When a debtor files a bankruptcy case, it is not permitted to pay pre-bankruptcy (i.e., prepetition) claims absent court authority, which leaves many of its vendors, landlords and trade creditors with significant unsecured claims and without much insight into the next steps for the bankrupt company. Will the company liquidate? Will the company reorganize with management in place? Will it be sold? Will litigation be pursued? How will preference actions against creditors be handled? Unsecured creditors often seek to serve on the creditors’ committee because it gives them a seat at the table and a unique opportunity to have a meaningful impact on the outcome of the case.

The following analysis focuses on the benefits of serving on a creditors’ committee. But in order to understand those benefits, some background regarding the role of committees, the committee formation process and eligibility requirements is provided first.

**Role of Creditors’ Committees**

Creditors’ committees are appointed to give influence to creditors who may otherwise be disenfranchised by the process – individual creditors are unlikely to hire lawyers to represent the interests of the entire unsecured creditor body because there would be no clear connection between the investment and return. But when these creditors are part of a creditors’ committee, they are given a voice in the process, for the reasons described below.

As a fiduciary representative of all unsecured creditors, the committee serves in the more substantive roles of watchdog, consultant and negotiator of the plan and asset purchase agreements. Its responsibilities are multitudinous, and the committee must be prepared to act quickly based upon the exigencies of the case.

**The Committee Formation Process**

Debtors are required to file a list of their largest creditors, which is used by the Office of the United States Trustee, an arm of the federal government, to solicit interest in serving on the creditors’ committee and then to appoint the committee. Even if your company is not listed on the list of largest creditors, you may still submit a form to the U.S. Trustee seeking to be appointed to the committee. On occasion, the list of top creditors is not accurate, and creditors with large claims that are not included on the list are appointed to the committee. In addition, certain types of claims, such as litigation claims, may not be included on the list of the debtor’s largest creditors, but the claims are large enough to be included on the committee.

Committees often consist of diverse creditor constituents, including trade vendors and suppliers, landlords, litigation claimants, unsecured bondholders and noteholders, unions and employees. In certain instances, in an effort to engender diversity on the committee, the U.S. Trustee may appoint creditors with smaller claims to the committee (i.e., when the outstanding debt is particularly meaningful to the creditor’s business). The interests of committee members may not always be aligned, so it is important to serve to ensure that your constituency’s interests are protected. Regardless of the size of each committee member’s claim, however, each voting committee member gets one vote.

In larger cases, an organizational meeting designed to select the committee is typically held within the first week or two after the case is filed. Accordingly, it is important to return the solicitation form to the U.S. Trustee promptly after the debtor’s bankruptcy filing or, if such forms have not yet been disseminated, make your interest known to the U.S. Trustee. If there is an in-person organizational meeting, creditors may attend the meeting by proxy. However, it is a best practice for creditors seeking to sit on the committee to appear in person at the organizational meeting, rather than by proxy, as the creditor itself is in the best position to answer any questions the U.S. Trustee may have about the nature of its claims. Depending on the jurisdiction in which the case files and the size of the case, the committee organizational meeting may take place telephonically, or the U.S. Trustee may form the committee without a meeting, in which case it simply informs creditors after they have been selected to serve.

Once the U.S. Trustee forms the committee, the committee often meets to select counsel and financial advisors and discuss matters requiring the committee’s immediate attention. Even if your company is not chosen to sit as an official committee member, committees often permit ex officio or non-voting members to participate in their deliberations. If you are not selected as an official committee member and would like to participate in an ex officio or non-voting capacity, you should reach out to committee counsel.
Benefits of Serving on a Creditors’ Committee

There are many benefits to creditors of sitting on a creditors’ committee. A few of these benefits are described below.

Committee Members Get a Seat at the Table and a Voice in the Process

Committees play an active role in addressing the key issues in the case, including first day matters, financing, and the sale and/or plan process. The role of the committee cannot be understated – it gives the creditor body and, more specifically, the individual members of the committee, a voice in the process.

A committee’s engagement in the debtor’s case begins immediately upon formation, so its professionals need to be prepared to hit the ground running. In just the first days and weeks of a case, decisions are often made which shape the outcome of the entire case. The committee and its professionals must be aggressive and unfailing in protecting the interests of unsecured creditors when faced with key case issues concerning, among other things, DIP financing, including the preservation of unencumbered assets, and the sale process, including ensuring that the process is conducted in a value-maximizing fashion. For example, the case constituents often negotiate a budget for the case in the days and weeks after formation of the committee. The committee needs to play an active role in that process to ensure that the budget accurately reflects the needs of the case, including payment of critical vendor claims (if any), payments to suppliers for goods shipped postpetition, claims arising under section 503(b)(9) of the Bankruptcy Code, stub rent claims and professional fees so the committee can fulfill its mandate.

In addition, upon appointment, the committee is often invited to – or its counsel requests that it – meet with the debtor’s management and professionals to discuss the parties’ goals for the case. This gives the committee the opportunity to hear the debtor’s view of the events leading to the Chapter 11 filing, obtain an understanding of any marketing process for the company’s assets that may have been conducted prior to the bankruptcy and learn about the debtor’s plans for the bankruptcy case and beyond. It also educates the committee before it weighs in, particularly with respect to the debtor’s intended course of action for the bankruptcy case. For example, based upon the information the committee receives, the committee may agree that a debtor’s assets need to be sold, but may disagree with the proposed timeline on which the debtor seeks to sell its assets or with how the debtor has conducted the process to date. In such a case, following a vote, it would direct its counsel to object to the proposed sale timelines or the process generally.

As the case progresses, the committee continues to have a meaningful role and a seat at the table. As discussed below, committees are given access to information that other creditors do not receive. This allows the committee to obtain an “inside track” into the process and, if the debtor is not conducting the case in a fashion that maximizes the value to creditors, the committee can act accordingly by supplementing the process or informing the court. In addition, a committee should be a consultation party in any auction process, meaning the debtor needs to consult with it concerning the conduct of the auction, including the selection of the highest and/or otherwise best bid. If the committee does not believe the results of the auction are in the best interests of creditors, it has standing to object and raise the deficiencies with the court.

Case Examples:

• In the Vestis Retail Group (d/b/a EMS, Bob’s Stores and Sport Chalet) case, shortly after formation, the committee met with the debtors and Versa, the equity holder and proposed purchaser of the company, which sought to effectuate a sale pursuant to a credit bid of its purported debt. The committee learned about the pre-bankruptcy marketing process, how the debtors ultimately chose Versa to act as the stalking horse bidder and Versa and management’s business plan for the go-forward company. The committee’s agreement to modify the process by supporting a private sale – as opposed to forcing a liquidation – resulted in a resolution with the debtor which allowed the sale to proceed, on the conditions that claims arising under section 503(b)(9) be promptly paid in full, preference actions would be waived and funds would be available to ensure the administrative solvency of the estates and a projected return to general unsecured creditors.

• In the Golfsmith case, the committee had the opportunity to meet with bidders at the auction to gain insight into their vision for the go-forward company. It also worked closely with the debtors to improve the bids and maximize value for creditors. Importantly, at the committee’s strong urging, the successful bidder purchased, and agreed not to pursue, preference actions against vendors and landlords.

• In the KB Toys and Vertis Paper cases, the committee used the threat of litigation (and, in the case of KB Toys, filed a motion to convert the case to a Chapter 7 case within 24 hours of formation) to negotiate a settlement with the case constituents, which resulted in creditor returns.

Committee Members Obtain Access to Confidential Information

Typically following the execution of an appropriate confidentiality agreement (which may be found in the committee’s bylaws), the debtor provides the committee with confidential information concerning its business, operations, financing, financial situation, sale process and/ or restructuring, exit financing, the go-forward business plan (in a going concern) and other matters. Such information is necessary in order for the committee to fulfill its statutory responsibilities and for the committee to determine whether a going concern sale, reorganization or liquidation will provide the greatest benefit to unsecured creditors. While committee members must always exercise fiduciary

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duties and act on behalf of the general unsecured creditor constituency as a whole, the information received by the committee necessarily informs certain decisions made by individual committee members.

Case Example:

• In the *Fuahu* case (d/b/a Nabi tablets), the committee reviewed the confidential list of parties contacted by the debtor’s investment banker and determined that it was insufficient. It supplemented the debtor’s marketing process by canvassing the marketplace and finding a party who was willing to bid on the debtor’s assets and provide the bridge financing necessary to get to a sale closing. The party replaced Mattel as the stalking horse bidder, and following an auction with only those two parties participating, the price more than doubled the stalking horse bid. During the auction, the committee was instrumental in valuing the bids.

Committee Often Has Control Over Investigation and Litigation, Including Preferences

In connection with the DIP financing, the debtor often stipulates that the prepetition lender’s liens and claims are valid, leaving the committee as the only party with responsibility for investigating not only the liens and claims of the prepetition lenders, but also the prepetition activities of the debtor, its insiders and others who may have received money from the debtor during the look-back period. The committee works closely with its counsel and financial advisors to conduct a thorough investigation, as it can be the case that recoveries from litigation may be the only form of recovery for general unsecured creditors. The committee may also use the threat of litigation to achieve concessions, including the payment of claims arising under section 503(b) (9) and stub rent claims in cases which would otherwise be administratively insolvent. The committee members direct counsel as appropriate in connection with any investigation.

Committees are also uniquely positioned to address the fate of preference actions. (Preferences are lawsuits against entities that received payments in the 90 days prior to the bankruptcy filing. While there are defenses to the receipt of such payments, raising such defenses can be expensive for defendants.) In certain cases, committees vote to pursue preference actions for the benefit of all creditors. In many other cases, however, committees find creative solutions to sell or otherwise not pursue preferences. Whether preferences are pursued often depends on the nature of the case (a going concern sale or reorganization vs a liquidation) and whether the likely recoveries from such actions would have a meaningful impact on the return to general unsecured creditors.

Case Example:

• In the *Appleseed’s* (d/b/a Orchard Brands) case, the committee – which was responsible for investigating causes of action pursuant to the terms of a DIP order – directed counsel to commence litigation against the former equity holders arising from a dividend recapitalization transaction, resulting in a settlement of a $300 million litigation.

• In the *HDL* case, the committee is pursuing multil- million dollar causes of action against defendants including the debtor’s directors and officers, from which the debtor was conflicted from pursuing.

The Opinion of the Committee is Highly Regarded

Throughout the case, a debtor will seek the support of the committee because the bankruptcy court often gives substantial consideration to the opinion of the committee. While pleadings filed by individual creditors are taken seriously by parties in interest and the court, if, for example, an individual creditor files an objection to the proposed sale process but the committee supports the process, the court is likely to give the committee’s support substantial weight assuming the committee has a sound basis for its support. Similarly, if the committee does not support a plan proposed by a debtor, the path to confirmation is likely to be an uphill (and expensive) one. On the flip side, if the committee supports a plan proposed by a debtor, such support is often instrumental in its confirmation and in obtaining the requisite number of votes required to confirm it.

Legal and Financial Representation and Committee Member Expenses Are Paid For by the Estate

Committees have their own counsel and financial advisors who will fight for the interests of unsecured creditors at all stages of the debtor’s case. Each voting committee member has a vote as to how counsel proceeds with all case matters, and counsel representing the committee must act on behalf of and take direction from the committee. The fees and expenses of committee counsel and financial advisor, as well as expenses incurred by committee members in connection with the debtor’s case, are paid for by the debtor, not by committee members. While certain committee members may need counsel to represent their individual interests depending on the case (which counsel’s fees would not be paid for by the estate), typically committee members would not need to hire counsel to simply monitor the case, because committee counsel is responsible for that and more. For example, committee counsel informs the committee of major filings in the case, including the order establishing the bar date and the process for filing proofs of claim.

Committee Participation Can Serve as a Networking Tool

Participating on a creditors’ committee can afford creditors a unique opportunity to interact with other similarly-situated individuals in the same industry. It also provides a valuable opportunity for committee members to interact with their customers (i.e., the debtor) and the debtor’s owners. Committee service can serve to strengthen relationships with other creditors, as well as the debtor (in a going concern scenario).
Participating on committees can be a rewarding and educational experience for creditors who seek to have a voice and influence in the restructuring or sale of their customers, and ideally, can serve as the building blocks to a relationship with a go-forward new entity or reorganized entity.

**About the authors:**

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Additionally, he has represented debtors in Chapter 11 cases, clients in bankruptcy-related litigation, purchasers of significant assets, and equity committees.

He has earned recognition for his work, including being honored by Best Lawyers in America for his work in bankruptcy, creditor debtor rights/insolvency and reorganization law (2014, 2015 and 2016).

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Her experience extends to representing clients in a wide variety of contested matters, including bankruptcy-related litigation and issues concerning post-petition financing.

She also participated in the representation of Crabtree & Evelyn in its Chapter 11 case. The case was named the "Chapter 11 Reorganization of the Year" by the Turnaround Atlas Awards.