

## **CREDITORS' COMMITTEES IN CHAPTER 11 PROCEEDINGS**

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Creditors' committees play a key role in the administration of a Chapter 11 case and the formulation of a viable plan of reorganization. Because the interests of unsecured creditors are usually most at risk upon commencement of a Chapter 11 case, and in response to the concern that secured creditors traditionally have had an overwhelming voice in reorganization proceedings and thus a powerful role in determining the success or failure of a reorganization, Congress has deemed it important for unsecured creditors, particularly large ones, to play an active role in reorganizing the debtor. With this in mind, and to enable small secured creditors to have a voice through representatives having fiduciary duties to all unsecured creditors, Congress implemented a system of oversight by creditors' committees.

The role of an official committee in a Chapter 11 case is one that, with administrative oversight of the U.S. Trustee, provides representation of an appropriate constituency for the benefit of the reorganization process. Toward that objective, a committee gathers information from its constituency and the debtor, and channels that information through the committee and its professionals to the court so that concerns of the constituency can be articulated by a representative group. Often, a committee participates in negotiation of a plan as well as the recommendation of acceptance or rejection of a proposed plan. Notably, committees are not formulated to provide a platform for a particular creditor. Instead, they are designed to enable investigation and provide a forum for negotiation on behalf of those claims or interests represented by the committees.

In essence, a committee is given broad powers to oversee and investigate the business of a Chapter 11 debtor. By virtue of its broad investigative authority, a committee is likely to be in the best position to assess the potential need for a trustee or examiner and bring such a need to the attention of the court. While a Chapter 11 trustee is charged with fully administering the estate (versus a Chapter 7 trustee who is charged with marshalling and liquidating assets), an examiner's role includes investigating and reporting on: (a) the acts, conduct, assets, liabilities and financial condition of the debtor; (b) the operation of the debtor's business and the desirability of continuing such business; and (c) any other matter relevant to the case or formulation of a plan.

As soon as practicable following the order for relief under Chapter 11, the U.S. Trustee is to appoint a committee of creditors holding unsecured claims. The U.S. Trustee may also appoint additional committees of creditors or equity security holders as appropriate. On request of any party in interest, the court may order the U.S. Trustee to appoint additional committees of creditors or equity security holders if necessary to assure adequate representation of such constituencies.

The Bankruptcy Code (the "Code") contemplates that a creditors' committee shall ordinarily consist of persons, willing to serve, that hold the 7 largest claims against the debtor of the kind represented on such committee, or of the members of a committee organized by creditors before the commencement of the case if such committee was fairly chosen and is representative of the different kinds of claims to be represented. Committee service is voluntary, and the seven largest unsecured creditors may not necessarily be willing to serve.

Courts have held that the only requirements for committee membership are that the person or entity be a creditor and hold a claim, and that the claim be unsecured. While courts have been liberal in determining whether a party seeking membership on a creditors' committee is eligible, membership may be restricted if, due to the status of a particular creditor or the relationship of that creditor to the debtor, a conflict of interest exists. Thus, membership may at times be limited to *ex officio* status. Some courts have held that an insider may have a conflict of interest so serious as to require complete disqualification from membership. That is not to say that one's status as an insider creditor automatically serves to disqualify membership on a committee. Many courts have held that a member of a committee cannot be removed absent specific evidence that such member has breached or was likely to breach a fiduciary duty to the class of creditors represented by the committee.

The Code provides that a majority of committee members must be present at a scheduled meeting in order to employ counsel or other professionals. This has been held to require a majority in number and dollar amount of claims. However, no guidelines are offered as to whether the ordinary decision-making process within a committee must be determined on the basis of one member - one vote, the size of the claim, or some other factor. It is recommended that committees adopt by-laws at the outset of the case to resolve disputes among members. The adoption of by-laws allows a mechanism for dealing with conflicts making functions including the appointment and duties of officers, appointment of professionals, appointment of alternate committee members, voting procedures, quorums and voting by proxy, and the formation of sub- committees. Members of a committee should also be willing to seek court guidance by moving for

instruction from the court in the event of an internal conflict splitting the committee into intractable factions.

The Code provides for a committee, with court approval, to employ one or more attorneys, accountants, or other agents to represent or perform services for the committee. An attorney or accountant representing the committee may not also represent another entity having an adverse interest in connection with the same case. However, representation of one or more creditors in the same class as the committee is not *per se* representation of an adverse interest.

Members of a committee have a fiduciary duty to the holders of the class of claims or interests they represent. That fiduciary duty obligates the committee to represent the interests of all creditors or equity security holders it is appointed to represent. While a creditor may pursue its own interests even while serving on a committee, that creditor may not use committee membership to further its own interest or otherwise breach its fiduciary role.

While courts have held that the most important function of a creditors' committee is to negotiate the terms of a plan, they have also held that a creditors' committee's function does not include involvement in the debtor's day-to-day operations. Thus, the Code authorizes a committee to consult with the debtor; it does not authorize the committee to operate the debtor's business. Committees may make recommendations regarding the debtor's business, but should not attempt to displace the persons who are legally responsible for the management of the debtor's financial affairs. In the case of a corporate debtor, the board of directors is responsible for management. If the officers and directors are unwilling or incapable of managing the debtor's business, a committee, in its capacity

as a party in interest, can and should make an application for the appointment of a trustee.

Congress clearly intended for committees to play a significant role in the administration of a Chapter 11 case and the formulation of a viable, consensual plan of reorganization. The Code and case law have given committees broad power to investigate the affairs of the debtor, participate in negotiating a plan, assist in the reorganization process, and initiate or participate in various proceedings. Nevertheless, service on a committee is fraught with potential conflicts for members and employed professionals alike. Such service may also be time consuming and ultimately unrewarding, particularly if the estate lacks sufficient assets to achieve a viable reorganization. Despite these drawbacks, active and responsible participation of a committee often offers the committee's constituency its only hope for some recovery from the debtor's bankruptcy estate. The committee gives constituents an important and influential voice in the reorganization process unavailable to individual constituents acting alone.