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Problems in the Code

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Reevaluating § 1104(c)(2): The Need for Modernization and Discretion

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"Bankruptcy courts are courts of equity, empowered to invoke equitable principles to achieve fairness and justice in the reorganization process."[1]

Courts' discretionary power allows bankruptcy courts to tailor solutions to the unique circumstances of each case, balancing the interests of debtors, creditors and other stakeholders. However, this equitable power is not absolute. In certain instances, bankruptcy courts find their hands tied by the express language of the Bankruptcy Code, which mandates specific actions regardless of the bankruptcy court's assessment of fairness or necessity.

A notable example of this statutory constraint is found in the Third Circuit's decision in *In re FTX Trading Ltd*.[2] In this case, the Third Circuit held that the U.S. Bankruptcy Court for the District of Delaware erred in exercising its discretion to deny the motion of the Office of the U.S. Trustee to appoint an examiner under § 1104(c)(2) of the Bankruptcy Code when the statutory requirements, including a minimum of $5 million in unsecured debt, were satisfied. In doing so, the Third Circuit overturned decades of precedent in the Delaware Bankruptcy Court, which had treated the appointment of an examiner, even under § 1104(c)(2), as being within the court's discretion.[3]

This decision has created significant debate, raising concerns about the potential unintended consequences of the decision, but the issue may lie with the language of the Code itself. Section 1104(c)(2) provides:

> [O]n request of a party-in-interest or the [U.S. T]rustee ... the court *shall* order the appointment of an examiner to conduct such an investigation of the debtor *as is appropriate* ... if —
>
> ...
>
> (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.[4]

Some have argued that the statute's use of the word "shall" requires the bankruptcy court to appoint an examiner upon meeting the specified conditions. Others have contended that the phrase "as is appropriate" must be interpreted to provide the bankruptcy court discretion regarding whether an examiner should be appointed.

FTX's epic rise and fall, its bankruptcy filing and the ensuing allegations of gross mismanagement — as well as criminal convictions for fraud and conspiracy — have been widely reported. Soon after the bankruptcy filing, the U.S. Trustee moved for the appointment of an examiner to investigate and report on FTX's extraordinary collapse, arguing, among other things, that § 1104(c)(2) mandated the appointment because the debtors' debts to customers alone far exceeded the $5 million threshold.

The debtors, official creditors' committee and other stakeholders opposed the motion, arguing, *inter alia*, that the phrase "as is appropriate" in § 1104(c)(2) provided the bankruptcy court with discretion to determine whether an examiner should be appointed, even though the pre-petition "bad actors" had been replaced by new, untainted management, and the debtors and other stakeholders were actively investigating and intending to report publicly on the collapse.

1 *In re Combustion Eng'g Inc.*, 391 F.3d 190, 235 (3d Cir. 2004) (internal quotation omitted).
2 91 F.4th 148 (3d Cir. 2024).
3 *See* Examiner Motion Hr'g Tr. at 12:16-25, *In re FTX Trading Ltd.*, No. 22-11068 (JTD) at D.I. 737 (Bankr. D. Del. 2022) (explaining that "every bankruptcy court in this district to [have] consider[ed] the issue has concluded that there is discretion," and identifying multiple rulings dating back as far as 1998).

4 11 U.S.C. § 1104(c)(2) (emphasis added).

The Delaware Bankruptcy Court acknowledged that the meaning of § 1104(c)(2) had created a split among jurisdictions — with some courts viewing the appointment as mandatory when the statutory conditions were met, and others holding it to be discretionary. The court found the legislative history instructive, emphasizing that the protections afforded through the appointment of an examiner were intended to be fact-specific. The court cited legislative commentary that

> [t]he standards for the appointment of an examiner are the same as those for the appointment of a [U.S.] Trustee. The protection must be needed and the cost and expense must not be disproportionately high.[5]

Noting that the debtors — now under new management — and the creditors' committee were actively investigating the alleged misconduct, the Delaware Bankruptcy Court concluded that the appointment of an examiner was inappropriate. In addition, the court found that the cost of an examiner's investigation likely would exceed $100 million[6] and would not be in the best interests of the estates' creditors. Accordingly, the court denied the U.S. Trustee's motion, exercising what it viewed as its discretion under § 1104(c)(2). The U.S. Trustee appealed the decision, the district court granted the certification motion for direct appeal, and the Third Circuit authorized the direct appeal.

The Third Circuit reversed the Delaware Bankruptcy Court, becoming only the second appellate court to decide the issue,[7] and holding that "the plain text of ... section 1104(c)(2) requires a bankruptcy court to appoint an examiner, if requested by the U.S. Trustee or a party-in-interest, and if 'the debtor's total fixed, liquidated, unsecured debt' exceeds $5 million."[8] The Third Circuit found that Congress's use of the word "shall" in the statute created a mandatory obligation to appoint an examiner once the specified conditions were satisfied.[9]

Applying the last antecedent rule of statutory construction, the Third Circuit concluded that the phrase "as is appropriate" modifies only the immediately preceding words "to conduct such an investigation of the debtor," not "shall order the appointment of an examiner,"[10] although the court still may determine the appropriate scope, degree, duration and cost of the examination. Furthermore, the Third Circuit held that this reading aligned with legislative intent, explaining that § 1104(c)(2) was enacted in 1978 to protect the public by "guaranteeing an automatically appointed examiner" in larger bankruptcy cases "to preserve and enhance debtors' and creditors' interests, as well as the public interest."[11]

The Third Circuit acknowledged that § 1104(c)(1) gives bankruptcy courts discretion to consider the interests of creditors, equityholders and other interests of the estate, but that § 1104(c)(2) does not. Under subsection (c)(2), the only determination for the bankruptcy court to make is whether the debt threshold has been satisfied.

The fundamental issue with § 1104(c)(2), as interpreted by the Sixth and Third Circuits, lies in the bankruptcy court's lack of discretion to determine whether the appointment of an examiner is appropriate, based on the specific facts and circumstances of a given case. By design, bankruptcy courts are courts of equity. Stripping bankruptcy courts of the ability to exercise equitable discretion undermines their core purpose: to ensure fairness and justice throughout the bankruptcy process.

Under this rigid interpretation, a bankruptcy court is required to appoint an examiner whenever a party-in-interest or the U.S. Trustee makes such a request and the debtor's fixed, liquidated and unsecured debts exceed $5 million, even if the appointment is unnecessary, duplicative or contrary to the interests of the debtor's estate and its stakeholders. This means that creditors — which might not even support or which expressly object to the appointment of an examiner — could be required to bear the substantial costs of an examiner's investigation, regardless of its utility or necessity. Such an outcome is inequitable, inefficient and arguably inconsistent with the intent of the statute.

Removing the bankruptcy court's discretion effectively prevents it from blocking wasteful or duplicative investigations. While the Third Circuit has interpreted the phrase "as is appropriate" as modifying only the scope and nature of the investigation — not the decision to appoint an examiner — the statute continues by specifying the subjects of investigations: "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.'" This language clearly presumes that such misconduct exists or has been alleged.

What if none of these issues are present? Numerous bankruptcy petitions are filed for reasons wholly unrelated to managerial misconduct, such as macroeconomic conditions, supply-chain disruptions, regulatory changes or even shifts in consumer preferences. In these cases, there might be no credible allegations of wrongdoing. Nevertheless, under the Third Circuit's decision, the bankruptcy court would still be required to appoint an examiner if requested, solely because the request was made and the statutory threshold of $5 million in debt was met. The result is a potentially wasteful and unjustified expenditure of estate resources, where even the bankruptcy court believes there is no benefit to the estate or creditors.

Moreover, under this decision, § 1104(c)(2) can become a litigation tactic. *De minimis* holdout creditors — or other parties with strategic motives — can exploit § 1104(c)(2) to delay proceedings or gain a perceived tactical leverage. Any party could trigger an investigation that imposes massive costs and procedural delays, regardless of the underlying merits or motivations, which a bankruptcy court no longer has discretion to consider, even if the motion is made in bad faith, is designed to obstruct the process, or threatens to drive the estate into administrative insolvency.

This interpretation of § 1104(c)(2) removes the bankruptcy court's ability to apply reason and discretion to a decision that can carry profound consequences for a bankruptcy case. Mandating the appointment of an examiner in all qualifying cases — without regard to necessity, context or impact — yields outcomes that are not only impractical but also funda-

5 Examiner Motion Hr'g Tr. at 16:14-24.
6 Examiner Motion Hr'g Tr. at 9:17-24.
7 *In re Revco*, 898 F.2d 498 (6th Cir. 1990).
8 *In re FTX Trading Ltd.*, 91 F.4th 148 (3d Cir. 2024).
9 *Id.* at 153.
10 *Id.* at 154.
11 *Id.* at 155.

mentally at odds with the equitable foundation upon which the bankruptcy system is built. Such rigidity fails both the letter and the spirit of the Bankruptcy Code, and requires legislative reform.

To begin addressing the issues posed by § 1104(c)(2), the statutory debt threshold must be increased. The current $5 million threshold, set in 1978, no longer reflects what constitutes a "large case" in today's economic landscape. As the Third Circuit noted in *FTX*, § 1104(c)(2) "was enacted to protect the public interest in larger bankruptcy cases."[12] However, $5 million is no longer representative of large chapter 11 cases in 2025.

This discrepancy becomes even more apparent when viewed in light of legislative developments such as the Small Business Reorganization Act of 2019, which created subchapter V of chapter 11 to streamline and reduce the costs of the bankruptcy process for small businesses. Subchapter V defines a "small business debtor" as one with no more than (now $3,024,725) in noncontingent, liquidated secured and unsecured debts.[13] Until recently, the Coronavirus Aid, Relief and Economic Security Act had temporarily raised that cap to $7.5 million,[14] illustrating that modern economic conditions demand higher thresholds for small business classification.

The original $5 million threshold in § 1104(c)(2) was meant to capture large, complex cases that justified the time and expense of appointing an examiner. Adjusted for inflation, $5 million in 1978 is equivalent to more than $25 million in 2025.[15] Thus, the current statutory threshold is outdated by nearly five decades of inflation.

The debt threshold is an important safeguard. Without it, smaller cases (like those that would have fallen under subchapter V under the CARES Act) could be subject to examiner motions under the guise of being in the public interest under § 1104(c)(2) when it would be a waste of resources to litigate the issue and contrary to the purpose of the statute. At a minimum, § 1104(c)(2) must be amended to raise the debt threshold to reflect present-day financial realities.

However, simply increasing the debt threshold in § 1104(c)(2) is not enough to resolve the problem. As currently written and interpreted by the Third and Sixth Circuits, the statute removes the bankruptcy court's ability to apply discretion — even in cases where an examiner's appointment is unnecessary, duplicative or counterproductive under the specific facts and circumstances of the case. This runs contrary to the equitable nature of bankruptcy proceedings. Bankruptcy courts must be empowered to exercise discretion to determine whether the appointment of an examiner is in the best interests of the debtor's estate and its stakeholders or is appropriate and necessary to protect the public interest in "larger" bankruptcy cases.

Therefore, legislative reform must go further than merely increasing the debt threshold. Congress should amend the language of § 1104(c)(2) to provide the bankruptcy court with discretion to deny an examiner's appointment where such action is not warranted by the facts and circumstances of a particular case.

Fortunately, the Third Circuit's opinion in *FTX* provides guidance for how this revision could be implemented. The Third Circuit's textual analysis hinged on two key phrases in the statute: "as is appropriate" and "shall." The phrase "as is appropriate" was interpreted narrowly by the Third Circuit, applying only to the scope of the examiner's investigation — not to the decision to appoint one in the first place. Meanwhile, the use of the word "shall" was interpreted by the Third Circuit to impose a mandatory duty on the bankruptcy court to appoint an examiner when the debt threshold is met and a party in interest or the U.S. Trustee requests it.

Recommendations

Congress should amend § 1104(c)(2) in two respects. First, the phrase "as is appropriate" should be replaced with "if appropriate," signaling that the bankruptcy court has discretion to determine whether the appointment is justified. Second, the word "shall" should be replaced with "may," thereby removing the compulsory nature of the appointment and reaffirming the bankruptcy court's equitable authority to decide the issue based on the unique circumstances of the case.

These revisions would make it clear that the bankruptcy court has the authority to deny an appointment when an examiner is not warranted, while still allowing it to authorize an investigation when necessary to protect the interests of the debtor's estate, its stakeholders or the public in "larger" chapter 11 cases. This approach balances transparency and accountability with judicial efficiency and practicality. It ensures that examiner appointments remain available in cases where credible allegations of fraud, mismanagement or other misconduct warrant independent investigation. At the same time, it empowers bankruptcy courts to reject unnecessary appointments that would only delay or derail a legitimate restructuring effort.

Conclusion

Ultimately, providing discretion to bankruptcy courts aligns with the broader equitable principles of bankruptcy law. The entire purpose of chapter 11 is to facilitate the restructuring of distressed entities in a way that maximizes value for all stakeholders through a fair and transparent process. This process necessarily involves the application of equitable principles. A rigid, mechanical rule that forces the appointment of an examiner regardless of context undermines the very flexibility that makes chapter 11 so effective. By modernizing the statute as proposed, Congress can reaffirm the central role of the bankruptcy court as a court of equity, empowered to promote both justice and efficiency in the restructuring process. abi

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12 *Id.* (emphasis added).
13 11 U.S.C. §§ 308, 1116.
14 Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, § 1113(a)(1), 134 Stat. 284, 310 (2020), *reprinted in* App. Pt. 41(dd)(i), *infra*.
15 "CPI Inflation Calculator," U.S. Bureau of Labor Statistics, www.bls.gov/data/inflation_calculator.htm (last visited May 21, 2025).