

The Benefits and Strategies of Serving on a Chapter 11 Creditors' Committee



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The United States Bankruptcy Code

- Title 11 of the United States Code is known as the Bankruptcy Code
- Cases can be filed under one of six different chapters:
 - Chapter 7 (liquidation)
 - Chapter 9 (municipal bankruptcy)
 - Chapter 11 (reorganization)
 - Chapter 12 (family farmer)
 - Chapter 13 (consumer)
 - Chapter 15 (recognition of foreign insolvency proceeding)
- For purposes of today's presentation, we will focus on Chapter 11 bankruptcy cases as this is the chapter in which committees are generally appointed.

Creditors' Committees

- Creditors' Committees are formed by the Office of the United States Trustee, which is a branch of the Department of Justice.
- There are two jurisdictions (North Carolina and Alabama) which do not operate under the UST system. Rather, they use Bankruptcy Administrators which serve the same function.
- Committees are typically formed only in larger cases, and are not formed in Subchapter V cases unless a motion is filed with cause for appointment established

Creditors' Committees

- The appointment process, as well as the powers and duties of unsecured creditors' committees, are governed by sections 1102 and 1103 of the Bankruptcy Code
- The UST's office is required to appoint an official committee, provided there is sufficient creditor interest. (11 U.S.C. § 1102)
 - Typically, UST will require at least three interested creditors to appoint a committee; however, occasionally, the UST's office will appoint a committee of two.
 - Typically, a committee is formed with an odd number of creditors (3, 5, or 7) in order to avoid voting deadlocks
 - In particularly large and complex cases, it is not unusual to see committees having 9 or even more members

Creditors' Committee Formation Process

- Chapter 11 debtors are required to file a “List of Creditors Holding 20 Largest Unsecured Claims” concurrently with the filing of the petition
- In larger/more complex cases, the debtor(s) may file a list of the top 30, 40, or even 50 creditors
- In cases involving multiple debtors, debtors may sometimes file individual debtor-by-debtor “Top 20” lists, or more commonly, will file a consolidated “Top 20” list
- Generally, the “Top 20” list is what is utilized by the UST in soliciting a creditors’ committee

Creditors' Committee Formation Process

- Shortly after filing, UST will issue letters to each “Top 20” creditor inviting them to submit a questionnaire indicating interest in committee service
- Deadline will be imposed for questionnaires to be submitted (generally 1-2 weeks from issuance of letters)
 - Some jurisdictions operate on a “first come first served” basis
- Upon receipt of questionnaires, UST may contact the creditor or its counsel to discuss the nature of the claim, existing disputes with the debtor, and other matters it deems relevant to committee appointment
- In certain circumstances, a creditors’ committee “formation meeting” will be held to select the committee
 - Typically virtual, especially in light of the pandemic
 - Pre-pandemic, Delaware was known for in-person formation meetings
- UST will form the committee either at the meeting, or if no meeting is held, will simply file a notice of appointment on the bankruptcy docket

Creditors' Committee Formation Process

- UST generally does not just pick the largest creditors willing to serve
- Rather, UST generally looks for diversity within the committee membership
 - Trade creditors
 - Landlords
 - Claimants (judgment holders)
 - Bond holders
- Secured claimants cannot serve (but on occasion creditors holding both secured and unsecured claims are allowed to serve)
- Generally, governmental entities do not serve
- Appeal rights are typically non-existent: especially in Delaware, UST will not disclose why it left a creditor off the committee

Why Serve on a Creditors' Committee?

- Committees are a party-in-interest in all chapter 11 cases, with the right to object to and be heard on any matter
- Committees have broad rights to investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan
- Committees have the right to participate in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan
- Without a committee, unsecured creditors are left protecting their own interests (at their own expense), increasing the risk of a "deal" between debtors and secured creditors that leave unsecured creditors out of the money

Why Serve on a Creditors' Committee?

- Committees have the ability to retain professionals to represent them – including attorneys, financial advisors, and accountants – at *no direct cost* to the Committee members
 - Oftentimes, legal expenses that would often be incurred directly by individual Committee members can be shifted to the Committee professionals
- Committee members still have the right to represent their own interests in the bankruptcy
 - But beware of potential conflicts
- Fees paid out of the bankruptcy estate
- Committees have substantially more overall influence in a chapter 11 case than individual creditors
- Most high-level negotiations in chapter 11 cases involve Committees; rare for an individual creditor to have a “seat at the table” in those discussions

Rights and Duties of Creditors' Committees

- Perform services in the interest of those represented
 - Investigate the bank and the bank's security interests (collateral analysis)
 - Seek buyers for going concern sales
 - Seek valuation experts in certain circumstances
 - Object to motions and claims
 - Oftentimes prosecute adversary claims
- Ensure cash collateral/DIP financing orders do not “give away the farm”
 - Preserve chapter 5 causes of action
 - No extra liens
- Investigate insider activity
 - Preferences and fraudulent transfers
 - Breaches of fiduciary duty
- Some of these tasks are accomplished through seeking “derivative standing.”
 - If the investigation of the bank turns up invalid/unperfected security interests, the Committee seeks standing from the court to file an adversary action against the bank
 - Can contest the validity and extent of liens and ultimately bring assets to the estate for distribution to unsecured creditors.

Rights and Duties of Creditors' Committees

- Oversee debtor's sale efforts
- Review Schedules of Assets and Liabilities and Statement of Financial Affairs
- Participate in Section 341 meeting of creditors
- Perform claims review and analysis (file objections)
- Analyze chapter 5 causes of action
- Analyze other estate causes of action
- Participate in negotiation of chapter 11 plan (or present own plan once exclusivity has expired)
 - Liquidation Trust
 - Creates a trust to oversee distribution of remaining assets
 - Disposes of litigation

Case Study: 4E Brands Northamerica

- U.S. subsidiary of Mexican company engaged in manufacture and sale of hand sanitizer
- Imported substantial product into the U.S. at beginning of COVID-19 pandemic
- Product was contaminated with methanol; hundreds of people injured and at least four deaths
- Parent company negotiated settlements with major creditors and then induced chapter 11 filing to scrub out remaining indebtedness
- Tucker Ellis retained to represent Committee
- Strategy resulted in over 300% improvement to unsecured creditor recoveries

Presenter Contact Information



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Questions or Comments?