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Bankruptcy Court Limits Rule 2004 Requests

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February 27, 2017 -The Southern District of New York Bankruptcy Court recently limited certain bankruptcy discovery requests pursuant to Federal Rule of Bankruptcy Procedure 2004 by applying the concept of proportionality contained in the 2015 amendments to Federal Rule of Civil Procedure 26. *In re SunEdison, Inc.*, Case No. 16-10992 (SMB), ECF No. 2280 (Jan. 18, 2017). The court's decision curtails the ability of non-debtors to conduct so-called "fishing expeditions," which have become increasingly costly with the spread of requests for electronically stored information (often referred to as "ESI"). The court's decision will be of particular interest to debtors' counsel and assist in their efforts to stave off disruptive, costly and distracting Rule 2004 requests.

In re SunEdison arises from the application of CSI Leasing, Inc. and CSI Leasing Malaysia Sdn. Bhd. (collectively, "CSI") to conduct a Rule 2004 examination of the debtors. CSI was a creditor of both the debtor-subsiary SunEdison Products Singapore Pte. Ltd. ("SEPS") and the non-debtor subsidiary SunEdison Kuching Sdn. Bhd. ("SEK") in connection with a failed equipment lease, entered into by SEK and guaranteed by SEPS. As a result of SEK's default on the lease and SEPS's default on the guarantee, CSI had a claim against each for approximately \$2.5 million. Notwithstanding the \$2.5 million owed to CSI, when SEK received approximately \$45 million for the sale of substantially all of its assets in March 2016, SEK transferred the money to the debtors, namely SunEdison, Inc. ("SUNE"), which is the ultimate parent company of both SEK and SEPS.

As part of its overall efforts to collect on its guarantee, CSI filed an application seeking Rule 2004 discovery in the chapter 11 proceedings. CSI requested, among other things, "all documents and communications" generally related to: (i) the transfer of the asset sale proceeds to the debtors; (ii) the debtors' chapter 11 cases; and (iii) SEK, the Malaysian proceeding, and CSI's recovery in that proceeding. After initially providing over 1,200 pages of responsive information on a rolling basis, the debtors subsequently objected to CSI's application and argued that discovery was unnecessary as to CSI's chapter 11 claims, which had been allowed. Beyond that, the debtors characterized CSI's application as "premature, overly broad, speculative and unduly burdensome".[1]

The court began by outlining the law governing Rule 2004 applications, noting that generally a party seeking Rule 2004 examination must demonstrate "good cause" for the examination. "Good cause," in turn, is typically

demonstrated by showing that the “proposed examination ‘is necessary to establish the claim of the party seeking the examination, or ... denial of such request would cause the examiner undue hardship or injustice.’”[2]

However, the court noted that Rule 2004 examinations require a balance between the needs of the examiner and the burden imposed on the examinee.[3] This balance is especially necessary when juxtaposed with the immense costs of modern discovery on the producing party. If left unchecked, the court was concerned that a “fishing expedition” could impose astronomical discovery costs on the party being examined.

In weighing this balance between the examiner’s need for discovery and the burden imposed on the examinee, the court found a solution in the Federal Rules of Civil Procedure’s proportionality requirements under Rule 26.[4] Despite the absence of a comparable amendment to Rule 2004, the court drew a parallel between the aims of Rule 2004 and Rule 26.[5] The court used this parallel to support the holding that an when the applicant is seeking the examination in one proceeding for claims in another proceeding, as in this case, there was no good cause for such examination.[6]

The court’s opinion imposes an additional limitation on Rule 2004 examinations, which has often been recognized as allowing wider discovery than that available under the Federal Rules of Civil Procedure. Under Rule 2004, the subject matter open to discovery is broader, there are fewer procedural safeguards, and discovery can generally be wielded against any related entity. Bankruptcy courts have imposed few restraints on this rule, most of which prevent parties from taking advantage of such open-ended discovery when there is an on-going civil action between the same parties. However, by borrowing a constraint on Rule 2004 from the Federal Rules of Civil Procedure, the court has checked what is often a burdensome discovery mechanism.

Footnotes

[1] Opinion at 7.

[2] Opinion at 9.

[3] Opinion at 9-10.

[4] Opinion at 10-11

[5] Opinion at 11.

[6] Opinion at 12.

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