Creditors' Rights & Bankruptcy Section Newsletter

Greetings:

This month we will begin a three part series on the use of Bankruptcy 2004 Discovery in hearings involving contested matters and trials involving adversary proceedings. We also present an interesting case out of the 9th Circuit Bankruptcy Appellate Panel involving post-petition accrued interest on over-secured claims. Enjoy!

As always, let us know how we can assist you in your credit and collection needs. If you have any ideas for future article or questions that need addressing, give us a call.

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Quote of the Month:

"The only thing worse than being blind is having sight but no vision." - Helen Keller

Self-Deprecating Lawyer Joke of the Month:

Lawyer: "Let me give you my honest opinion."
Client: "No, no. I'm paying for professional advice."

Bankruptcy Litigation – Using The Fruits Of Bankruptcy Rule 2004 Discovery In Contested Matters And Adversary Proceedings (Part I)

Authored by Bruce W. Akerly, Partner

Bankruptcy Rule 2004, Fed. R. Bankr. P. 2004 ("Bankruptcy Rule 2004"), is a great tool to gain information concerning a debtor's pre-petition financial and business affairs. It is unique to bankruptcy. The results of Bankruptcy Rule 2004 discovery often leads to information which serves as the basis for filing a contested matters (e.g, objections to exemptions) or adversary proceedings (*e.g.*, objections to discharge or the dischargeability of debts and challenges to the validity, extent and priority of liens). However, all too often, there is push back from Courts and opposing counsel to admitting the fruits of Bankruptcy Rule 2004 discovery into evidence in these proceedings. This reluctance is misplaced and begs the need to revisit the underpinnings of and justifications for admitting Bankruptcy Rule 2004 discovery into evidence.

Bankruptcy Rule 2004 provides, in pertinent part:

> (a) **Examination on Motion.** On motion of any party in interest, the court may order the examination of any entity.
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> (b) **Scope of Examination.** The examination of an entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In a family farmer's debt adjustment case under chapter 12, an individual's debt adjustment case under chapter 13, or a reorganization case under chapter 11 of the Code, other than for the reorganization of a railroad, the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan.
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> (c) **Compelling Attendance and Production of Documents.** The attendance of an entity for examination and for the production of documents, whether the examination is to be conducted within or without the district in which the case is pending, may be compelled as provided in Rule 9016 for the attendance of a witness at a hearing or trial. As an officer of the court, an attorney may issue and sign a subpoena on behalf of the court for the district in which the examination is to be held if the attorney is admitted to practice in that court or in the court in which the case is pending.

What discovery is permitted under Bankruptcy Rule 2004? On its face, Bankruptcy Rule 2004 permits "examination of any entity." "Entity," is defined in the Bankruptcy Code to include "person, estate, trust, governmental unit, and United States trustee." 11 U.S.C. § 101(15). The rule does not specifically provide for paper discovery – e.g., interrogatories, requests for production, and requests for admission - *per se,* although subsection (b) provides that Bankruptcy Rule 9016 may be used to compel the attendance of an examinee and "the production of documents." Fed. R. Bankr. P. 9016. Bankruptcy Rule 9016 provides: "Rule 45 Fed. R. Civ. P. applies in cases under the Code." But is that a limitation? Traditionally, the production of documents is sought in connection with an oral examination. But does the rule preclude interrogatories or requests for production? Not necessarily.

Neither Bankruptcy Rule 2004 nor the Bankruptcy Code defines the term "examination." Black's *Law Dictionary* defines "examination" generally to mean interrogation of a witness. See Black's *Law Dictionary* (4th ed. 1968). Logic dictates that a person or entity could, technically, be "examined" in different contexts. Merriam Webster Dictionary defines "examination" to mean "a close and careful study of someone or something." See www.merriam-webster.com. Therefore, the term "examination" would appear to include discovery tools such as interrogatories, requests for inspection of property, and requests for production of document and things.

Further, while Bankruptcy Rule 2004 provides that the scope of examination "may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge," Bankruptcy Rule 2004(b), courts have held that discovery under Bankruptcy Rule 2004 is broader than that typically permitted under the Federal Rules of Civil Procedure, amounting to a "lawful fishing expedition." *See In re Bounds, No. 09–12799, 2010 WL 3447683, at *5–6, 2010 Bankr. LEXIS 2983, at *14 (Bankr. W.D. Tex., August 31, 2010)* (noting that numerous courts have likened a Bankruptcy Rule 2004 examination to a fishing expedition). See also *In re NE 40 Partners, Ltd. Partnership*, 440 B.R. 124, 129 (Bankr. S.D. Tex. 2010) ("[T]he discovery tools available to a creditor or trustee Chapter 7 trustee should allow a trustee to present the "who, what, where, when, and how," thus forcing trustees to do their homework before filing an adversary proceeding and subsequently improving judicial economy" citing *Benchmark Elecs., 343 F.3d at 724 (5th Cir. 2003)*.").

Bankruptcy Rule 2004 affords both debtors and creditors broad rights of examination of a persons and entities with respect to the business and financial affairs of the debtor and administration of the estate. However, its scope is not limitless. For example, examinations cannot be used to harass or oppress the party and should not be used to obtain information for use in an unrelated case or proceeding pending before another tribunal. *In re Snyder*, 52 F.3d 1067 (5th Cir. 1995) (citations omitted). Under the Federal Rules of Civil Procedure, discovery is generally limited to information which is relevant to the claims

What's On Your Mind?

If you have an issue or question you would like addressed in a subsequent e-newsletter, please let us know and we will attempt to do so.

asserted or is likely to lead to the discovery of relevant information. *See* Fed. R. Civ. P. 26(b)(1).

One would presume that this breadth of scope would include the tools necessary as a means to that end. Of course, this breadth is precisely why counsel for the respondents/defendants in contested matters/adversary proceedings frequently object to the use of Bankruptcy Rule 2004 discovery in evidentiary hearings/trials.

Should A Bankruptcy Court Apply The Default Rate Of Interest To A Secured Creditor's Claim During The Pendency Period Between The Filing Of The Case And The Effective Date Under A Confirmed Plan Of Reorganization?

Authored by Bruce W. Akerly, Partner

Section 506(b) of the Bankruptcy Code provides that an over secured creditor is entitled to recover interest on its claim during what is referred to as the "pendency" period. However, the statute does not specify the rate of interest to apply. The United States Supreme Court, in its *Ron Pair* decision, held that a creditor's entitlement to interest is not dependent on an agreement or contract between the parties, but it failed to address the question of what rate of interest applies when an agreement exists.

The Bankruptcy Appellate Panel of the Ninth Circuit Court of Appeal recently determined that the question is not answered by what is "fair and equitable" – the test applied to confirmation under section 1129(b) of the Bankruptcy Code. *See In re Beltway One Development Group, LLC* (9th Cir. BAP, March 31, 2016). Instead, the court determined that interest to be permitted under section 506(b) is an issue separate and distinct from the fair and equitable test. Instead, the court viewed the issue as one of claims determination. What is the appropriate amount of the over secured creditor's claim? In this regard, the court applied the presumptive rule that the default interest rate provided for in the parties' agreement should apply so long as it does not violate the applicable state interest laws. The court did not, however, that the presumptive interest rule was a rebuttable presumption based on equitable considerations.