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Pre-Trial Discovery Considerations In Bankruptcy

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Discovery Issues in Bankruptcy
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A. 341 Meeting of Creditors

1. *Scope of inquiry*: The scope of questions that may be asked at a debtor's 341 meeting of creditors is the same as a 2004 exam described *infra*. Section 343 provides that a debtor shall appear under oath and subject to examination by creditors, panel trustees, or the U.S. Trustee. 11 U.S.C. § 343. Bankruptcy Rule 2004(b) provides that the scope of inquiry at a 341 meeting of creditors is the same as the scope for a 2004 examination. *In re Morrison*, 443 B.R. 378, 380 (Bankr. M.D.N.C. 2011) ("[T]he scope of a typical Rule 2004 examination applies to a debtor's examination at his or her meeting of creditors."). Although there is wide latitude in the types of questions that may be asked, it should not be treated as a substitute for the in-depth inquiry that occurs during a 2004 exam. *In re Muy Bueno Corp.*, 257 B.R. 843, 851 (Bankr. W.D. Tex. 2001) ("The § 341 meeting provides the trustee and creditors with a cheap, inexpensive, and convenient tool to get an overall feel for the bankruptcy estate, and to do so early in the case.")

2. *Admissibility as direct evidence in subsequent trials/hearings*: At least in the Eleventh Circuit, testimony given at a 341 meeting is admissible as direct evidence, but other courts have disagreed. *Compare In re Jost*, 136 F.3d 1455, 1459 (11th Cir. 1998) (finding that it was reversible error to exclude debtor's testimony given at § 341 meeting and 2004 exam); *In re Hardy*, 319 B.R. 5, 6 (Bankr. M.D. Fla. 2004) (noting that "[w]hile the testimony of a debtor is under oath, there is no opportunity to offer defenses or to cross-examine or present witnesses in an attempt to explain or clarify the direct testimony of the debtor," court was constrained by *Jost* to admit 341 testimony) *with In re Kincaid*, 146 B.R. 387, 389 (Bankr. W.D. Tenn. 1992) (quoting Paskay, 1973 *Handbook For Trustees And Receivers In Bankruptcy*, p. 271 (1973)) ("Testimony of debtors at a bankruptcy meeting of creditors is not admissible as direct evidence in a later adversary proceeding or contested matter.").

3. *Objections to questions*: Not entirely clear. *Compare In re McFadden*, 477 B.R. 686, 692 (Bankr. N.D. Ohio 2012) (quoting 3 Collier on Bankruptcy ¶ 341.02[5][e], 341–13 (16th ed. 2011)) ("[I]f the debtor believes that the questions are beyond the scope permitted, or unduly repetitious, the debtor may object and even refuse to answer.") *with In re Morrison*, 443 B.R. 378, 380 n.2 (Bankr. M.D.N.C. 2011) ("[T]he objection on 'relevance' grounds was not a proper objection in the context of a Section 341 meeting."). However, a debtor who decides to refuse to answer a question does so at his or her own peril. *See e.g. In re Donohoo*, 243 B.R. 536, 537 (Bankr. M.D. Fla.

1999) (finding sanctions appropriate against debtor who refused to answer questions about government's debt at 341 meeting of creditors).

B. 2004 Examinations

1. *Scope*: Any party in interest may conduct an examination provided it relates to "acts, conduct, or property or 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." Fed. R. Bankr. P. 2004(b). In Chapters 11, 12, and 13, the scope is extended to include inquiry into the operation of any business, desirability of its continuance, source of money or property to be acquired for consummating a plan, and any other matter relevant to plan formation. Fed. R. Bankr. P. 2004(b). "The scope of a Rule 2004 examination is 'unfettered and broad;' the rule essentially permits a 'fishing expedition.'" *In re Mastro*, 585 B.R. 587, 597 (B.A.P. 9th Cir. 2018). But a 2004 exam may not be used to abuse or harass the examined party and it may not "stray into matters which are not relevant to the basic inquiry." *Id*. (internal citations omitted).

2. *The pending proceeding limitation*: Generally, it is not proper to use a 2004 exam to gather evidence for claims that are the subject of a pending adversary or contested matter. *Matter of M4 Enterprises, Inc.*, 190 B.R. 471, 475 (Bankr. N.D. Ga. 1995). The pending proceeding rule prevents "Rule 2004 [from] usurping the narrower rules for discovery in a pending adversary." *In re Int'l Fibercom, Inc.*, 283 B.R. 290, 292 (Bankr. D. Ariz. 2002).

    a. Where discovery is stayed in a separate proceeding due to the bankruptcy filing, courts may exercise their discretion to permit a 2004 examination notwithstanding the fact that it relates to a separate proceeding. *Id*. ("Yet although Rule 2004 does not contain any exception precluding such discovery when it is available in other pending litigation, courts have frequently imposed such a limitation…. Here, discovery is not presently available in any of the other pending litigation, due to the automatic stay arising from PF.Net's bankruptcy case. With one exception, it appears that discovery was in fact presently available in the other pending litigation in all of the authorities relied on by AT & T. Consequently those authorities have limited, if any, significance for the situation where such alternative discovery methods are stayed, as here. On these facts, such strict application of the 'pending litigation' analysis would be adverse to the purpose underlying the Bankruptcy Rule 2004.")

    b. The pending proceeding limitation probably does not apply when future litigation is only anticipated. *In re Table Talk*, 51 B.R. 143, 145 (Bankr. D. Mass. 1985) (citations omitted) (permitting 2004 examinations by trustee where

one purpose was to determine potential anti-trust claims); *In re Washington Mutual, Inc*., 408 B.R. 45, 53 (Bankr. D. Del. 2009) (citation omitted) (granting debtors' Rule 2004 examination of creditor and indicating "that there is no justification to prevent the Rule 2004 examination of JPM simply because Debtors may obtain evidence which could be used in a pending proceeding in which JPM is not yet a party.").

3. *Who may be examined*: Rule 2004 permits the examination of "any entity." Fed. R. Bankr. P. 2004(a). Any third party with a relationship to the debtor may be examined under Rule 2004 "[b]ecause the purpose of the Rule 2004 investigation is to aid in the discovery of assets." *In re Ionosphere Clubs, Inc*., 156 B.R. 414, 432 (S.D.N.Y. 1993), aff'd, 17 F.3d 600 (2d Cir. 1994); *In re E. W. Resort Dev. V, L.P., L.L.L.P.*, No. 10-10452 (BLS), 2014 WL 4537500, at *7 (Bankr. D. Del. Sept. 12, 2014) (2004 is appropriate to examine "third parties that possess knowledge of the debtor's acts, conduct, liabilities or financial condition which relate to the administration of the bankruptcy estate.").

4. *Who may request an examination*: Rule 2004 permits "any party in interest" to request an examination. This includes but is not limited to creditors, creditors' committees, equity security holders, equity security holders' committees, trustees, prospective asset purchasers, and debtors. *In re Summit Corp*., 891 F.2d 1, 5 (1st Cir. 1989).

5. *Sanctions:* A party who fails to comply with discovery requests may be held liable for civil contempt, have its case dismissed or converted, or may be subject to an arrest warrant. *In re Stasz*, 387 B.R. 271, 276 (B.A.P. 9th Cir. 2008) (upholding contempt sanctions against debtor who missed four scheduled 2004 exams); *In re Sanders*, 417 B.R. 596, 601 (D. Ariz. 2009) ("it is clear that 'cause' existed [to convert case under § 1112]; Sanders had failed to attend no less than three scheduled Rule 2004 Examinations."); *In re Rodriguez*, 255 B.R. 118, 121 (Bankr. S.D.N.Y. 2000) (noting that "[i]f, however, the debtor ignores the Rule 2004 order, the trustee can request her arrest, Fed. R. Bankr. P.2005, or sue to revoke her discharge, 11 U.S.C. § 727(d)(3), and seek to dismiss the case with prejudice. 11 U.S.C. § 349(a).").

6. *Relationship to depositions*: 2004 examinations are akin to depositions and are not presumptively public. *In re Thow*, 392 B.R. 860 (Bankr. W.D. Wash. 2007). Furthermore, courts have applied some of the rules that govern depositions under the Federal Rules of Civil Procedure to 2004 examinations. *See e.g. In re Analytical Sys., Inc.*, 71 B.R. 408, 413 (Bankr. N.D. Ga. 1987) (finding that the duty imposed under Rule 30(b)(6) "to designate a person having knowledge of the matters sought" applies to 2004 examinations.).

C. Discovery in Adversary Proceedings and Contested Matters

1. *Summary*: A party in a separate litigation cannot take advantage of Rule 2004 to obtain discovery from its opponent. Once an adversary proceeding or contested matter is commenced, discovery may only be obtained under the federal rules of discovery. The purpose of this rule, often called the "pending proceeding" or "pending litigation" rule, is to ensure that litigants do not circumvent the federal rules that are meant to govern their proceedings, in favor of the broader and more permissive discovery available under Rule 2004.

2. *General discovery provisions (Rule 7026)*: Rule 26 is made applicable to adversary proceedings by Bankruptcy Rule 7026. Similarly, Bankruptcy Rule 9014 makes Rule 26 applicable in contested matters. As discussed above, discovery under Rule 26 provides greater procedural protections than Rule 2004 and it is therefore improper to use Rule 2004 to circumvent compliance with Rule 26. Rule 26 imposes various procedures and requirements on the parties involved in discovery. This includes duties of disclosure under 26(a) and of continuing disclosure under 26(e), limitations on the scope of discovery and protections against certain disclosures under 26(b), rules governing issuance of protective orders under 26(c), and the timing and sequence of discovery under 26(d) and 26(f).

    a. Certain disclosure obligations are limited in contested matters, including mandatory initial disclosures under 26(a)(1), disclosures regarding expert testimony under 26(a)(2) and additional pre-trial disclosures under 26(a)(3), and the meeting prior to a scheduling conference under 26(f). Fed. R. Bankr. P. 9014(c). However, the Court maintains discretion to alter the applicability of Rule 26 in contested matters. *See id*.

3. *Depositions (Rules 7030/31)*: Depositions are governed by Rules 30 and 31 and are made applicable to adversary proceedings by Bankruptcy Rules 7030 and 7031, respectively. Similarly, Rules 30 and 31 are made applicable to contested matters by Bankruptcy Rule 9014. Rule 30 governs oral depositions, while Rule 31 governs depositions by written questions. Both rules set forth procedures governing when depositions may be taken and how notice of depositions must be provided. Rule 30 also sets forth the rules of how the examination and cross-examination will proceed at an oral deposition, for example, the duration of the examination, management of documents used during a deposition, and consequences for failure to appear at a deposition.

4. *Interrogatories (Rule 7033)*: Bankrupt Rule 7033 incorporates Federal Rule of Civil Procedure 37, which empowers parties to send interrogatories to opposing parties. The number of interrogatories is capped at 25, including discrete subparts, and they may request information regarding any matter permissible under Federal Rule of Civil

Procedure 26(b). Fed. R. Civ. P. 33(a)(1)-(2). If the answer to an interrogatory is ascertainable by review of a party's business records and the burden for determining the answer would be the same for either party, that party has the option of producing the business records. Fed. R. Civ. P. 33(d).

5. *Requests for admission (Rule 7036)*: Parties are permitted to serve an unlimited number of requests for admission regarding any fact, application of law to fact, opinions, or the genuineness of documents. Fed. R. Civ. P. 36(a)(1)(A)-(B) (incorporated by Bankruptcy Rule 7036). An important sanction for parties to consider is that if a request for admission remains unanswered more than 30 days after service, the fact is deemed admitted. Fed. R. Civ. P. 36(a)(3). If a fact is admitted, the matter is "conclusively established" unless the court permits an amendment or withdraw of a response to a request for admission.

6. *Sanctions (Rule 7037)*: Bankruptcy Rule 7037 incorporates Federal Rule of Civil Procedure 37, which details the sanctions that may result from a party's failure to comply with a discovery request. Courts have a broad range of sanctions that it may employ against a party who disobeys a discovery order including taking certain facts as established, prohibiting a party from supporting or opposing claims or defenses, striking pleadings, staying proceedings pending compliance, entering default judgment or dismissal, or finding the party in contempt. Fed. R. Civ. P. 37(b)(2)(A)(i)-(vii). However, before dismissing the case or entering default judgment, the court is required to weigh "(1) the public's interest in expeditious resolution of litigation; (2) the court's need to manage its docket; (3) the risk of prejudice to the other party; (4) the public policy favoring the disposition of cases on their merits; and (5) the availability of less drastic sanctions." *Adriana Int'l Corp. v. Thoeren*, 913 F.2d 1406, 1412 (9th Cir. 1990).

D. Discovery Provisions in the 2018 Local Rules

1. *Local Rule 5005-1*: Parties are required to file a "notice of service" for deposition transcripts, interrogatories and answers, requests for production, inspection, and requests for admission. The underlying papers are not to be filed with the Court. This rule is unchanged from the Local Rules in place prior to the 2018 amendment.

2. *Local Rule 7017-1/9013-1(e)*: In the event of a discovery dispute, the parties are required to engage in a "personal consultation and a sincere effort to resolve" the dispute, which requires a face-to-face meeting or phone conversation. New to the 2018 Local Rules, parties are required to call chambers and await further instructions before filing a discovery motion. A motion to compel may only be brought when "the Court has authorized the filing." Local Rule 9013(f) (Detailing the rules for motions to compel "when the Court has authorized the filing.").