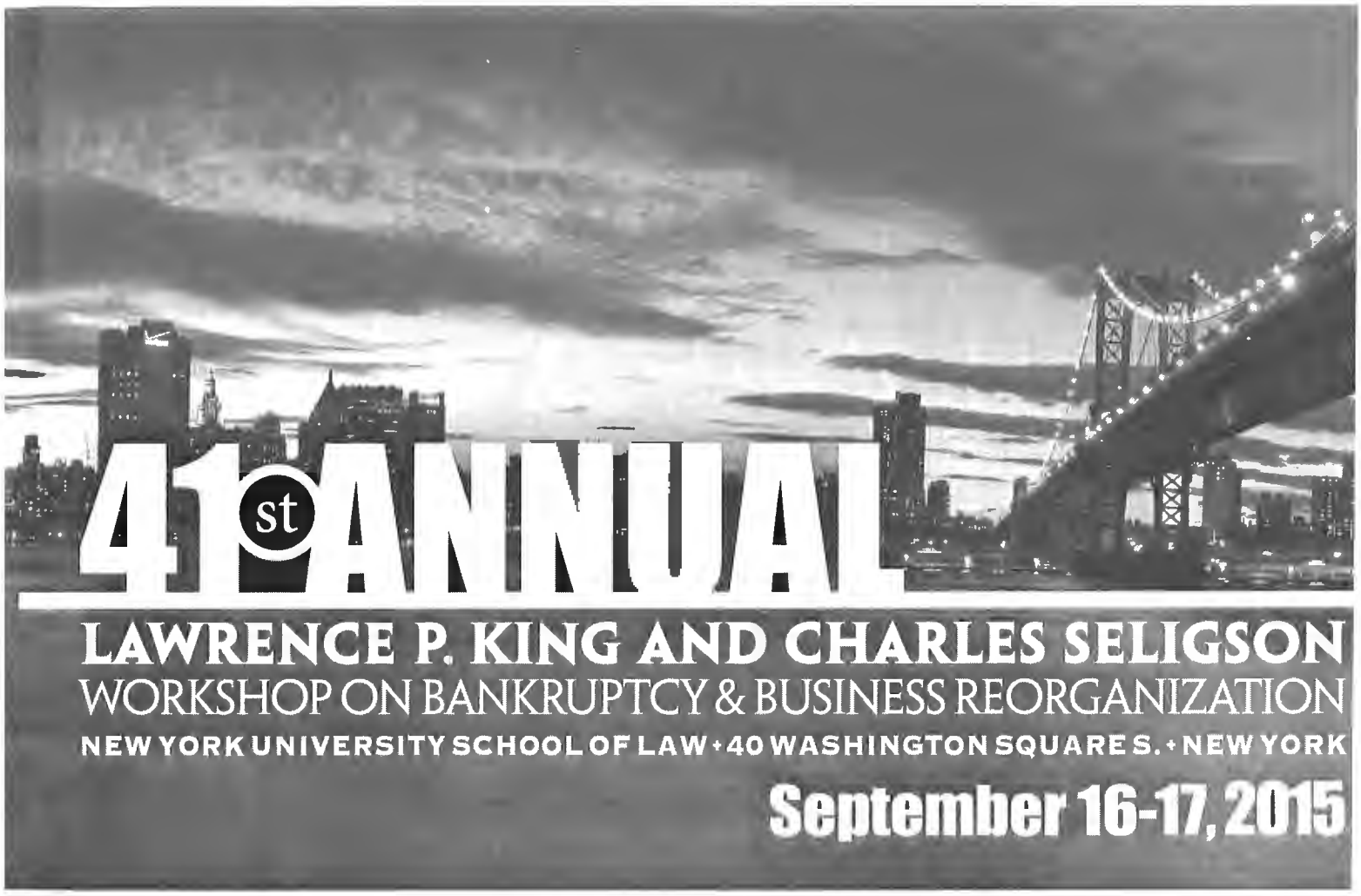

Educational Materials

THE "ESTATE NEUTRAL" PROPOSED BY THE ABI COMMISSION AND THE "RESPONSIBLE PARTY" PROPOSED BY THE NATIONAL BANKRUPTCY CONFERENCE: SOME OBSERVATIONS

Harold S. Novikoff
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In its 2012 – 2014 Final Report and Recommendations, the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 (the "Commission") recommended that Bankruptcy Code ("Code") sections 1104 (b) and (c) be amended to replace the provisions for appointment of an examiner with provisions for the appointment of an "estate neutral." The relevant portion of the Commission's Report (pages 32 through 38) is included as Annex A to this outline. An outline prepared by the Committee to Rethink Chapter 11 of The National Bankruptcy Conference (the "NBC"), which was adopted by the NBC, contains a more sweeping proposal for provisions contemplating a "Responsible Party" that would largely replace section 1104's provisions for an examiner and a chapter 11 trustee. The NBC outline is included as Annex B. Neither proposal is a fully-drafted legislative solution, but each merits serious consideration by the restructuring community.[1] The discussion below summarizes the Commission and NBC approaches, and offers some analysis and observations.

I. Summary of the Commission Proposal – the Estate Neutral

A. Recommended Principles – the Commission's proposal is set forth in the form of Recommended Principles, followed by a Background discussion and more detailed Recommendations and Findings. The Background and Recommendations and Findings sections contain citations to numerous cases and commentaries on examiners, and are an excellent resource for practitioners. The Recommended Principles recommend as follows:

1. Delete any reference in the Code to "examiner" and replace with the concept of a more flexible "estate neutral."

2. Amend Code section 1104(c) to set forth the standards for, and potential duties of, an estate neutral as described below.

3. Amended section 1104(c) should *not* mandate the appointment of an estate neutral under any circumstances.

4. The court may order the U.S. Trustee to appoint an estate neutral if:

   a. a trustee is not appointed; *and*

   b. the appointment is in the best interests of the estate *or* for cause.

[1] The author of this outline was a principal drafter of the NBC proposal and was a Commissioner on the Commission.

5. The order directing the U.S. Trustee to appoint an estate neutral should specify the scope of the estate neutral's duties and the duration of the appointment. There is a presumption against the appointment of multiple estate neutrals in a single case, but the court can appoint more than one to serve different functions if necessary or warranted by the circumstances.

6. The estate neutral should not:

   a. Propose a chapter 11 plan for the debtor;

   b. Act as a mediator in any matter affecting the chapter 11 case *unless* such action is the primary purpose of the original appointment;

   c. Initiate litigation on behalf of the debtor or the estate *unless* such action is within the scope of the original appointment and the person serving as estate neutral was not previously engaged to investigate or examine matters relating to the litigation or the chapter 11 case; or

   d. Operate the debtor's business (except as provided in the Commission's Recommended Principles for small and medium-sized enterprise cases).

7. In carrying out an order to appoint an estate neutral, the U.S. Trustee should appoint a disterested person in accordance with the procedures established for appointment of a chapter 11 trustee (*i.e.,* after consultation with parties in interest).

8. A party in interest may object to the person appointed as estate neutral under the same procedures and subject to the same standards set forth in the Recommended Principles for chapter 11 trustees. Pursuant to those Recommended Principles, an objecting party should plead with particularity, and the objection should be filed and heard on an expedited basis. The court should approve the U.S. Trustee's selection unless the objecting party establishes by clear and convincing evidence that:

   a. The U.S. Trustee did not properly consult with parties in interest;

   b. The selected person is not eligible under Code section 321;

   c. The selected person has not qualified under section 322;

   d. The selected person is not disinterested; or

   e. The selected person has a disqualifying conflict of interest.

   N.B. The court approves or disapproves the U.S. Trustee's selection but is not otherwise involved in the selection process.

B. Background

1. The Commission discusses the current examiner statute, and the intepretation of the standards for appointment.

2. The Commission notes that examiners were sought in a minority of cases, and most often in "huge" contentious cases.

3. While noting that an examiner's role is primarily investigatory, the examiner may have an important effect on the direction of a case.

4. Comments regarding benefits of an examiner noted by the Commission:

   a. May promote efficiency by avoiding multiple investigations.

   b. May aid the estate in identifying viable sources of recovery.

   c. May unearth information that might otherwise have been undiscovered or unavailable.

   d. The examiner is independent and neutral, which can give extra weight to the examiner's assessment of the strengths and weaknesses of the positions of parties in interest.

5. Comments regarding detriments of an examiner noted by the Commission:

   a. Extra layer of cost and delay.

   b. Notwithstanding its potential value and cost to the estate, the examiner's report is not admissible as evidence.

6. The Commission notes that mediators and facilitators appointed on an *ad hoc* basis have played beneficial roles in chapter 11 cases, but some courts interpret current Code section 1104 as prohibiting such appointments.

C. Recommendations and Findings

1. The Commission found value in the availability of a neutral in the case, but opted to have the estate neutral replace the examiner to provide greater flexibility in fashioning the neutral's role.

2. Based on their experience, the Commissioners found "little correlation" between the current standards for mandatory appointment and the utility of the appointee in any given case. Thus, the Commission recommended eliminating any mandatory appointment requirement.

3. On the other hand, the Commissioners recommended that the standards for appointment be expressed as "best interests of the estate" and rejected the notion that the appointment must be found to serve all interests.

4. The Commission recommended greater flexibility in fashioning a role of an estate neutral as an independent appointee with a neutral perspective, and noted ways in which the appointment could reduce costs.

5. The Commission declined, however, to recommend a statutory role for a reorganization executive,[2] but considered the potential value of such a position in considering and developing the role of an estate neutral. Commissioners who opposed the statutory reorganization executive viewed appointment of a trustee as a better alternative.

D. Chapter 11 Trustee – the Commission also offered some Recommended Principles regarding the Code's chapter 11 trustee provisions, including:

1. Clarifying the burden of proof to show cause under Code section 1104(a) should be based on the preponderance of the evidence (not clear and convincing).

2. Clarifying the bases for objections to the person appointed as chapter 11 trustee.

3. Deleting the election provisions of Code section 1104(b).

4. Appointment of a chapter 11 trustee should not automatically terminate exclusivity.

N.B. These recommendations offer potential improvements to the Code, but do not change the role of a chaper 11 trustee.

II. Summary of the NBC Proposal – the Responsible Party or "RP"

A. Overview of Proposal – the NBC's Committee to Rethink Chapter 11 was permitted to offer sweeping changes for consideration by the full Conference. In contrast to the Commission proposal, which essentially modifies the existing trustee and examiner provisions of the current Code (though changing the name of an examiner to an estate neutral), the Responsible Party envisioned by the NBC would largely (though not entirely) replace both the trustee and examiner under the current Code, and heavily changes the appointee's duties and selection process. The NBC characterizes its proposal as a "'Clean Slate' Corporate Governance Proposal." The NBC proposal is a fundamental departure from the existing statutory framework, and in the interests of brevity the following summary omits many details. Please refer to Annex B for the details (including special treatment of cases with less than $10 million of assets).

[2] The Commissioners had access to a draft of the NBC proposal before its adoption by the full NBC. There were some changes between that draft and the final versoin that was ultimately adopted, but the changes were not particularly material. Some of the Commission's discussion of a statutory reorganization executive may relate to the Commission's decision not to follow the NBC's approach.

1. The RP's duties are extremely flexible, are tailored to the particular case, and are set forth in a court-approved "RP Plan."

2. Motion for appointment of an RP

   a. The motion must specify the proposed RP, the proposed RP Plan and, if the movant is not the debtor, cause for the appointment. If the debtor is the movant, the appointment of an RP is mandatory (though not necessarily the RP nor the RP Plan specified by the debtor).

   b. The debtor or a Proposing Party may be the movant. The Proposing Party may be an official committee or major stakeholder in the chapter 11 case (*see* Annex B for details). The U.S. Trustee is *not* a Proposing Party.

   c. It is contemplated that the RP and RP Plan will be the subject of early negotiation among the debtor and major stakeholders. (The parties may also agree that there is no need for an RP.) If no consensus has been reached, the debtor and any Proposing Parties may submit responsive pleadings containing alternative candidates for RP and alternative RP Plan proposals.

   d. All parties in interest (including the U.S. Trustee) have standing to be heard in support or in opposition to the motion, and any proposed RP or RP Plan, *but only the debtor and Proposing Parties may submit candidates for RP*. Only a candidiate proposed by the debtor or a Proposing Party may be appointed as the RP.

   e. The RP may be a pre-existing employee of the debtor, a crisis manager, an advisor, an accountant, a lawyer or a business professional.

   f. The bankruptcy court will take into consideration the timing of the motion when determining whether to grant it. If the court believes that the parties are using an RP motion for "gamesmanship" purposes, it may deny the motion even if cause otherwise exists. The hearing will generally be conducted within 30 days of the filing of the motion.

3. If a Proposing Party is the movant, cause must be shown.

   a. Cause includes the current grounds for appointment of a trustee (*i.e.,* fraud, dishonesty, incompetence or gross mismanagement by current management, which are referred to in the NBC Proposal as "Special Grounds"), but also contain a number of grounds identifying particular needs of the debtor or estate, such as

i. Absence of material financial controls.

ii. Vacancies in two or more officer positions.

iii. Material restatements of financial statements.

iv. Demonstrated need for increased operation efficiencies or a substantial operational reorganization.

v. Significant government investigations.

vi. Contemplated substantial sales or other material transactions outside the ordinary course of business requiring experience or expertise lacked by management.

vii. Debtor's management is deficient or lacks required experience.

viii. The debtor's board is wholly interested.

ix. The appointment is in the best interests of the estate.

b. If the RP Plan provides for the RP to supersede, in whole or in substantial part, the debtor's board of directors, Special Grounds must be shown unless the debtor consents.

4. RP Plan

a. The order appointing the RP will contain an RP Plan containing at a minimum:

i. The terms of the RP's engagement, including duties, compensation, responsibilities, reporting requirements, and indemnification.

ii. Any changes or restrictions in the role or authority of the pre-existing board of directors and/or officers. *If Special Grounds have been shown*, the RP may have all of the powers currently available to a chapter 11 trustee, including taking over board or officer duties and filing a chapter 11 plan.

iii. Whether the RP is a company officer or court appointee.

iv. Whether the RP may retain separate professionals. It is contemplated that the RP will use the debtor's professionals, unless and only to the extent that there is a need to have his own.

b. It is contemplated that the RP Plan will be based on what is submitted in the motion and responsive pleadings, but the court may fashion whatever it feels is appropriate.

5. Selection process

a. The court selects the RP from the pool of RP candidates submitted by the debtor and Proposing Parties. No candidate not so submitted can be appointed.

b. In choosing the RP and specifying the term of the RP Plan, the court is instructed to take into consideration, among other things:

i. The nature of the cause shown (*e.g.*, if the cause shown is a lack of financial controls, select an RP with experience in financial controls and the RP Plan should give the RP powers and responsibilities relating to financial controls).

ii. The views of parties in interest.

iii. The qualifications of the candidates for the RP position.

iv. The status of any plan negotiations.

v. The likelihood that a substantial portion of the estate assets will be transferred uring the case.

vi. The pre-petition conduct of the debtor, its insiders and it creditors.

vii. The extent to which insiders control the debtor.

viii. The complexity of the debtor's corporate and capital structure.

c. The RP should hold no substantial conflicts of interest with the debtor's estate that are likely to affect the performance of the RP's duties, but in the case of an employee of the debtor may hold claims or equity interests that are not materially disproportionate to his role as employee.

6. Debtor incentives for appointment – if an RP has been appointed:

a. Unless otherwise specified in the RP Plan, appointment of an RP is an automatic 3 month extension of any exclusivity periods (but not beyond any statutory cap).

b. Decisions by the debtor's management will be entitled to deference in the context of motions for authority to take action outside the ordinary course of business if supported by the RP.

c. Prohibitions on DIP lender/adequate protection control covenants would be applicable.

d. No chapter 11 trustee may be appointed (but the RP may be replaced by another RP for cause relating to post-appointment matters). An examiner may be appointed to conduct an investigation for cause shown (not mandatory), but only if and to the extent the RP Plan does not provide for such an investigation.

B. Reasons for change the Code – the NBC stated what it viewed as the deficiencies in the Code's governance provisions in explaining why it thought such a sweeping change is required.

1. Debtor in possession – the DIP governs unless a trustee is appointed, controls the filing of a plan during exclusivity, and is given deference by many courts, but has done nothing to warrant the position other than file a chapter 11 petition. The DIP may be:

a. A poor manager

b. Unsuitedfor a restructuring, sale, liquidation, litigation and/or investigatory role.

c. Heavily influenced by ownership of equity, prospect for continued employment and/or personal compensation

d. May lack credibility with DIP lenders and other stakeholders, resulting in tough covenants and control provisions.

e. The foregoing undermines the justification for the deference often accorded to DIPs by bankruptcy courts, and may hamper reorganization efforts.

2. Chapter 11 trustee – a trustee has broad managerial, restructuring and investigatory powers, and is generally selected by the U.S Trustee after consultation with parties in interest. Appointment of a trustee terminates exclusivity.

a. In practice, chapter 11 trustees have been rarely sought and appointed, even in situations involving fraud, mismanagement and/or loss of trust by management. For example, CROs or the equivalent were retained in Enron, Worldcom and Lehman in lieu of trustees.

b. Selection through voting contemplated by Code section 1104(b)(1) rarely occurs and is limited to unsecured creditors, even if the capital structure is dominated by secured debt.

c. A trustee may be unsuitable for operating a business.

d. Often entails a new layer of expenses, and trustees often retain their own professionals.

e. Although the U.S. Trustee generally consults with the major parties in interest, the appointment process is inherently unpredictable and experience with chapter 11 trustees is generally regarded as uneven at best.

f. Loss of control and termination of exclusivity are strong disincentives for a debtor to consent to appointment.

3. Chief Restructuring Officer ("CRO") – even though not expressly contemplated by the Code, this has become a popular option where management support is needed. Some concerns expressed by the NBC:

a. Selection is generally not a transparent process. Selection is typically by the debtor and may in practice be influenced by senior secured creditors.

b. Due in large measure to the absence of express authority in the Code for appointment of a CRO, the CRO's role, responsibilities, reporting and fiduciary duties may not be clear.

4. Examiner – generally limited to an investigative role, disqualified from prosecuting identified causes of action, and his report has little or no evidentiary value Other concerns identified by the NBC:

a. Mandatory appointment provisions.

b. Investigations may be expensive and cause delays, even where there is little justification for the investigation.

c. Generally not effective to address corporate governance concerns.

d. Non-transparent selection process.

III. Comparison of the Proposals, and Some Observations

A. Fine tuning *versus* sweeping change

1. It may be somewhat of an overstatement to characterize the Commission's recommendations as fine tuning, but not by much. The Commission's

substantive recommendations were limited to (a) removing the exclusivity termination impact of trustee appointment, (b) removing the mandatory appointment requirement for examiners, and (c) making the examiner role broad enough to handle some mediation and facilitation roles. These are regarded widely as sound suggestions by the restructuring community, but all were also considered "low hanging fruit" and not particularly novel or controversial. If you are of the opinion that corporate governance works fairly well now in chapter 11 cases – or, at least, that the problems with corporate governance are addressed by the Commission's focused suggestions – you may well be in full agreement with the Commission's approach.

2. It is unlikely that the adoption of the Commission's recommendations would create any new or unforeseen problems in chapter 11 cases. It is also unlikely that the Commission's recommendations will correct many of the problems identified by the NBC – if you regard them as problems.

3. On the other hand, if you consider corporate governance in chapter 11 cases to be "broken" and requiring a more fundamental fix, you may conclude that the Commission's suggestions may not do enough. Much of this may depend on how uncomfortable you are with the fact that the system currently relies on the use of CROs, which is arguably a "work around" that has no clear statutory basis and lacks the transparency of a judicial appointment.

4. Even if you feel that the system requires a sweeping change, you may not favor the approach suggested by the NBC. The NBC's approach has the potential to insert an independent, neutral appointee into a chapter 11 case with a mandate that is tailored for the case. This could be a powerful tool for facilitating chapter 11 reorganizations. Nonethless, it has been subjected to some carefully considered criticism:

   a. It may disincentivize chapter 11 filings by increasing the risk that the directors and officers may lose control over at least some aspects of the debtor's business or reorganization.

   b. It could lead to distracting litigation early in the case.

   c. It may be undesirable for the Bankruptcy Judge to make the selection in view of the potential for influence or corruption (though the judge would be strictly limited to candidates submitted by major parties).

B. The Need for a Case Mediator/Facilitator – both proposals may make the chapter 11 process more efficient by creating an avenue for introducing a strong neutral into the process who could facilitate resolution of difficult issues in the case. Some of the most contentious recent filings arguably could use such a figure.

Query whether it is prudent to depart from the time-tested adversarial system in favor of a more heavily mediated system?

3. The Estate Neutral

Recommended Principles:

- The Bankruptcy Code should be amended to delete any reference to an "examiner" and to incorporate the concept of a more flexible "***estate neutral***," as described in these principles.
- Section 1104(c) of the Bankruptcy Code should be amended to set forth the standards for, and potential authority and duties of, an estate neutral, as described in these principles.
- Section 1104(c) should not mandate the appointment of an estate neutral in any circumstances.
- The court should be permitted to order the U.S. Trustee to appoint an estate neutral if (i) a trustee is not appointed and (ii)(a) the appointment is in the best interests of the estate, or (b) for cause.[116]
- An order directing the U.S. Trustee to appoint an estate neutral should specify the scope of the estate neutral's duties and the duration of the appointment. The court may direct the U.S. Trustee to appoint more than one estate neutral in any given case to serve different functions if necessary or warranted by the circumstances of the case. Nevertheless, the Bankruptcy Code should include a presumption against the appointment of more than one estate neutral in any given case.
- An order directing the U.S. Trustee to appoint an estate neutral should not permit that individual to: (i) propose a chapter 11 plan for the debtor; (ii) act as a mediator in any matter affecting the chapter 11 case, unless such action is the primary purpose of the individual's original appointment; (iii) initiate litigation on behalf of the debtor or the estate, unless such action is within the scope of the individual's original appointment and the individual was not previously engaged to investigate or examine matters relating to the litigation or the debtor's chapter 11 case; or (iv) except as provided in the principles for small and medium-sized enterprise cases, operate the debtor's business.
- Upon the entry by the court of an order directing the U.S. Trustee to appoint an estate neutral, the U.S. Trustee should, in conformity with the procedures established for the appointment of a chapter 11 trustee, appoint a disinterested person to serve as the estate neutral. A party in interest should have the ability to object to the person appointed as the estate neutral under the same procedures and subject to the same standards established in the principles governing objections to the person appointed as the chapter 11 trustee. *See* Section IV.A.2, *The Chapter 11 Trustee.*

116 Bankruptcy cases in Alabama and North Carolina are not under the jurisdiction of the U.S. Trustee, but rather are administrated by Bankruptcy Administrators in those jurisdictions. Accordingly, the applicable rules of those jurisdictions would govern the appointment process.

The Estate Neutral: Background

A chapter 11 trustee is not the only alternative to the debtor in possession. An examiner with a specific directive may be appointed to investigate the affairs of the debtor.[117] An examiner does not displace the debtor in possession or its management, and it is available only if no trustee has been appointed and only upon request of a party in interest or the U.S. Trustee and after notice and a hearing. In those circumstances, section 1104(c) requires the court to appoint an examiner if such appointment is in the interests of creditors, equity security holders, or the estate, or 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."[118]

Whether the appointment of an examiner is truly mandatory in any given case has met with resistance by some courts and created a split in the law.[119] Professor Jonathan C. Lipson reviewed "dockets from 576 of the largest chapter 11 cases commenced between 1991 and 2007" and discovered that "examiners were requested in only 87 cases, or about 15 percent of the sample," and that the "motions were granted in only 39 cases, less than half of cases where [an examiner was] sought, and about 6.7 percent of all cases in the sample."[120] Professor Lipson concluded that despite statements by some commentators to the contrary, examiners "are neither 'routinely' sought nor 'automatically' appointed in large cases."[121] Professor Lipson also concluded that examiners were more likely appointed in "huge," contentious cases, and that a request for the appointment of a trustee increases the odds that an examiner will be appointed.[122]

Setting aside the debt threshold in section 1104(c)(2), courts have generally interpreted the "interests" test in section 1104(c)(1) to broadly encompass the interests of all parties in interest. As one court explained, "the basic job of an examiner is to examine, not to act as a protagonist in

117 For a general discussion of the role and appointment of examiners in chapter 11 cases, *see* Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 Am. Bankr. L.J. 1 (2010).

118 11 U.S.C. § 1104(c).

119 *See, e.g., In re* Wash. Mutual, Inc., 442 B.R. 314, 324 (Bankr. D. Del. 2011) ("The Court denied the Initial Examiner Motion . . . finding that there was no appropriate scope for an examiner to conduct an investigation given that issues pertinent to, and even beyond the scope of, the chapter 11 cases had been 'investigated to death.'"); *In re* Spansion, Inc., 426 B.R. 114, 127 (Bankr. D. Del. 2010) ("I find no sound purpose in appointing an examiner, only to significantly limit the examiner's role when there exists insufficient basis for an investigation. To appoint an examiner with no meaningful duties strikes me as a wasteful exercise, a result that could not have been intended by Congress."); *In re* Erickson Ret. Communities, LLC, 425 B.R. 309, 312 (Bankr. N.D. Tex. 2010) ("At first blush, the issue here seems to be whether, because the $5 million unsecured debt threshold is met . . . the appointment of an examiner is mandatory. Many courts have been confronted with this issue and have held yes — an examiner is required whenever the $5 million unsecured debt threshold of Section 1104(c)(2) is met. This court agrees with such courts that, where the $5 million unsecured debt threshold is met, a bankruptcy court ordinarily has no discretion. The only judicial discretion that comes into play is in defining the scope of the examiner's role/duties. The court can make the scope of an examiner's duties very broad or very narrow." (citations omitted)); *In re* Vision Dev. Grp. of Broward Cnty., LLC, 2008 WL 2676827, at *3 (Bankr. S.D. Fla. Jun 30, 2008) ("[A] request for, and appointment cannot be waived by request made late in case of, an examiner may be made 'at any time before the confirmation of the plan.'") (quoting 11 U.S.C. § 1104(c)(2)). *See also* Walton v. Cornerstone Ministries Invs., Inc., 398 B.R. 77, 81 (N.D. Ga. 2008) ("[E]very district court and nearly every bankruptcy court that has confronted the question has also read the provision to be mandatory on its face."); *In re* Schepps Food Stores, Inc., 148 B.R. 27, 30 (S.D. Tex. 1992) ("This reasoning is both grammatically and contextually wrong. In the provision, 'as is appropriate' modifies 'investigation.' The statute allows the court to determine the scope, length, and conduct of the investigation, rather than the appointment itself.").

120 Jonathan C. Lipson, *Understanding Failure: Examiners and the Reorganization of Large Public Companies*, 84 Amer. Bankr. L. J. 1 (2010). *See generally supra* note 66 and accompanying text (generally discussing limitations of chapter 11 empirical studies).

121 *Id.* at 4. Indeed, Professor Lipson includes this quote from the Honorable Robert Gerber of the U.S. Bankruptcy Court for the Southern District of New York: "[M]andatory appointment [of examiners] is terrible bankruptcy policy, and the Code should be amended . . . to give bankruptcy judges . . . the discretion to determine when an examiner is necessary and appropriate. . . ." *Id.*

122 *Id.* at 5. Professor Lipson also notes that examiners are more likely to be sought in cases pending in Delaware or the Southern District of New York (where most of the "huge" cases are filed), and that allegations of fraud do not automatically result in either a request for, or order appointing, an examiner. *Id.*

the proceedings."[123] For this reason, "appointment under § 1104(c)(1) must, therefore, be in the interests of everyone with a stake in the case, including creditors, equity security holders, and other interests of the estate."[124] When only certain parties (*i.e.*, the movants) would likely benefit from the appointment of an examiner, such request was not deemed to satisfy the "interests" test.[125] In deciding whether to appoint an examiner, courts have also considered the overall financial benefit that an examiner could bring to the estate.[126] Allegations of corporate fraud and misconduct by a debtor's insiders or affiliates are often cited as reasons for appointing an examiner so that the examiner may investigate such allegations.[127]

It is noteworthy that although the language in section 1104 is not explicit, some courts and scholars have stated that the "interests" test for the appointment of examiners is the same "interests" test that is applied to the appointment of trustees: the "best interests" test.[128] This reasoning may be based on the fact that the "interests" test in section 1104(a) respecting trustee appointments and section 1104(c) respecting examiner appointments is substantially identical;[129] indeed, the statute does not explicitly provide for a "best interests" test.[130]

123 Official Comm. of Asbestos Pers. Injury Claimants v. Sealed Air Corp. (*In re* W.R. Grace & Co.), 285 B.R. 148, 156 (Bankr. D. Del. 2002).

124 *In re* Gliatech, Inc., 305 B.R. 832, 836 (Bankr. N.D. Ohio 2004) (citations omitted). Another court explained that "[a] single creditor group 'cannot justify the appointment of a[n] . . . examiner simply by alleging that it would be in its interests.'" *In re* Sletteland, 260 B.R. 657, 672 (Bankr. S.D.N.Y. 2001) (citations omitted). *See also In re* Lenihan, 4 B.R. 209, 212 (Bankr. D.R.I. 1980) ("[W]ill such an appointment benefit the estate of the debtor and the interests of creditors? A bankruptcy court, which must eventually pass upon questions of fairness, good faith, best interest, etc. prior to confirmation, cannot blindfolded by the tactical jockeying of the parties in determining what is in the interest of the estate.") (citations omitted).

125 *See, e.g., In re* Loral Space & Commc'ns Ltd., 313 B.R. 577, 583–84 (Bankr. S.D.N.Y. 2004), *rev'd and remanded on other grounds*, 2004 WL 2979785 (S.D.N.Y. Dec. 23, 2004) ("The Ad Hoc Committee's motion clearly fails the 'in the interests of the estate' test of section 1104(c)(1) of the Bankruptcy Code. First, under section 1104(c)(1) the appointment of an examiner must be in the interests of the estate in general. Here, however, the appointment of an examiner would, at best for the shareholders, advance only their interests in opposition to the Debtors' plan."). On appeal, the district court reversed and remanded to the bankruptcy court, mandating the appointment of an examiner but solely on the ground that "[o]n its face, Section 1104(c)(2) mandates the appointment of an examiner where a party in interest moves for an examiner and the debtor has $5,000,000 of qualifying debt." *In re* Loral Space & Commc'ns Ltd., 2004 WL 2979785, at *4 (S.D.N.Y. Dec. 23, 2004).

126 *See, e.g., In re* Loral Space & Commc'ns Ltd., 313 B.R. 577, 584 (Bankr. S.D.N.Y. 2004), *rev'd and remanded on other grounds*, 2004 WL 2979785 (S.D.N.Y. Dec. 23, 2004) ("[T]he appointment of an examiner would not be in the estates' interest in the light of the negligible benefits of the requested valuation balanced against its cost."); *In re* Shelter Res. Corp., 35 B.R. 304, 305 (Bankr. N.D. Ohio 1983) ("The appointment of an examiner would entail undue delay in the administration of this estate and most likely cause the debtor to incur substantial and unnecessary costs and expenses detrimental to the interests of creditors and parties in interest."); *In re* Hamiel & Sons, Inc., 20 B.R. 830, 837 (Bankr. S.D. Ohio 1982) (conducting cost/benefit analysis when considering appointment of trustee or examiner).

127 *See, e.g., In re* Keene Corp., 164 B.R. 844, 856 (Bankr. S.D.N.Y. 1994) ("Often, appointment of an examiner is warranted when the debtor's transactions with affiliates should be investigated.") (quoting M. Bienenstock, Bankruptcy Reorganization 299 (1987)). Another bankruptcy court appointed an examiner because it found that it was in the interest of creditors to involve an examiner in light of the significant amount of debt, receivables, and other obligations at stake and that "[t]he involvement of an examiner will contribute valuable perspective to a case with many competing interests at stake." *In re* First Am. Health Care of Ga., Inc., 208 B.R. 992, 995 (Bankr. S.D. Ga. 1996).

128 *See In re* Lenihan, 4 B.R. 209, 211 (Bankr. D.R.I. 1980) (holding that the decision to appoint an examiner "rests on a determination by the court that such appointment would be in the *best interests* of creditors, equity security holders, and the estate; the same test used to determine whether the appointment of a trustee is warranted") (emphasis added); Ryan M. Murphy, *Does the Recent String of Examiner Appointments in Delaware Represent a Sea Change in Approach or Merely a Perfect Storm of Cases?*, Norton J. Bankr. L. 2011.04-2 (2011) ("[A] bankruptcy court is authorized to appoint an examiner under two scenarios: (1) where it is in the *best interest* of the estate and interested parties; or (2) where the debtor's fixed, unliquidated debts (excluding claims for goods, services, taxes and insider transactions) exceed $5 million.") (citations omitted) (emphasis added); 5 Norton Bankr. L. & Prac. 3d § 99:25 ("The 'best interests' test for the appointment of an examiner, like the Code § 1104(a)(2) provision for the appointment of a trustee6 is a flexible and discretionary standard.").

129 Section 1104(a) provides that the court shall appoint a trustee if, among other reasons, "such appointment is in the interests of creditors, any equity security holders, and other interests of the estate." 11 U.S.C. § 1104(a)(2). Section 1104(c) provides that the court shall appoint an examiner if, setting the debt threshold aside, "such appointment is in the interests of creditors, any equity security holders, and other interests of the estate." 11 U.S.C. § 1104(c)(1).

130 "Sections 1104(a)(2) and (c)(1) of the Bankruptcy Code, using identical language, authorize the appointment of a trustee or examiner, respectively, if 'such appointment is in the interests of creditors, any equity security holders, and other interests of the estate.' Under these provisions, a creditor group, no matter how dominant, cannot justify the appointment of a trustee or examiner simply by alleging that it would be in its interests. It must show that the appointment is in the interests of all those with a stake in the estate, which in this case would include the Debtor. As Collier points out, 'Use of the word 'and' suggests that creditors cannot on their own obtain the appointment of a trustee under the provision in order to disenfranchise equity security holders or other interests.'" *In re* Sletteland, 260 B.R. 657, 672 (Bankr. S.D.N.Y. 2001).

If appointed, the primary duty of an examiner under current law is to (i) "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"[131] and (ii) "(A) file a statement of any investigation conducted . . . 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 unsecured creditors' committee or equity security holders' committee, to any indenture trustee, and to such other entity as the court designates."[132]

The examiner's investigation and report may have an important effect on the direction of the case, as well as on the pursuit of claims for the benefit of creditors. For example, the examiner's reports in the chapter 11 cases of Lehman Brothers, Residential Capital, and Tribune Company assessed the merits of claims asserted by parties in the case, identified additional potential claims and causes of action, and provided parties in interest with substantial information concerning the debtor and its case that otherwise likely would have been undiscovered or unavailable.[133] Commentators summarize these benefits as follows:

> 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 preempt the bankruptcy field by vastly reducing the need for early and duplicative discovery efforts by separate creditors or committees. [134]

Notwithstanding the potential benefit to the estate, some observers argue that an examiner simply adds another layer of cost and delay to the process and that the debtor in possession or unsecured creditors' committee can serve the same function.[135] The primary response to this potential critique is that an examiner comes to the process with a special, independent, and neutral role, which no other party can claim. The principle that the proper role of an examiner is that of a disinterested, nonadversarial officer of the court has been so widely accepted that it can hardly be doubted.[136]

131 11 U.S.C. § 1104(c).

132 *Id.* § 1106(a)(4) (referred to in 11 U.S.C. § 1106(b)).

133 *See* Report of Kenneth N. Klee, Examiner, *In re* Tribune Co., No. 08-13141 (July 26, 2010) [Docket Nos. 5130, 5131, 5132, 5133]; Report of Anton R. Valukas, Examiner, *In re* Lehman Bros. Holdings, Inc., No 08-13555 (Bankr. S.D.N.Y. Mar. 11, 2010) [Docket No. 7531]; Report of Arthur J. Gonzalez, Examiner, *In re* Residential Capital, LLC, No. 12-12020 (Bankr. S.D.N.Y. May 13, 2013) [Docket No. 3698]. (Kenneth N. Klee and Arthur J. Gonzalez are Commissioners.)

134 Clifford J. White III & Walter W. Theus, Jr., *Chapter 11 Trustees and Examiners after BAPCPA*, 80 Am. Bankr. L. J. 289, 290 (2006).

135 *See, e.g.*, Dickerson, *supra* note 19, at 904 ("[H]aving an examiner in a case can substantially increase the costs of the reorganization and, accordingly, reduce the amount available to pay creditor claims. Because examiners are often appointed in cases that have active creditor committees, courts have refused to appoint an examiner if doing so would increase the number of fiduciaries already involved in a case. Some courts have argued that examiners often duplicate the work already being performed by creditors' committees.").

136 Examples of cases stating this principle: Kovalesky v. Carpenter, 1997 WL 630144, at *3 (S.D.N.Y. Oct. 9, 1997) ("Examiners . . . play a chiefly information-seeking role and, like the court itself, must remain a neutral party in the bankruptcy process."); *In re* Big Rivers Elec. Corp., 213 B.R. 962, 977 (Bankr. W.D. Ky. 1997) ("[The examiner is] a party who is not an adversary but rather an independent third party and officer of the Court."); *In re* Interco Inc., 127 B.R. 633, 638 (Bankr. E.D. Mo. 1991) ("[T]he Examiner's role is by its nature disinterested and nonadversarial. There is no doubt that the Examiner is a neutral party in a bankruptcy case."); *In re* Baldwin United Corp., 46 B.R. 314, 316 (Bankr. S.D. Ohio 1985) ([The Examiner] is first and foremost disinterested and nonadversarial. . . . [H]e answers solely to the Court.").

Accordingly, the examiner provides an independent assessment of the matter at hand and can identify value, encourage parties to recognize the strengths and weaknesses of their respective positions in the case, facilitate quicker resolutions of disputes, and ultimately produce benefits for the estate. Nevertheless, one criticism of the process is that the examiner's report, which may identify this value and was paid for by the estate, may not be admissible as evidence in prosecuting or defending the causes of action investigated in the report.

Under current law, the role of an examiner is limited to the investigatory function described above. Yet examiners may add value to cases in other capacities given their uniquely independent and neutral posture. For example, courts have appointed mediators and facilitators to help chapter 11 cases progress, either when plan negotiations are stalled or major litigation threatens to derail reorganization efforts.[137] Such mediators and facilitators have proven effective in some cases, but they currently are appointed on an *ad hoc* basis and with little governing authority. Expanding the potential scope of an examiner to include the role of mediator and facilitator as well as similar functions would allow parties in interest and the court to use an independent neutral party to address specific issues in a particular case in an efficient and controlled manner. Many courts interpret section 1104 as currently prohibiting this kind of appointment, whether termed an "examiner" with expanded powers or a "trustee" with limited powers.[138]

The Estate Neutral: Recommendations and Findings

The Commission reviewed the case law and academic literature concerning the frequency and use of examiner appointments and the interpretation of the current statute, which mandates the appointment of an examiner in certain circumstances. The Commissioners explored, in the alternative, the utility of a new estate neutral, particularly in cases when, for example, stakeholders found value in leaving the debtor in possession in control, but certain matters in the case needed an independent assessment either because it was difficult for a debtor to investigate itself or because the debtor and stakeholders were too vested in their respective positions to identify areas of potential

137 Examples of cases using court-appointed mediators: *In re* R.H. Macy & Co., Inc. 1994 WL 482948 (Bankr. S.D.N.Y. Feb. 23, 1994); *In re* Lehman Bros., Inc., Ch. 11 Case No. 08-13555 (JMP) (Bankr. S.D.NY.) (Jan. 16, 2009) [Docket No. 2569]. *See also* Cassandra G. Mott, *Macy's Miracle on 34th Street: Employing Mediation to Develop the Reorganization Plan in a Mega-Chapter 11 Case,* 14 Ohio St. J. on Disp. Resol. 193, 207–10 (1998); Harvey R. Miller, *The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play,* 69 Am. Bankr. L.J. 431, 437 (1995). For an example of a court-approved arbitration procedure in the context of claims resolutions, *see* Meyer v. Dalkon Shield Claimants Trust, 164 F.3d 623, at *1 (4th Cir. 1998) (unpublished table decision) (explaining alternative dispute resolution procedures used to address products liability claims).

138 *See, e.g.,* Official Comm. of Asbestos Pers. Injury Claimants v. Sealed Air Corp. (*In re* W.R. Grace & Co.), 285 B.R. 148, 156–57 (Bankr. D. Del. 2002) (denying debtor's motion to appoint examiner with expanded powers or trustee with limited purpose to prosecute fraudulent transfer claims because "the basic job of an examiner is to examine, not to act as a protagonist in the proceedings" and "[t]here is no such entity as a limited purpose trustee under the [Bankruptcy] Code"); Kovalesky v. Carpenter, 1997 WL 630144, at *3 (S.D.N.Y. Oct. 9, 1997) ("Examiners . . . play a chiefly information-seeking role and, like the court itself, must remain a neutral party in the bankruptcy process."); *In re* Interco Inc., 127 B.R. 633, 638 (Bankr. E.D. Mo. 1991) ("[T]he examiner's role is by its nature disinterested and non-adversarial. There is no doubt that the examiner is a neutral party in a bankruptcy case."); *In re* Baldwin United Corp., 46 B.R. 314, 316–17 (Bankr. S.D. Ohio 1985) ("[W]e never contemplated, nor in our opinion does the Bankruptcy Code contemplate, that the examiner act as a conduit of information to fuel the litigation fires of third-party litigants."); *In re* Hamiel & Sons Inc., 20 B.R. 830, 832 (Bankr. S.D. Ohio 1982) (an examiner "constitutes a court fiduciary and is amenable to no other purpose or interested party"). *But see* S. Rep. No. 989, 95th Cong. 2d Sess. 116 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787 ("The [bankruptcy] court is authorized to give the examiner additional duties as circumstances warrant."); *In re* Mirant Corp., 2004 WL 2983945, at *2–3 (Bankr. N.D. Sept. 1, 2004) (examiner authorized to monitor and mediate plan negotiations); *In re* Pub. Serv. Co. of N.H., 99 B.R. 177 (Bankr. D.N.H. 1989) (examiner authorized to mediate negotiations related to chapter 11 plan); *In re* UNR Indus., Inc., 72 B.R. 789 (Bankr. N.D. Ill. 1987) (examiner appointed to negotiate chapter 11 plan and facilitate resolution of substantive differences).

compromise. As further explained below, the Commission determined that the concept of an estate neutral should replace examiners under the Bankruptcy Code.

The Commissioners found little correlation between the standards for a mandatory appointment and the utility of the appointee in any given case, based on experiences with examiners under section 1104(c) of the Bankruptcy Code. Accordingly, the Commission voted to eliminate the mandatory nature of the appointment process and to permit the court to order the appointment of an estate neutral, upon request of a party in interest or the U.S. Trustee and after notice and a hearing, if such appointment would be in the best interests of the estate. The Commission specifically considered the existing case law, and it rejected a standard that required all interests to be served by the appointment. It found that, given the role contemplated for estate neutrals under these principles, the appointment standard should be flexible and tailored by the court to the particular case. Courts should determine if, on balance, the best interests of *the estate* would be served by the appointment.

The Commissioners further discussed the proper role of estate neutrals in the reorganization process. Absent the appointment of a trustee, all parties in the chapter 11 case have potentially diverging interests and may be motivated purely by self-interest. For example, the debtor in possession acts as a fiduciary for the estate, but the estate itself likely has different constituencies. The debtor in possession is also working to reorganize its business and preserve relationships with employees, vendors, and other constituents that ultimately serve the interests of the estate. Likewise, a statutory unsecured creditors' committee owes its duties to general unsecured creditors, but those creditors are not the only stakeholders in the case. The Commissioners observed that an estate neutral-like appointee is the only party uniquely situated to provide an independent and neutral perspective in the case. The Commission also considered other potential rationales for expanding the role of the new estate neutral from that of a traditional examiner in chapter 11 cases, such as facilitating dispute resolution and reducing information asymmetries.

The Commissioners recognized the costs associated with the appointment of an examiner under the current law, as well as the additional costs that might accompany the new estate neutral, which could be used more frequently and for a wider array of tasks. Not only would the estate compensate the estate neutral, but the estate also would compensate any professionals that the court authorizes the estate neutral to retain. The Commissioners explored ways to contain these costs, including through court-approved budgets and restrictions on the efforts by the debtor in possession and the unsecured creditors' committee that may be duplicative of those assigned to the estate neutral. The Commissioners believed that this kind of oversight by the court and other stakeholders could mitigate the potential increases in costs. The Commissioners did not believe, however, that such restrictions should be statutorily mandated, but rather left to the court and parties in interest to determine in any given case.

The Commission also considered the potential cost savings that an estate neutral may generate in cases when the parties are at an impasse in negotiations or need an independent investigation to facilitate resolution of particular matters. The Commissioners discussed how courts should balance the costs associated with an estate neutral with the potential efficiencies created by the appointment. The Commissioners also observed that, even under this cost-benefit analysis, the circumstances of the case could warrant the appointment of more than one estate neutral to perform different functions

in the case, but the Commissioners believed that this should be the exception rather than the rule. The Commissioners did not want to create roles for third parties in the case or impose additional costs on the process if unnecessary or if the benefits would be marginal at best. Accordingly, the Commission recommended a presumption against the appointment of more than one estate neutral in any given case, which could be rebutted by evidence that the circumstances of the case and a cost-benefit analysis support the additional appointment. The Commission also concluded that, with the elimination of the mandatory appointment provision, if the circumstances of the case warrant the appointment of an estate neutral, the potential benefit of the estate neutral to the estate would likely outweigh any additional costs to the estate. The Commission ultimately voted to provide more flexibility to the court and the parties in using estate neutrals, as set forth in the principles above, and to recommend use of estate neutrals in lieu of examiners.

The Commissioners discussed the related concept of a statutory reorganization executive, which would be similar in some ways to an examiner with expanded powers but different in several key respects. For example, a statutory reorganization executive would likely be suggested and supported by the debtor and could operate the debtor's business, work directly with the parties to help facilitate a plan, and function more as an insider of the debtor (akin to a chief restructuring officer).[139] The Commissioners explored the contours of this new fiduciary, which some Commissioners believed would need to be accountable to the debtor's board of directors and subject to applicable state fiduciary duty laws. The Commissioners who supported the concept of a statutory reorganization executive viewed it as a private solution that parties would use more readily than seeking the appointment of a trustee or examiner. The Commissioners who opposed the concept of a statutory reorganization executive voiced concerns similar to those noted above respecting an examiner with expanded powers and viewed the appointment of a trustee as the better alternative. Ultimately, the Commission voted against the concept of a statutorily recognized reorganization executive, but did consider the potential value of such a position in considering and developing the parameters of the role of an estate neutral.

4. Statutory Committees

Recommended Principles:

- Except as provided in the principles for small and medium-sized enterprise cases, the appointment of an unsecured creditors' committee should remain mandatory as provided under section 1102(a) of the Bankruptcy Code unless the court orders otherwise for cause. The term "cause" should include that such an appointment would not be in the best interests of the estate or that the interests of general unsecured creditors do not need representation in the particular case because, for

139 The Commissioners distinguished a chief restructuring officer from the proposed statutory reorganization executive, as the chief restructuring officer typically is retained as an officer of the company under applicable state law, subject to the same duties and obligations as the debtor's other officers. The Commissioners found the current process for engaging chief restructuring officers in appropriate cases sufficient and not inconsistent with the Commission's position on either the estate neutral or the restructuring officer.

NATIONAL BANKRUPTCY CONFERENCE
COMMITTEE TO RETHINK CHAPTER 11

Corporate Governance Considerations

Reasons for a Change; Potential Deficiencies under Current Law and Practice

- **Debtor in possession** – (a) governs unless a trustee is appointed, (b) controls the filing of a plan during exclusivity period, and (c) entitled to deference and/or protection of business judgment rule with respect to a wide spectrum of decisions that are outside the ordinary course of business (including financings, sales and settlements)
    - May be poor manager
    - May be unsuited for restructuring (business and plan), sale, liquidation, litigation or investigatory role
    - May be heavily influenced by ownership of equity, opportunity for continued employment and/or personal compensation
    - May lack credibility with DIP lenders (actual or potential), creditors, employees and/or other prepetition stakeholders
        - DIP lenders respond with tougher covenants and control provisions
        - May undermine justification for courts to defer to debtor's business judgment if court believes that management/board is weak or compromised
- **Chapter 11 Trustee** – (a) broad managerial, restructuring and investigatory powers, (b) appointment terminates plan exclusivity, and (c) generally selected by U.S. Trustee (subject to Court approval) after consultation with parties in interest
    - In practice, chapter 11 trustees have been rarely sought and appointed,
        - Even in situations involving fraud, mismanagement and/or loss of trust by management, the parties typically opt for a CRO or the equivalent (*e.g.* Enron, Worldcom, Lehman)
        - Recent exceptions are MF Global (alleged prepetition misuse of customer funds) and Thornburg Mortgage (alleged postpetition DIP misconduct)
    - Biggest deficiency is the lack of consistent and complete creditor input. Voting contemplated by section 1104(b)(1) rarely occurs and is limited to unsecured creditors (which seems inappropriate in capital structures dominated by secured debt)
    - Trustee may not be suitable for operating a business

- Trustees often involve a new layer of expenses, including a new set of attorneys and financial advisors carrying out a broad range of activities
- Appointment may be unpredictable, and experience with chapter 11 trustees is generally regarded as uneven at best
- Loss of control and exclusivity are strong disincentives for a debtor to consent to the appointment of a trustee

- **Chief Restructuring Officer ("CRO")/Crisis Management Team** -- (a) not expressly contemplated by the Bankruptcy Code, (b) typically selected and hired by the debtor, and (c) role in DIP governance will vary on a case-by-case basis
  - In practice, selection may be heavily influenced by senior secured creditors
  - Responsibilities and reporting to creditor constituencies and other stakeholders may be unclear
  - Fiduciary duties are unclear if they are not corporate officers
- **Examiner** – (a) investigative role only, (b) mandatory appointment upon request of a party in interest in many cases, regardless of the need for an investigation, (c) disqualified from prosecuting identified causes of action, and (d) selected by U.S. Trustee (subject to Court approval) after consultation with parties in interest
  - Generally, an examiner is not a solution to address governance concerns
  - Investigations can be quite expensive and may cause delays
  - Examiner's report may be informative but of little or no evidentiary value in a litigation context (may be helpful in a settlement context)

Desirable Attributes of a Governance Proposal for Chapter 11 Cases

- Achievable quickly and with little litigation
- An individual with a defined senior role in the debtor's governance, either inside or outside the debtor's senior management team, is capable, widely trusted by the debtor and major stakeholders, has the authority to do what is necessary under the particular circumstances of the chapter 11 case, and warrants reasonable business judgment deference by the court
  - This includes being sufficiently competent and credible as to reduce the desire/need for many extraordinary controls in DIP financing and use of collateral orders
- Respects state law corporate governance statutes/caselaw

- Minimize disincentives for commencing a chapter 11 case or for management/board to remain with the debtor and to provide cooperation and assistance with the restructuring

- The individual does not require a new set of a attorneys and financial advisors carrying on a broad range of activities

- *For purposes of convenience only, we will refer to the individual in this new governance proposal as a "Responsible Party" or "RP"*

"Clean Slate" Corporate Governance Proposal

- Motion for Appointment. After a motion brought upon notice and a hearing by the debtor or a Proposing Party (defined below), an RP may be appointed and an RP Plan (defined below) may be made specified by the court. Such motion shall specify a proposed RP and RP Plan (defined below).

    - If the debtor is the movant:

        - No showing of cause is required.

        - Appointment of an RP nominated by the debtor or a Proposing Party, and specification of an RP Plan, are mandatory.

    - If a Proposing Party is the movant:

        - Cause must be shown.

        - If cause is shown, appointment of an RP nominated by the debtor or a Proposing Party, and specification of an RP Plan, are mandatory.

    - It is contemplated that the RP and the RP Plan will be the subject of early negotiations among the debtor, creditors' committee, major prepetition lenders and sources of DIP financing to arrive at a consensual arrangement that is appropriate for each particular case. If consensus is not reached:

        - The debtor and any Proposing Party, as the case may be, may file responsive pleadings to such a motion in which they may propose an alternative RP and RP Plan.

        - All parties in interest have standing to be heard in support of or in opposition to any such motion, RP or RP Plan.

    - If the court determines to appoint an RP, it must select from the RP candidates proposed by the debtor and the Proposing Parties.

    - The court has discretion to change proposed RP Plan provisions, and is not limited to the party's proposals.

- After a motion brought upon notice and a hearing by the debtor or a Proposing Party, a previously appointed RP may be replaced and/or a previously specified RP Plan may modified, in each case for cause shown.

- Timing: The bankruptcy court, when determining whether to appoint an RP and the scope of such RP's duties, shall take into consideration the timing of such request. If the timing is suspect (*e.g.*, if the court believes that parties are using RP motions for "gamesmanship" purposes), the court may deny a motion for an RP even if cause may otherwise exist. The hearing on an RP motion shall be conducted within 30 days of the filing of the motion unless the Court, for cause shown or *sua sponte*, determines otherwise.

• Proposing Parties.

  - The following are eligible as Proposing Parties:

    - Any official committee, unless otherwise specified in the order appointing such committee.

    - One or more creditors holding in the aggregate more than $1 million of claims of any one or more classes (secured or unsecured, senior or subordinated).

    - A union representing more than one-third of the debtor's employees.

    - Any other person(s) authorized to do so by an order of the bankruptcy court.

  - The U.S. Trustee is not a Proposing Party, but has standing to be heard in support of or in opposition to any motion for appointment of an RP, and any proposed RP or RP Plan.

  - If the debtor has assets of less than $10 million, only the debtor may propose that an RP be appointed. Once the debtor proposes the appointment of an RP, then any Proposing Party may propose an alternative RP or RP Plan.

• RP Plan.

  - The order appointing the RP will include an "RP Plan," which will consist at a minimum of provisions specifying:

    - The terms of the RP's engagement and responsibilities, including compensation, indemnification and insurance.

    - The duties of the RP, to whom the RP reports and whether the debtor's management will report to the RP.

- Any changes or restrictions in the role or authority of the pre-existing board of directors and/or officers. Subject to the Special Grounds requirement described below, it is contemplated that the RP may, if so specified in the RP Plan, have all of the powers currently available to a chapter 11 trustee, including taking over some or all of the responsibilities of the board and/or officers, proposing a chapter 11 plan and/or requiring that certain corporate action may be taken only with the RP's authorization, consent or approval.

- Whether the RP is a company officer or court appointee. *N.B.* Court appointment of an RP as a corporate officer may be subject to state corporate law.

- Whether the RP may retain separate professionals. It is contemplated that the RP will use the debtor's professionals unless (and then, only to the extent) that there is a need for the RP to retain his own.

- If the RP is to supplant the Board with respect to some or all of its duties, and Special Grounds are not present, it may only be for cause shown by clear and convincing evidence, and such displacement is limited to the matters for which cause has been shown.

- Unless terminated sooner under the RP Plan, the RP will be terminated and discharged upon dismissal or conversion of the case and upon substantial consummation of a confirmed chapter 11 plan.

- Cause; Standards for Selecting Among Proposed RPs and RP Plans.

  - In the context of a motion by a Proposing Party for the appointment of an RP, "cause" can include (this is a non-exhaustive list):

    - Fraud, dishonesty, incompetence or gross mismanagement by current management before or after the commencement of the case ("Special Grounds").

    - The absence of material financial controls.

    - The vacancies of two or more officer positions in the company.

    - Material restatements of the company's financial statements in the past 18 months.

    - A demonstrated need for increased operational efficiencies or a substantial operational reorganization of the debtor's business.

    - There are or have been significant governmental investigations of the company or its officers, employees or directors within the past 18 months.

- It is reasonably contemplated that there will be substantial sales or other material transactions out-of-the-ordinary course of the debtor's business during the pendency of the chapter 11 case that will require experience or expertise that debtor's management lacks and will likely be required for a successful reorganization.

- The debtor's management is deficient or lacks experience in an area of operational, transactional, financial or restructuring competency that will likely be required for a successful reorganization.

- The debtor's board of directors is wholly interested.

- The appointment is in the best interests of the estate.

- In the case of an RP Plan providing for the RP to supersede, in whole or in substantial part, the debtor's board of directors, Special Grounds must be shown unless the debtor consents (the "Special Grounds Requirement").

- In the case of a motion to replace an RP or modify an RP Plan, cause should be limited to matters occurring, arising or discovered after the prior appointment or specification.

- In choosing the RP and specifying the terms of the RP Plan, the court shall take into consideration, among other things (this is a non-exhaustive list):

  - The nature of the cause shown (*e.g.* if the cause shown was a deficiency in financial controls, the RP selected should have experience in financial controls and the RP Plan should give the RP powers and responsibilities relating to financial controls).

  - The views of the parties in interest.

  - The qualifications of the candidates for the RP position (including, to the extent relevant, their knowledge of and experience with the debtor's business, the relevant markets and industries, sales of businesses and assets, reorganization practices and chapter 11 plan negotiations).

  - The status of any plan negotiations (including those occurring prior to the commencement of the case).

  - The likelihood that a substantial portion of the estate assets will be transferred during the case.

  - The conduct of the debtor, its insiders and creditors prior to the commencement of the case.

  - The extent to which insiders control the debtor.

- The complexity of the debtor's corporate and capital structure.
- Any other factors reasonably likely to contribute to the prospects for a chapter 11 plan of reorganization to be confirmed under section 1129(a) (including section 1129(a)(8)) within a reasonable time frame in light of the size and nature of the debtor's business, operations, assets and liabilities.
- The best interests of the estate.

- The RP should hold no substantial conflicts of interest with the debtor's estate that are likely to affect the performance of the RP's duties, but in the case of an employee of the debtor may hold claims or equity interests that are not materially disproportionate to his role as employee.
  - The RP may be an employee of the debtor, a crisis manager, an advisor, an accountant, a lawyer or a business professional.
  - All of the RP's interests in the debtor or connections to other parties in the case must be disclosed publicly in a filing with the court prior to entry of the order appointing the RP (similar to Rule 2014 disclosure)

- Greater Deference to a Debtor if an RP Has Been Appointed. (*N.B.* some of the following require coordination with other projects of the Rethink Committee);
  - Decisions by the debtor's management will be entitled to court deference in the context of motions for authority to take action outside the ordinary course of business only if (a) an RP has been appointed and (b) if so specified in the RP Plan, supported by the RP.[1]
  - Prohibitions on DIP lender/adequate protection control covenants are applicable only if an RP has been appointed.
  - Unless otherwise specified in the RP Plan, appointment of an RP provides an automatic 3 month extension of any exclusivity periods (but not beyond any applicable statutory cap on exclusivity).
  - No chapter 11 trustee may be appointed after the appointment of an RP. (The RP can be replaced by another RP as described above.) An examiner may be appointed, for cause shown (not mandatory), after the appointment of an RP to conduct an investigation, but only if and to the extent that the RP Plan does not provide for such an investigation.

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[1] This does not affect the insulation from liability otherwise available to officers and directors under the business judgment rule.

- Other Matters.
    - The RP has standing to file pleadings with the bankruptcy court, and may be requested by the bankruptcy court to appear to address questions from the court.