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**AVOID GETTING ENTANGLED IN A DEBTOR'S WEB:
OBTAINING INFORMATION FROM THE DEBTOR**

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Charlotte: Just a minute, Wilbur. [*she climbs up and wraps the fly*]

Charlotte: He'll make a nice breakfast for me.

Wilbur: [*shuddering*] Ooooh. You mean you eat flies?

Charlotte: Why, certainly. I eat anything that gets caught in my web. I have to live, don't I?

Wilbur: Why, yes, of course. [*nervously*]

Wilbur: Do they taste good?

Charlotte: Delicious.

Wilbur: LECCH!

Charlotte: Course, I don't really EAT them, I drink their blood. I love blood.³

INTRODUCTION

E.B. White probably never imagined that the passage above from *Charlotte's Web* would be used to illustrate the not uncommon scenario, of a surety or fidelity insurer, unfamiliar with bankruptcy law, getting entangled in a debtor's web, much like the fly in Charlotte's web.

¹ The authors acknowledge with gratitude the assistance of Edward J. Comey and Timothy C. Garding in preparing this manuscript.

² **Note**: The views expressed in this article are those of the authors and do not necessarily reflect the views of The Westfield Group or any of its affiliated insurance companies. This article is for general informational purposes only. None of it constitutes legal advice, nor is it intended to create any attorney-client relationship between you and the author. You should not act or rely on this information concerning the meaning, interpretation, or effect of particular contractual language or the resolution of any particular demand, claim, or suit without seeking the advice of your own attorney.

³ E.B. WHITE, CHARLOTTE'S WEB.

Perhaps nothing better captures the problems and hurdles sureties and fidelity insurers face upon the filing of bankruptcy by one of its principals as the following observation by one leading commentator:

The problem is that bankruptcy law is not a user-friendly body of law. Sitting down to read the Bankruptcy Code is more likely to induce slumber than to reveal the path to enlightenment.⁴

Taking their cue from Charlotte, bankrupt debtors are all too often able to entangle sureties and fidelity insurers—and eventually suck the blood from them—by obscuring their true financial condition in their schedules and financial statements. By preying on the surety or fidelity insurer’s lack of knowledge regarding the debtor’s case, the value of the collateral at risk or the likelihood of a successful reorganization, bankrupt debtors often are able to gain a tactical advantage.

More detrimental to the sureties and fidelity insurers’ position, however, is their inability to avoid becoming the fly entangled in Charlotte’s web. This can be excruciatingly frustrating when it is the surety or the fidelity insurer who assumed the risk of the bargain, only to have the bankrupt debtor attempt to change the terms (materially, in some instances) thereafter.

Fortunately for sureties and fidelity insurers, bankruptcy law does offer some protection or opportunities for sureties and fidelity insurers. In particular, Rule 2004 of the Federal Rules of Bankruptcy Procedure provides surety and fidelity insurers with the relief necessary to address the lack of knowledge hurdle imposed by some debtors seeking to improperly use the automatic stay as a shield. Under Rule 2004 of the Federal Rules of Bankruptcy Procedure, a creditor can obtain information—necessary to making strategic decisions—without first requiring the surety or fidelity insurer to commence litigation against its principal or insured. Like a books and records provision under a General Agreement of Indemnity, FED. R. BANKR. P. 2004,⁵ authorizes a bankruptcy court-ordered examination of a person, including the debtor (principal or indemnitors), to appear and to produce and explain documents requested. As one bankruptcy court noted,

[t]he sweeping general examination of debtors and others to recover assets and uncover fraudulent conduct is a traditional feature of bankruptcy jurisprudence that is traceable to the first bankruptcy statute enacted by the English Parliament more than 450 years ago.⁶

In fact, through a Rule 2004 examination, a surety or fidelity insurer often can flesh out evidence and information that may be important for establishing case administration evidence, and in some instances, may result as the basis for objecting to the discharge of the debtor. For example, the failure of a debtor to preserve financial records and/or attempts to conceal

⁴ CHAD L SCHEXNAYDER, BANKRUPTCY AND THE SURETY in THE LAW OF SURETYSHIP 317 (Edward Gallagher ed., 2000).

⁵ Hereinafter “Rule 2004”.

⁶ *In re Symington*, 209 B.R. 678, 683 (Bankr. D. Md. 1997).

the debtor's true financial condition are grounds for denying a discharge.⁷ Similarly, if the debtor furnishes false information⁸ and/or conceals financial information by invoking his or her Fifth Amendment privilege,⁹ the debtor risks denial of relief under the Bankruptcy Code.

Therefore, in order to properly prepare themselves for the challenges that a debtor filing for bankruptcy presents, sureties and fidelity insurers must—before filing a proof of claim—consider all forms of relief in order to determine what is the most effective remedy available. In making this determination, sureties and fidelity insurers should consider taking a Rule 2004 examination, if time permits. By arming themselves with the right information, sureties and fidelity insurers may be able to gain a tactical advantage to avoid becoming the fly entangled in Charlotte's web.

*"When spider webs unite, they can tie up a lion."
-Ethiopian Proverb*

EXAMINING THE PARAMETERS OF A RULE 2004 EXAMINATION

The Scope of a Rule 2004 Examination

"[P]eculiar to bankruptcy law and procedure because it affords few of the procedure safeguards that an examination under Rule 26 of the Federal Rules of Civil Procedure does,"¹⁰ Rule 2004 is designed to furnish guidelines for examining the debtor or any person in connection with the administration of the estate. Essentially, a Rule 2004 examination is a bankruptcy proceeding, undertaken upon the express authorization of a bankruptcy court. Specifically, Rule 2004 authorizes a bankruptcy court-ordered examination of a person, including the debtor (principal or indemnitors), not unlike a deposition, requiring the principal or its agents to appear and to produce and explain documentation, upon a motion by a party in interest.¹¹ In some jurisdictions, however, local rules permit the court clerk to enter an *ex parte* order.¹² A bankruptcy court's decision to order a Rule 2004 examination is reviewed for abuse

⁷ 11 U.S.C. §727(a)(3).

⁸ 11 U.S.C. §727(a)(4); *see also In re Chalik*, 748 F.2d 616, 618 (11th Cir. 1984);

⁹ *See In re Peklo*, 201 B.R. 331, 334 (Bankr. D. Conn. 1996) (Chapter 7 case dismissed for refusal to answer questions at creditors' meeting on Fifth Amendment grounds); *In re Bartlett*, 162 B.R. 73, 79 (Bankr. D. Conn. 1996) (debt nondischargeable on default for refusal to produce documents).

¹⁰ *In re Table Talk, Inc.*, 51 B.R. 143, 145 (Bankr. D. Mass. 1985); *see also In re GHR Energy Corp., supra; In re GHR Companies, Inc.*, 41 B.R. 655, 660 (Bankr. D. Mass. 1984); *In re Duratech Indus., Inc.*, 241 B.R. 283, 289 (E.D. N.Y. 1999).

¹¹ FED. R. BANKR. P. 2004 (a). Important to note here is that although Rule 2004 does not define the term "party in interest," caselaw has defined parties in interest to include the debtor, the trustee, creditors and creditors committee and/or equity security holders. *In re Matter of M4 Enter., Inc.*, 190 B.R. 471, 474 (Bankr. N.D. Ga. 1995).

¹² *See* Rule 2004-1, Local Rules of the District of Columbia Bankruptcy Court; Rule 2004-1, Local Rules of the Eastern District of Virginia Bankruptcy Court; Rule 2004-1, Local Rules of the Maryland Bankruptcy Court. In fact, in certain districts, such as the Southern District of Florida, no order is even necessary to authorize an examination pursuant to FED. R. BANKR. P. 2004. *See* Rule 2004-1 (a), Local Rules of the Southern District of Florida Bankruptcy Court; Rule 2004-1 (b), Local Rules of the New Jersey Bankruptcy Court.

of discretion.¹³ In addition, attendance may be compelled by a subpoena,¹⁴ and a bankruptcy court may set the time and place for the Rule 2004 examination.¹⁵

FED. R. BANKR. P. 2004, in pertinent part, provides:

- (a) Examination on motion. On motion of any party in interest, the court may order the examination of any entity.
- (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.
- (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.

¹³ See *In re Enron Corp.*, 281 B.R. 836, 840 (Bankr. S.D. N.Y. 2002) (noting that the bankruptcy court “has the discretion to grant a request for a 2004 examination” (citations omitted)); see also *In re Dinubilo*, 177 B.R. 932, 939 (E.D. Cal. 1993), called into doubt on other grounds by *In re Symington*, 209 B.R. 678 (Bankr. D. Md. 1997), (“A bankruptcy court’s decision to order a Rule 2004 examination is reviewed under an abuse of discretion standard.” (citing *In re Hammond*, 140 B.R. 197, 200 (S.D. Ohio 1992); *In re Hawley Coal Mining Corp.*, 47 B.R. 392, 393 (S.D. W.Va. 1984); 8 Lawrence P. King, *Collier on Bankruptcy* ¶ 2004.04 (15th ed. 1993) (“Collier on Bankruptcy”). “A bankruptcy court abuses its discretion if it bases its decision on an erroneous view of the law or clearly erroneous factual findings. A [bankruptcy] court [also] abuses its discretion if the reviewing court has a definite and firm conviction that the lower court committed a clear error of judgment in the conclusion it reached based on all the appropriate factors.” *In re Williams*, 224 B.R. 523, 529 (2d Cir. BAP 1998) (citations omitted).

¹⁴ FED. R. BANKR. P. 2004 (c); see also FED. R. BANKR. P. 2005.

¹⁵ FED. R. BANKR. P. 2004 (d).

- (d) Time and place of examination of debtor. The court may for cause shown and on terms as it may impose order the debtor to be examined under this rule at any time or place it designates, whether within or without the district wherein the case is pending. . . .

Thus, “a Rule 2004 examination represents a threshold inquiry into the assets and conduct of debtor’s bankruptcy. As an investigatory tool, its nature is inquisitory rather than accusatory, although information discovered by its employment may presage litigation.”¹⁶

More important, “[t]he purpose of a Rule 2004 examination is to allow the court to gain a clear picture of the condition and whereabouts of the bankrupt's estate.”¹⁷ For this reason, the scope of the Rule 2004 examination is broadly defined as relating 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.¹⁸ Further, 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 therefore, any other matter relevant to the case or the formulation of the plan.¹⁹ As long as the subject matter of the Rule 2004 examination relates to the administration of the bankruptcy estate, the debtor cannot limit the scope of the Rule 2004 examination by motion or otherwise.²⁰ Consequently, Rule 2004 has been referred to as “the basic discovery device used in bankruptcy cases,” permitting the examination of any party without the requirement of a pending adversary proceeding or contested matter.²¹ Its broad discovery mechanism aids the trustee and parties in interest with the gathering of necessary information for the proper and effective administration of the bankruptcy estate,²² the discovery of assets,²³ and the exposure of fraudulent conduct.²⁴

¹⁶ *In re Symington*, 209 B.R. at 684.

¹⁷ *In re Lang*, 107 B.R. 130, 132 (Bankr. N.D. Ohio 1989).

¹⁸ FED. R. BANKR. P. 2004 (b).

¹⁹ HON. NANCY C. DREHER, MEETING OF CREDITORS, MEETING OF EQUITY SECURITY HOLDERS, AND THE 2004 EXAMINATION IN BANKRUPTCY LAW MANUAL §3A:21 (5th ed.). See also *In re Tom's Foods, Inc.*, 345 B.R. 795 (Bankr. M.D. Ga. 2006) (the substance of e-mails exchanged between a CEO and attorney regarding how to address impending litigation against the company, CEO, and other officers concerned matters within the debtor’s affairs).

²⁰ See *In re Dinubilo*, 177 B.R. 932, 940 (Bankr. S.D. Ohio 1992)

²¹ *In re French*, 145 B.R. 991, 992 (Bankr. D. S.D. 1992).

²² *In re Arkin-Medo, Inc.*, 44 B.R. 138, 140 (Bankr. S.D. N.Y. 1984); *In re Good Hope Refineries, Inc.*, 9 B.R. 421, 423 (Bankr. D. Mass. 1981); *In re GHR Energy Corp.*, 33 B.R. 451, 453 (Bankr. D. Mass. 1983).

²³ *In re Foerst*, 93 F. 190 (S.D. N.Y. 1899).

²⁴ *Id.*

Not surprisingly, numerous courts have recognized the scope of a Rule 2004 examination as “unfettered and broad.”²⁵ Yet, although Rule 2004 examinations are allowed for the “purpose of discovering assets and unearthing frauds,”²⁶ some courts have also described Rule 2004 examinations as a fishing expedition,²⁷ exploratory and groping,²⁸ sufficiently broad to encourage harassment on every human subject,²⁹ and an unfettered right to inquire to all transactions and occurrences relating to the debtor.³⁰ As such, a creditor surety, for instance, can use a Rule 2004 examination to obtain information relating to the all aspects of bonded jobs performance, subrogation issues, and other particular matters of interest to the surety.³¹

Determining who can be deposed and when

As discussed, it is well established that a Rule 2004 examination is not limited to the debtor in possession or its agents, but may properly extend to creditors and third parties who had have dealings with the debtor.³² As one Ohio bankruptcy court noted, “an inquiry pursuant to Rule 2004 may ‘cut a broad swath through the debtor’s affairs, those associated with him, and those who might have had business dealings with him.’”³³

More important, while neither Rule 2004 nor the Bankruptcy Code sets explicit limits as to which parties may be examined,³⁴ the language of Rule 2004 makes it evident that an examination may be had only of those persons possessing the knowledge of a debtor’s acts, conduct, or financial affairs.³⁵ Nevertheless, the Rule 2004 examination, whether of a debtor

²⁵ *In re Table Talk, Inc.*, *supra*.

²⁶ *Id.*

²⁷ *In re GHR Energy Corp.*, 33 B.R. at 453 (citing *In re Foerst*, 93 F. 190, 191 (S.D. N.Y. 1899)); *In re Hughes*, 281 B.R. 224, 226 (Bankr. S.D. N.Y. 2002); *In re Cont’l Forge Co., Inc.*, 73 B.R. 1005, 1007 (Bankr. W.D. Pa. 1987).

²⁸ *In re GHR Energy Corp.*, *supra*; *In re Autocue Sales & Distrib. Corp.*, 151 F. Supp. 798, 800 (S.D. N.Y. 1957).

²⁹ *In re GHR Energy Corp.*, *supra*; *In re Georgetown of Kettering*, 17 B.R. 73, 75 (Bankr. S.D. Ohio 1981).

³⁰ *In re Public Ser. Co. of New Hampshire*, 91 B.R. 198, 199 (Bankr. D. N.H. 1988); *In re Kroh*, 80 B.R. 488, 490 n.2 (Bankr. W.D. Mo. 1987).

³¹ *In re Analytical Sys., Inc.*, 71 Bankr. 408 (Bankr. N.D. Ga. 1987).

³² *In re Chereton, Inc. v. U. S.*, 286 F.2d 409, 413 (6th Cir. 1961); *In re Fin. Corp. of Am.*, 119 B.R. 728, 733 (Bankr. C.D. Cal. 1990); *In re Mittco*, 44 B.R. 35, 36 (Bankr. E.D. Wis. 1984); *In re Fearn*, 96 B.R. 135, 138 (Bankr. S.D. Ohio 1989); *In re Recoton Corp.*, 307 B.R. 751, 755 (Bankr. S.D. N.Y. 2004); *In re Hughes*, 281 B.R. 224, 226 (Bankr. S.D. N.Y. 2002).

³³ *In re Fearn*, 96 B.R. at 138 (citing *In re Mantolesky*, 14 B.R. 973, 976 (Bankr. D. Mass. 1981); see, e.g. *In re Symington*, 209 B.R. 678 (Bankr. D. Md. 1997); *In re Lufkin*, 255 B.R. 204 (Bankr. E.D. Tenn. 2000); *In re Enron Corp.*, 281 B.R. 836 (Bankr. S.D. N.Y. 2002).

³⁴ *In re GHR Energy Corp.*, *supra*.

³⁵ *In re Metiom*, 318 B.R. 263, 272 (Bankr. S.D. N.Y. 2004) (examination of a non-party corporation about its converting and misappropriating of the debtor’s software and other assets was appropriate); *In re Wilcher*, 56 B.R. 428, 434 (Bankr. N.D. Ill 1985) (determining that although third parties may be examined under Rule 2004 with an

at the Code §341 meeting of creditors (or at a later time), or of any third party possessing knowledge of a debtor's affairs *must* relate to the acts, conduct, property, liabilities, or financial condition of the debtor, or to any other matter that will assist in the administration of the estate or to the debtor's right to discharge.³⁶ Thus, under the appropriate circumstances, a creditor may be able to take a Rule 2004 examination of the debtor's employer,³⁷ accountant,³⁸ or attorney.³⁹

In addition, a Rule 2004 examination may be held at any time after an involuntary or voluntary petition is filed.⁴⁰ Additionally, while it has been held permissible for a court to issue an order for such an examination after a plan has been confirmed where the plan provided that the court retained jurisdiction over various matters,⁴¹ the general rule is that if a case has been closed, a court no longer has the authority to issue an order authorizing a Rule 2004 examination.⁴²

eye toward uncovering defalcations affecting the estate, only those persons possessing knowledge of debtor's acts, conduct or financial affairs so far as this relates to debtor's proceeding in bankruptcy may be examined; Rule 2004 may not be used as a mechanism to launch into outright investigation of non-debtor's private business affairs); *In re Johns-Manville Corp.*, 42 B.R. 362, 364 (Bankr. S.D. NY. 1984) (the examination of witnesses having knowledge of the debtor's acts, conduct, liabilities, assets, etc. is proper, but examination of witness as to matters having no relationship to debtor's affairs of administration of estate is improper).

³⁶ *Id.*

³⁷ *In re Rosenberg*, 303 B.R. 172 (B.A.P. 8th Cir. 2004) (debtor listed a claim against former employer as an asset of the estate in her amended schedules, thereby bringing the claim to the trustee's attention and the purview of the Rule 2004).

³⁸ *In re Mittco*, *supra*.

³⁹ *In re Interactive Network, Inc.*, 243 B.R. 766 (Bankr. N.D. Cal. 2000) (cases where an attorney's conduct may be the basis of the claim or defense, such as the basis of a creditor's claims of waiver); *In re Buick*, 174 B.R. 299, 305 (Bankr. D. Colo. 1994) (attorney who has personal knowledge of the debtor's complex financial affairs is a transferee or transferor of assets and acts beyond any role as counsel).

⁴⁰ FED. R. BANKR. P. 2004 (d).

⁴¹ *In re Express One Intern, Inc.*, 217 B.R. 215, 217 (Bankr. E.D. Tex. 1998) (exam allowed to determine if debtor is setting aside money to pay disputed administrative claim); *In re Cinderella Clothing Indus., Inc.*, 93 B.R. 373, 377 (Bankr. E.D. Pa. 1988) (examination must be limited to matters over which court has retained jurisdiction); *In re Good Hope Refineries, Inc.*, 9 B.R. at 422 (debtor sought to investigate potential causes of action against third party).

⁴² *In re Kekahuna*, 35 B.R. 13 (Bankr. D. Haw. 1983) (court would not permit examination to investigate whether the debtor did not disclose assets after case was closed).

“Will you walk into my parlor?” said the Spider to the Fly,
“’Tis the prettiest little parlor that ever did you spy.”
-Mary Howitt

MAXIMIZING YOUR RULE 2004 EXAMINATION

FED. R. BANKR. P. 2004 vs. FEDERAL RULES OF CIVIL PROCEDURE

The most significant difference between Rule 2004 examinations and pretrial discovery under the Federal Rules of Civil Procedure is timing.⁴³ As discussed above briefly, a Rule 2004 examination does not require the surety or fidelity insurer to commence litigation against its principal before it may be used. As the *In re Symington* Court, explained:

[a] Rule 2004 examination is undertaken *prelitigation*, that is, before the filing of a lawsuit or motion, whereas discovery in the contexts of the Federal Rules of Civil Procedure is *pretrial*, that is, after the filing of a complaint or motion, but before a hearing on dispositive motions or trial on the merits. A Rule 2004 examination may even be conducted in the absence of a pending adversary proceeding or contested matter, although it obviously requires the pendency of a bankruptcy case. Because it is normally requested before the filing of a complaint or a contested matter, and indeed is independent of a complaint or contested matter, the examination need not be tied to specific factual allegations at issue between parties to a complaint or contested matter. For this reason alone, the bankruptcy examination is subject to fewer objections on grounds of relevance than would burden discovery filed in a lawsuit or contested motion. It is also less costly to the movant because it does not require the filing of an underlying adversary proceeding or contested matter.

Id. at 684.

Further, a Rule 2004 examination also does not incorporate an extended waiting period before an inspection of documents is allowed or the documents must be produced, unlike ordinary discovery procedures under the Federal Rules of Civil Procedure. Indeed, there are fewer procedural safeguards afforded to the deponent in a Rule 2004 examination than in a deposition conducted under the Federal Rules of Civil Procedure.⁴⁴

Moreover, the authorization to conduct prelitigation discovery under Rule 2004 belongs solely to the movant.⁴⁵ The deponent has no reciprocal right to make a discovery demand

⁴³ *In re Symington, supra.*

⁴⁴ *In re Lang, supra; In re Fearn, supra.*

⁴⁵ *In re Symington*, 209 B.R. at 685.

upon the movant.⁴⁶ This is completely opposite to discovery conducted in a contested matter or adversary proceeding under Rule 26 of the Federal Rules of Civil Procedure, which contemplates both parties having a right to engage in discovery.⁴⁷

Despite its strategical advantages, sureties and fidelity insurers alike should take note that a Rule 2004 examination is not a substitute for discovery, and in any pending adversary proceeding, discovery must be conducted in compliance with the rules of discovery.⁴⁸ This is particularly important because in a Rule 2004 examination, there are no specific issues, no rules of evidence, no right to object, and no right to have counsel present.⁴⁹

*“Touch but a cobweb in Westminster Hall, and the old spider of
the law is out upon you with all this vermin at his heels.”
-Henry Fox*

SPECIAL CONSIDERATIONS TO KEEP IN MIND

Limitations on a Rule 2004 Examination

Notwithstanding, sureties and fidelity insurers alike, should be aware that Rule 2004 examinations are not without bounds.⁵⁰ A creditor’s right to a Rule 2004 examination must be supported by just cause.^{51, 52} Although a Rule 2004 examination may be ordered *ex parte*, a court must first consider whether the examination is proper⁵³ and (if necessary) may limit the Rule 2004 exam after it considers the purpose of the examining party.⁵⁴ For example, a Court is more likely to allow a trustee seeking to discover the existence and location of the debtor’s

⁴⁶ *In re Symington*, 209 B.R. at 685.

⁴⁷ *Id.*

⁴⁸ *In re Wilcher*, 56 B.R. at 434 (stating that the proper mode of discovery against a third party is contained in Federal Rules of Civil Procedure).

⁴⁹ *In re McLaren*, 158 B.R. 655, 658 (N.D. Ohio 1992); *U.S. v. Jackson*, 836 F. 2d 324, 326 (7th Cir. 1987). However, while this is generally the case, as discussed later in this paper, there are situations where courts have upheld the examinee’s objections to answer questions asked during a Rule 2004 examination on the grounds of privilege.

⁵⁰ *In re Buckner*, 271 B.R. 213 (B.A.P. 10th Cir. 2001); *In re Buick*, *supra*.

⁵¹ *In re Metiom, Inc.*, *supra*.

⁵² It is important to note here that an examination under Rule 2004 is technically available to “any party in interest.” FED. R. BANKR. P. 2004 (a). Generally, a debtor is able to utilize Rule 2004 to examine parties whose testimony might assist in the general administration of cases filed under Chapters 11 and 13 of the Code. In Chapter 7 cases, however, the general administration of the estate is entrusted to the trustee. In these circumstances, it is the trustee who should ordinarily conduct any Rule 2004 examinations of the debtor or others who dealt with the debtor. Creditors are not per se authorized to conduct an examination of the debtor unless a request is made of the trustee and the trustee declines.

⁵³ *In re GHR Energy Corp.*, *supra*.

⁵⁴ *In re Valley Forge Plaza Assoc.*, 109 B.R. 669 (Bankr. E.D. Pa. 1990).

assets (which would benefit the bankruptcy estate as a whole)⁵⁵ more leeway under a Rule 2004 examination than a debtor examining the internal affairs of its creditors⁵⁶ or a creditor seeking to avoid the procedural safeguards of Bankruptcy Rules 7026 to 7037.⁵⁷ For that reason, a debtor may move to quash a subpoena or may object to the entry of a court order setting a Rule 2004 examination. Upon such an objection, the party seeking the examination bears the burden of proving good cause for the examination.⁵⁸

Further, despite its expansiveness, a Rule 2004 examination may not be used for purposes of harassment and “cannot stray into matters that are not relevant to the basic inquiry,”⁵⁹ and examination of a witness as to matters having no relationship to the debtor’s affairs or administration of the estate.⁶⁰ Thus, a Rule 2004 examination

may not be used as a device to launch into a wholesale investigation of a nondebtor’s private business affairs and it not intended to provide the debtor with unlimited access to the internal affairs of its creditors and those employed by its creditors. It is not intended to be used a vehicle for gathering confidential information for which no reasonable need is shown.⁶¹

Court also have prohibited the use of the Rule 2004 examination after a case has been closed,⁶² postconfirmation,⁶³ or cases involving matters barred by res judicata.⁶⁴ Additionally, courts have recognized an examinee’s right to assert that certain testimony is privileged, and to object as long the examinee establishes a proper basis for the objection to the question propounded.⁶⁵

⁵⁵ *In re Matter of Isis Foods, Inc.*, 33 B.R. 45 (Bankr. W.D. Mo. 1983).

⁵⁶ *In re GHR Energy Corp.*, *supra*.

⁵⁷ *In re Matter of Sutera*, 141 B.R. 539 (Bankr. D. Conn. 1992).

⁵⁸ *In re Wilcher*, *supra*.

⁵⁹ 9A AM. JUR. 2D *Bankruptcy* §1125 (May 2008); *In re Mittco, Inc.*, 44 B.R. 35, 36 (Bankr. E.D. Wis.1984).

⁶⁰ *Id.*; *In re Continental Forge Co., Inc.*, *supra*; *In re Johns-Manville, Corp.*, 42 B.R. 362 (Bankr. S.D. N.Y. 1984).

⁶¹ 9A AM. JUR. 2D *Bankruptcy* §1125 (May 2008).

⁶² *In re Kekahuna*, *supra*.

⁶³ *In re Carmelo Bambace, Inc.*, 134 B.R. 125 (Bankr. S.D. N.Y. 1991). *Cf.*, *Matter of Sun Med. Mgmt., Inc.*, 104 B.R. 522 (Bankr. M.D. Ga. 1989) (debtor permitted to used 2004 exam postconfirmation to discover assets and uncover alleged frauds by entity against which judgment for over \$1,900,000.00 had been entered).

⁶⁴ *In re Wilcher*, *supra*.

⁶⁵ *In re Mittco*, *supra*; *U.S. v. Zappola*, 646 F. 2d 48, 53 (2d Cir. 1981).

Invoking the Fifth Amendment

Generally, in a federal civil proceeding, parties may discover information that is relevant and non-privileged.⁶⁶ It is well settled that courts should broadly and liberally interpret the scope of discovery in order to provide parties with information essential to proper discovery of all relevant facts, and thereby, eliminating surprise and promoting settlement.⁶⁷ In fact, when in doubt as to the relevancy of a particular discovery request, courts should permit discovery.⁶⁸ These underlying principals in a party's right to discover pertinent information, however, often come into conflict when the party from whom discovery sought attempts to assert a privilege, such as the Fifth Amendment or attorney-client⁶⁹ privileges, in the information sought in order to prevent disclosure. As one commentator noted,

[t]he underlying principles of fairness and openness in civil discovery are turned upside down when a witness invokes the Fifth Amendment privilege in a civil proceeding—particularly in a bankruptcy proceeding, which is marked by its transparency.⁷⁰

Essentially, the Fifth Amendment privilege against self-incrimination protects an individual from being compelled to give testimony that may be incriminating or that may provide evidence (in the form of testimonial communications and nonverbal communicative conduct)⁷¹ that tends to establish guilt of a crime and that the witness reasonably believes could be used in any proceeding, civil,⁷² criminal, administrative, judicial, investigatory or adjudicatory, including bankruptcy proceedings.⁷³ In technical terms, under the Fifth Amendment,

a person has a right to remain silent without suffering any penalty for such silence and “penalty” means the imposition of any sanction that makes assertion of the Fifth Amendment privilege “costly.”⁷⁴

⁶⁶ Fed. R. Civ. P. 26(b)(1); see also *Coker v. Duke & Co., Inc.*, 177 F.R.D. 682, 685 (M.D. Ala. 1998).

⁶⁷ *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351 (1987); see *Coker*, 177 F.R.D. at 685.

⁶⁸ *Id.*

⁶⁹ Note: The scope of the attorney-client privilege is not the subject of this paper, but for a more detailed discussion on the subject see *In re Bame*, 251 B.R. 367, 371-372 (Bankr. D. Minn. 2000).

⁷⁰ ALLEN B. DIAMOND & ERIN E. JONES, AVOIDING LITIGATION PITFALLS: AN INTRODUCTION TO THE FIFTH AMENDMENT PRIVILEGE AGAINST SELF-INCRIMINATION IN BANKRUPTCY PROCEEDINGS, 27-APR AM. BANKR. INST. J. 20 (April 2008).

⁷¹ *Fisher v. U.S.*, 425 U.S. 391, 409-10 (1976).

⁷² In civil proceedings, the Fifth Amendment privilege against self-incrimination applies not only at the trial stage, but also at any time during discovery. *In re Adelphia Comm. Corp.*, 317 B.R. 612, 623-24 (Bankr. S.D. N.Y. 2004).

⁷³ *Kastigar v. U.S.*, 406 U.S. 441, 444-445 (1972); *U.S. v. Seiffert*, 501 F. 2d 974, 980 (5th Cir. 1974); *In re Standard Fin. Mgmt. Corp.*, 76 B.R. 864, 865 (Bankr. D. Mass. 1987); *In re Ross*, 156 B.R. 272, 274-75 (Bankr. D. Idaho 1993). See also *In re Cotillion Inv., Inc.*, 343 B.R. 344 (Bankr. S.D. Fla. 2006); *In re Gi Yeong Nam*, 245 B.R. 216 (Bankr. E.D. Pa. 2000).

Moreover, the invocation of the Fifth Amendment privilege in a Rule 2004 examination is rather the exception than the norm. On occasion, however, the Fifth Amendment privilege against self-incrimination arises in the context of a Rule 2004 examination—despite the fact that a corporate debtor has no such privilege—because the individuals, corporate officers, agents and employees do have such a privilege.⁷⁵

Notwithstanding, even after an examinee invokes the Fifth Amendment, a surety or fidelity insurer should take care not to prematurely end the Rule 2004 examination. As with most privileges, the Fifth Amendment is subject to certain limitations. A property assertion of the Fifth Amendment privilege requires three elements: (i) a compelled disclosure; (ii) found to be testimonial; and (iii) which is incriminating.⁷⁶ For instance, examinees invoking the Fifth Amendment must do so on a question-by-question basis and are not entitled to a blanket objection.⁷⁷

Further, because it can be difficult to conduct a factual investigation when a witness invokes the Fifth Amendment privilege and refuses to testify, bankruptcy courts have recognized greater restrictions on a witness' ability to invoke the Fifth Amendment in a bankruptcy proceeding. As the Court in *In re Bartlett*, 162 B.R. 73, 77 (Bankr. D. N.H. 1993) (citing *In re Fairbanks*, 135 B.R. 717) (Bankr. D. N.H. 1991), stated:

* * * * *

[T]he ability to invoke the [Fifth Amendment] privilege may be greatly diminished when invocation would interfere with the

⁷⁵ ALLEN B. DIAMOND & ERIN E. JONES, *supra*. See also *Braswell v. U.S.*, 487 U.S. 99, 105 (1988); *In re Tower Metal Alloy Co.*, 200 B.R. 598, 605-606 (Bankr. S.D. Ohio 1996). Important to highlight here is that sureties and fidelity insurers should pay particular attention when the invocation of the Fifth Amendment is made by a corporate representative or corporate records custodian, because the corporate representative or custodian is acting in a representative capacity and has an obligation to produce corporate records upon demand. *Braswell*, 487 U.S. at 110. Consequently, an invocation of the Fifth Amendment privilege by a representative or custodian is a claim of privilege by corporation, which has no such privilege. *Id.* at 106. Therefore, the invocation of the Fifth Amendment is improper and the corporate representative cannot refuse to testify or refuse to produce corporate documents on the basis of the Fifth Amendment. This is a thorny issue, however, because if the response to the question propounded somehow implicates the corporate representative in his individual capacity, the representative may still be able to invoke the Fifth Amendment. He cannot, however, refuse to produce corporate documents on the basis of an individual personal privilege, even if the documents would tend to incriminate the representative. *Id.* at 110.

⁷⁶ *In re Bame*; 251 B.R. 367, 378 (Bankr. D. Minn. 2000); *In re ICS Cybernetics*, 107 B.R. 821, 827 (Bankr. N.D. N.Y. 1989). Important to note is that witness invoking the Fifth Amendment bear the burden to show that there is a reasonable perception on their part of the danger of self-incrimination. *In re Boughton*, 243 B.R. 830, 835-836 (Bankr. M.D. Fla. 2000).

⁷⁷ ALLEN B. DIAMOND & ERIN E. JONES, *supra*. See also *In re Morganroth*, 718 F. 2d 161, 167 (6th Cir. 1983); *U.S. v. Goodwin*, 625 F. 2d 693, 700-01 (6th Cir. 1980); *In re Connelly*, 59 B.R. 421, 423 (Bankr. N.D. Ill. 1986). Note: there is no constitutional right not to be incriminated by the testimony of another. *Doe v. U.S. (In re Grand Jury Subpoenas)*, 144 F. 3d 653, 663 (10th Cir. 1998). Rather, the privilege against self-incrimination is solely for the benefit of the witness, not for the protection of other parties. *Id.* Consequently, a party incriminated by evidence produced by a third party sustains no violation of his own Fifth Amendment rights. *California Bankers Ass'n v. Shultz*, 416 U.S. 21, 55 (1974).

effective operation of a generally applicable, civil regulatory requirement.

* * * * *

Under chapter 7 of the Code there is a statutory liquidation procedure of general applicability which depends upon, and requires full disclosure by the debtors involved in such proceedings.... [L]iquidation of business cases under chapter 7 of the Code would be severely hampered, if not rendered impossible, were the bankruptcy debtor able to withhold from the trustee the books and records of the business on grounds of possible incriminatory effects as to certain of those records.

Furthermore, the Bartlett Court recognized that a discharge in bankruptcy was not a constitutional right.⁷⁸ Citing the bankruptcy court in *Matter of Metzgar*, the Court explained:

While a debtor is entitled to invoke his fifth amendment right to refuse responses in a bankruptcy proceeding ... a discharge in bankruptcy is neither an inherent nor a constitutional right.... The bankruptcy court can dismiss, *sua sponte*, a petition that cannot be administered due to a debtor's refusal to provide information.... Requiring him to choose between the benefits of discharge and the costs of self-incrimination does not necessitate forfeiture of one constitutional right to secure another since only the latter stems from the Constitution.... A debtor seeking relief from his obligations pursuant to the Bankruptcy Code and in a Bankruptcy Court does so willingly and voluntarily and is not entitled to as much consideration in being compelled to testify as would be another witness who had no interest in the proceeding.⁷⁹

The Court further reasoned that a debtor cannot enjoy the benefits of the bankruptcy process while avoiding its burdens. "To do so would allow the debtor to use the Fifth Amendment as a shield, while impermissibly using the Bankruptcy Code as a sword with which to take an unfair advantage of creditors."⁸⁰ As such, the debtor must choose between "protection from prosecution and protection from particular creditors"⁸¹, or risk jeopardizing obtaining a discharge.

⁷⁸ See e.g. *Grogan v. Garner*, 498 U.S. 279, 286, (1991) (citing *United States v. Kras*, 409 U.S. 434, 445-446 (1973)) ("We have previously held that a debtor has no constitutional or 'fundamental' right to a discharge in bankruptcy."); *Matter of Metzgar*, 127 B.R. 708 (Bankr. M.D. Fla. 1991); *In re Save More Foods, Inc.*, 96 B.R. 1 (D. D.C. 1989); *In re Connelly*, 59 B.R. 421, 448 (Bankr. N.D. Ill. 1986); and *In re McDonald*, 25 B.R. 186, 189 (Bankr. N.D. Ohio 1982).

⁷⁹ *Id.* at 78, quoting *Matter of Metzgar*, *supra*, at 71.

⁸⁰ *Id.* at 79, quoting *In re Lederman*, 140 B.R. 49, 53 (Bankr. E.D. N.Y. 1992).

⁸¹ *Id.*

Moreover, a Rule 2004 examinee's refusal to respond on the grounds that the answers might incriminate him, in some circumstances, may result in the court drawing an "adverse inference" from the refusal to answer.⁸² As one commentator advised,

[e]ven when a witness invokes the Fifth Amendment privilege against self-incrimination, it may be possible, through specific questioning, for the court to draw adverse inferences as to certain facts. . . .in order to take advantage of any potential adverse inference, the examining party must not prematurely end the examination once the witness had indicated his intention to assert the privilege as to any and all questions. There may be great value in continuing the examination of a witness who selectively invokes the privilege. In addition to potentially obtaining adverse inferences instructed by the court, such witness may waive privilege through his continued testimony.⁸³

Consequently, the invocation of the Fifth Amendment privilege during a Rule 2004 examination is not necessarily an insurmountable hurdle that surety and fidelity insurer cannot overcome. Rather, if the surety and fidelity insurer are strategic and calculating, the invocation of the Fifth Amendment may result as blessing in disguise.

CONCLUSION

The passage of time is usually a surety or fidelity creditor's worst enemy in bankruptcy. As time elapses, post-petition interest, attorneys' fees and other charges accrue to the oversecured surety or fidelity creditor and unless the collateral is appreciating in value, the equity cushion, if any, is quickly disappearing. For that reason, making an informed decision at an early stage in a bankruptcy case can make the difference. At the outset, sureties and fidelity insurers should carefully weigh all options available to them—under the bankruptcy law and state law, alike—before blindly charging forward in order to maximize pro creditor resolutions and minimize costs. Keeping in mind that the scope of Rule 2004 examination is broader than that allowed in connection with a deposition taken pursuant to Bankruptcy Rule 7030, it may be worthwhile for the sureties or fidelity insurers to conduct a Rule 2004 examination before initiating an adversary proceeding or contested matter. Although generally not fatal, it is easier (and less costly) for the surety and fidelity insurer to strategically plan ahead, in order to avoid becoming the entangled fly in Charlotte's web.

⁸² ALLEN B. DIAMOND & ERIN E. JONES, *supra*. See also *Baxter v. Palmigiano*, 425 U.S. 308, 319-20 (1976).

⁸³ ALLEN B. DIAMOND & ERIN E. JONES, *supra*.

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APPENDIX A:

PRACTICE POINTERS FOR A RULE 2004 EXAMINATION

1. A request is to be made by motion, and as a matter of course, the motion may be heard *ex parte* and granted. This is the practice in most districts; however, local district rules should be consulted and observed in the filing of such a motion.
2. The Rule 2004 examination, whether of a debtor at the Code §341 meeting of creditors, or of any person including the debtor under this Rule, may relate to the acts, conduct, property, liabilities, or financial conditions of the debtor.
3. In instances of an individual bankruptcy under Chapter 11, 12, or 13, where the debtor operates a business, the examiner may inquire into the nature and extent of the business, the desirability of the continuing business, the source of any money or property acquired or to be acquired to consummate the plan and any consideration given or offered for that property, and generally any other matter relevant.
4. A Rule 2004 examination may be accompanied by a document production.
5. Attendance may be compelled under Bankruptcy Rule 2004 by the use of a subpoena. See *also* FED. R. BANK. P. 9016.
6. A creditor's right to a 2004 exam must be supported by just case, and if objected to by the debtor, the creditor bears the burden of proving good cause for the examination.
7. In a Rule 2004 examination, there are no specific issues, no rules of evidence, no right to object, and no right to have counsel present.
8. An examinee may assert that certain testimony is privileged, but must establish the proper basis for the objection as to each question.
9. Examination under Rule 2004 may extend to creditors and third parties who have had dealing with the debtor, who have a relationship with the debtor, or who have knowledge of the debtor's affairs (i.e. debtor's employer, accountant, or attorney).
10. Any evidence resulting from such a Rule 2004 exam must be admitted under the provisions of the Federal Rules of Evidence before it may be considered by the Court.
11. Courts will usually not allow a 2004 exam where an adversary proceeding is pending.
12. A Rule 2004 exam may not be used to abuse or harass a witness, and examiner cannot examine a witness on matter bearing no relations to the debtor's affairs.