UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

C.F. SWYERS PRINTING, INC. Case No. 00-14050

Debtor

MEMORANDUM OF DECISION

This Memorandum explains the Order entered August 29, 2000, granting Fleet's request for the appointment of an examiner.

What the Court is about to say is not intended to cast aspersions on anyone involved in this case. Rather it is an analytic device, the purpose of which will become clear.

In general, it is not unfair to say that Chapter 11 sometimes provides a safe haven for scoundrels, so long as they are willing to "clean up their act" once they become Chapter 11 debtors-in-possession.

But that safe haven is not free. Chapter 11 is an expensive process. Again, this Court has no reason before it to conclude that the principals of this Debtor are scoundrels. It is clear to this Court, however, that they actively endeavored to mislead and delay the Debtor's largest creditor, and then brought the Debtor to Chapter 11 for cover, when the creditor would no longer be delayed. And so this case presents the question of whether the transaction costs of

Chapter 11 should be higher for this Debtor, than they are in the case of a debtor who did nothing worse than default on its obligations.

Specifically, the question is whether the creditor's request to appoint an examiner should be granted.[1] The Court hereby grants the request. 11 U.S.C. § 1104's focus on pre-petition conduct assures that a debtor may not, with complete impunity, act more and more outrageously towards a creditor as it slides closer and closer to Chapter 11.

1. CREDIBILITY

The Court finds the testimony of Jack Swyers unreliable. After asserting that he knew that Ms. Harris knew that the account receivable report was subject to later reconciliation, he heard her testify here that that was not true. So his testimony changed - he didn't really "know" that Ms. Harris knew that the report could not be relied upon, but rather it was his brother who had told him so. Similarly, he asserted that Sisson and Anderson told him that they knew that the receivables on his report that were more than 90 days old were no good, and that they would not be counted. But after the bankers testified that they never told him any such thing, his testimony became that Hanratty told him that as a general rule, the bank does not count receivables over 90 days, and that Hanratty told him that consequently, he should hurry up and send his report over and not worry about "cleaning it up."

[1] The Debtor argues that the added cost of an examiner would come at the expense of unsecured creditors. Perhaps that will be the case. Perhaps not. In part, that depends on the results of the examiner's investigation.

Mr. Swyers previously asserted that the bankers wished him well on his move to Florida. After the bank denied knowing about the move until long after it occurred, and explained that they would have had to help him find another lender, his counsel simply argued that Swyers had no duty to tell them that he had moved his headquarters to Florida.

2. THE UNDISPUTED FACTS

An undisputed fact is that Clarence "Buzz" Swyers made repeated promises to provide additional collateral, or to "cash out" the bank, and to provide various reports demanded by the bank (per the Credit Line Agreement), and that after various periods of forbearance based on his promises (and a long history of being a good customer of the bank), the corporate Chapter 11 filing substituted for performance of his promises.

Also undisputed is that a "reconciliation" of the accounts receivable report, which reconciliation was prepared after the Chapter 11 filing, is the first time that the Debtor told the bank that the accounts receivable statement for the period ended May 31, 2000, which the bank received in June, was incorrect by nearly $1 million.

On the other hand, it is also undisputed that the Debtor has offered to open its books and records to the bank, that a CPA has confirmed that there is "no money missing," and that the write-down of the receivables, etc., are in full accord with generally accepted accounting principles.

3. DISCUSSION

It is this Court's view that a debtor who did not merely default, but who in fact held a creditor at bay by making promises that seemed feasible, but which promises were dishonored by the debtor, cannot simply say to the creditor "trust me now that I have filed Chapter 11." Nor may that debtor say to the creditor "go spend more money to satisfy yourself that my lies didn't really hurt you." Nor may that debtor say "Judge, let me prove to you that my lies did not hurt them."

This last point is very much at issue. The Debtor argues that it must be given the right to prove that it did not harm the bank, and that, consequently, there is no need for an examiner.

This Court does not agree that the Debtor has such a right. A criminal procedure analogy might be useful. Hypothesize a motion to quash a grand jury subpoena, filed by the target of the grand jury's inquiry, claiming that he did nothing criminal and wanting the court to hear his alibi. There can be no doubt that it is the grand jury that should hear the alibi first, and should have the opportunity to examine the alibi witnesses and other evidence. And ultimately, if there is an indictment, the court will adjudge the facts on the basis of evidence provided by both sides, each of which has had the benefit of full investigation and discovery.

Of course, in criminal law, the prosecutor does not have to make a motion (on notice to the target) seeking an order to permit the prosecutor to present a matter to the grand jury. But it is not inapt to think of a motion to appoint an examiner to be like a grand jury subpoena, and the debtor's defense to be like a motion to quash the subpoena. Like a grand jury,

an examiner conducts an inquest. Just as a prosecutor is not required on motion practice to try the merits of a criminal case that has yet to be (and might never be) commenced, and to do so solely on the basis of the self-serving testimony of the target who has yet to be fully investigated and examined, a creditor who has good reason not to believe a word a debtor says is not required to disprove everything the debtor self-servingly offers in an effort to prove why his duplicitous conduct was harmless in the end.[2]

Requesting an examiner is a request to implement a procedure to obtain information. It is not, of itself, a question. So it does not suffice for the Debtor to say "overrule the question because we are prepared to prove the answer." Rather, the inquest it seeks "shall" be granted if "in the interest of creditors, any equity security holders, and other interests of the estate . . . ," provided that there are, at the least, "irregularities" to be investigated.

This Court finds this to be an "irregularity" warranting examination: Reporting $1.2 million in receivables to the lender in June, as of May, then writing hundreds of thousands of those down in July, as of May, when the Chapter 11 petition has been filed and the write-down means not only that the Debtor no longer considers the lender to be oversecured (and thus no longer entitled to post petition interest), but also that the Debtor believes the lender to be so undersecured that very little adequate protection is required.[3]

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[2]As stated in *In re 1243 20th St., Inc.*, 6 B.R. 683 (Bankr. D.C. 1980), "[T]he hearing on the appointment of an examiner is, at [an] early juncture of the case, limited in scope and not in the nature of an adversary proceeding. Therefore, [the decision] is not intended to reach the merits of a particular transaction or transactions in which the debtor may have been involved."

[3]Cf. *In re Gilman Services Inc.,* 46 B.R. 322 (Bankr. Mass. 1985).

4. CONCLUSION

This Court exists to help creditors and debtors alike deal with the consequences of the fact that the debtor is unable to perform its obligations to others because of excess debt. A debtor who has acted deceptively toward a creditor in the days leading up to the Chapter 11 case ought not be treated with the same solicitude that the Court would show a debtor who has not so acted. Appointment of an examiner is the least intrusive remedy for such conduct. Unlike appointment of a trustee, it leaves the principals in control. Unlike conversion or dismissal, it permits, and could even enhance, an effort to reorganize. It is no more expensive that the common remedy of providing an accountant for the creditors committee. And where, as here, the Debtor has no credibility in the eyes of its major creditor, it lessens that distrust as a possible obstacle to reorganization.

In enacting the Reform Act of 1978, Congress intended to attract Chapter 11 filings before it is too late for reorganization. Today's result mildly deters buying delay at the expense of honesty of dealing, and assures creditors that the Court too will insist on independent investigation where it is shown that the Debtor did act deceptively on its way to this Court. It may even benefit the principals, in that a "clean" report might restore the lender's willingness to work toward reorganization.

Because of all the above, I find it is in the best interest of creditors, any equity

security holders[4] and other interests of the estate, to grant the motion.

The United States Trustee is ordered to appoint an examiner as soon as practicable.

SO ORDERED.

Dated: Buffalo, New York
August 30, 2000

/s/ Michael J. Kaplan

Michael J. Kaplan, U.S.B.J.

[4] In its analysis of the legislative history, the *Gilman* court made it clear that this reference to equity was not intended to protect management from an examiner, but rather was intended to protect mere stockholders from scoundrels that are part of management.