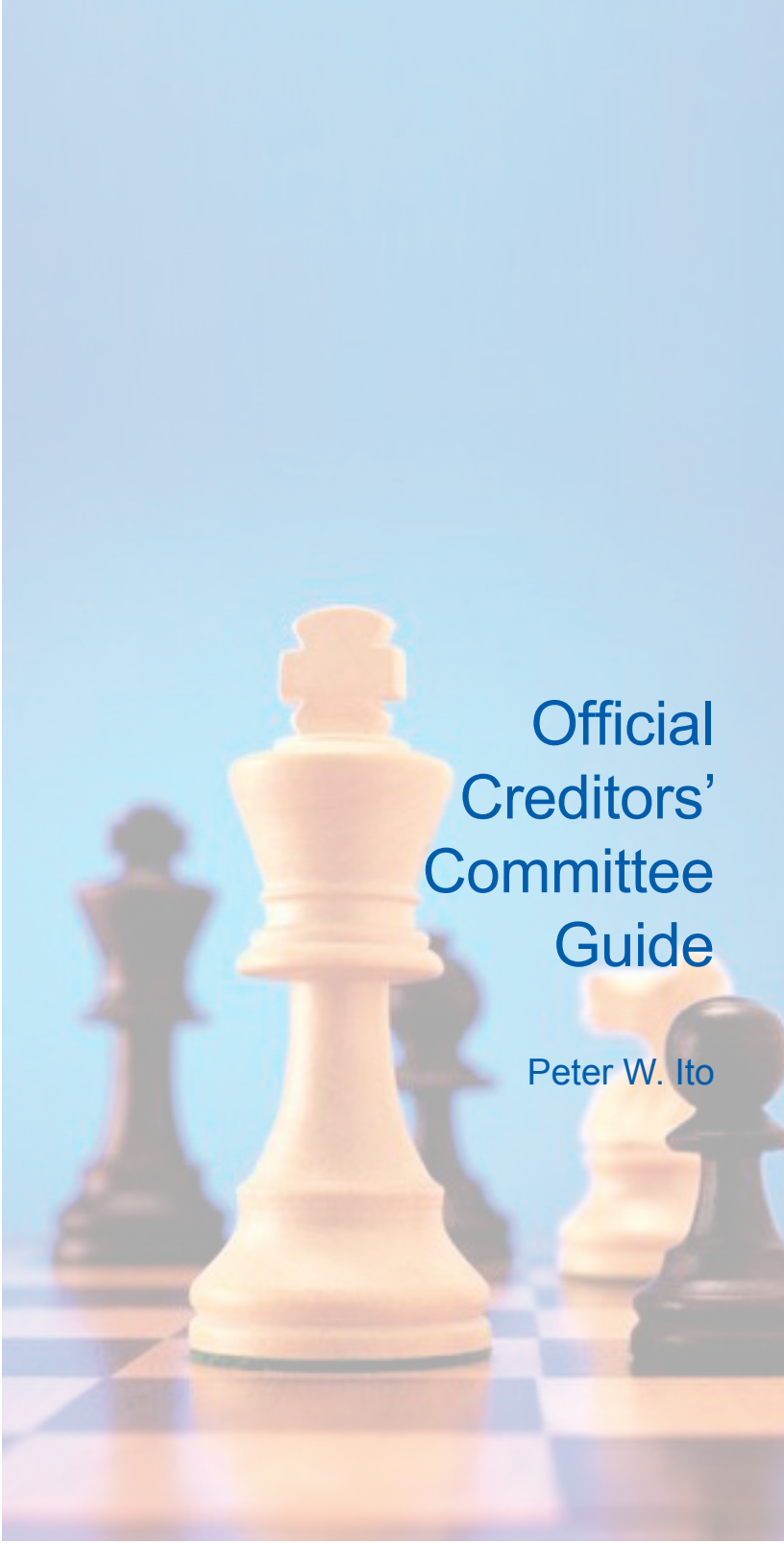

Official Creditors' Committee Guide

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The Ito Law Group possess a sophisticated understanding of the recovery, realization, and restructuring of troubled debt. We are experienced in complex creditors' rights litigation, including lender-liability defense, fraudulent transfers, preferential transfers, and pre- and post-judgment remedies to preclude the dissipation of assets. We provide our clients with practical, multi-disciplinary guidance in matters relating, but not limited to, bankruptcy, finance, litigation, insurance, employment, drug and medical device, healthcare, environmental compliance, real estate and government regulatory matters.

The Ito Law Group has represented clients in many of the nation's largest bankruptcy proceedings and workouts. We are particularly well-suited to assist committees formed in bankruptcy cases and parties affected by bankruptcy.

Reorganization Under Chapter 11 and the Creditors' Committee

A debtor's filing of a bankruptcy petition pursuant to Chapter 11 of the U.S. Bankruptcy Code can intimidate creditors and interest holders. Many business people see bankruptcy as an entirely negative event, which can mean that all monies owed by the debtor will never be repaid, or that any meaningful recovery can come only as the result of long, expensive litigation. However, reorganization can present opportunities for creditors to protect their rights without expending substantial sums on attorneys' fees. Put simply, a successful reorganization can ensure a significant return to creditors. One of the options available to maximize recovery for our clients who become creditors of a bankrupt entity is to participate in the bankruptcy process through membership on a statutory committee, such as the official creditors' committee.

What is a Creditors' Committee?

In General

A creditors' committee is a group of creditors appointed by the Office of the United States Trustee (U.S. Trustee), a division of the Department of Justice, to advise and assist the bankruptcy court in making decisions that affect the rights of unsecured creditors. Section 1102 of the Bankruptcy Code provides that the U.S. Trustee ***shall*** appoint a committee in a Chapter 11 case; however, such appointments usually occur only in large

cases where it appears there will be substantial assets at issue. In addition, a creditors' committee is appointed only if a sufficient number of creditors express an interest in serving on the committee.

Committees composed solely of other types of interest holders, such as equityholders or bondholders, are sometimes appointed in addition to the creditors' committee. Although less common than creditors' committees, such committees have similar duties and obligations under the Bankruptcy Code, and are appointed in the same fashion.

Reorganization pursuant to the Bankruptcy Code provides a debtor, or a trustee if one is appointed, with extensive opportunities to influence the nonbankruptcy rights of parties affected by the bankruptcy filing. In bankruptcy cases, the most active players are often the debtor and secured creditors because these parties have the most at stake. Unsecured creditors, equityholders, or bondholders often have as much to lose in the aggregate, but those losses are spread among many players, diluting the incentive for any single creditor to participate in the bankruptcy process. Committees are formed to offer such creditors an opportunity to provide meaningful input, at a lower cost to each interested party, and to provide the court with an unbiased opinion regarding the interests of all members of the class.

Obligations of a Committee

Committee members act as fiduciaries for the entire class they represent. A committee has standing on all issues before the court that affect the committee's constituents. The most important of these issues usually include the management of the debtor and the terms of a plan of reorganization. Typically, creditors are the parties most knowledgeable about how well management has been doing its job and what the company can realistically achieve through reorganization. The Bankruptcy Code provides committees with the authority to hire lawyers, accountants, or other professionals who can undertake any necessary investigation of the debtor at the debtor's expense.

A committee's most important role usually is the development of a plan of reorganization. Commonly, the debtor initiates such a plan, and negotiates with all committees appointed to seek their approval and support of the plan. A committee's duty is to analyze the impact of a plan on the entire class and determine if the treatment proposed under the plan is preferable to liquidating the debtor or some other plan of reorganization. A committee has the ability under certain circumstances to propose its own plan, in lieu of or in competition with the

debtor's plan. A committee's support or opposition to a plan of reorganization is often a decisive factor in plan confirmation.

In most cases, the debtor's management is allowed to remain in control of the debtor after a bankruptcy is filed. However, if a committee believes that fraud or mismanagement has occurred, or that the interests of creditors would be better served by removal of management, a committee is often the best-suited party to bring this matter before the court.

A related role for the committee is to analyze the liabilities and assets of the debtor's estate, including claims of other parties against the estate, and claims the estate may have against other parties. Often the debtor is reluctant to dispute the claims of important creditors, or creditors with which the debtor's management has personal relationships. Similarly, the debtor is usually reluctant to attack transfers made to insiders of the debtor. A committee has a unique ability to investigate these matters and to bring them to the attention of the court in the context of commenting on the debtor's management. Furthermore, if the debtor is unable or unwilling to pursue such claims, under certain circumstances, the committee can bring such actions derivatively to increase the value of the estate.

Why Should Creditors be Members of a Committee?

Serving on a committee provides three essential advantages to a creditor: committee preferences are usually given more weight than the concerns of a single creditor; committee counsel is paid from the assets of the debtor – not directly from the creditor's pocket; and committee members obtain networking opportunities with the debtor and other creditors within its industry.

Weight of Opinion

Most judges place considerable weight on the opinions expressed by committees because committees are representing the interests of an entire constituency as fiduciaries, as opposed to the self-interest of a single party. Consequently, participation in committee decisions often gives a creditor the ability to exert greater influence upon the bankruptcy process than if the creditor filed responses solely on its own behalf. Noteably, committee membership does not preclude the committee members from protecting their own individual rights or from asserting positions contrary to committee positions. The value of committee membership is, to a large degree, relative to how involved the committee member is in committee decisions, and whether the individual member is able to create a consensus within the committee.

Networking Opportunities

Participation in a committee provides committee members with a unique opportunity to network with both the debtor and other creditors involved in the industry. Committee members receive both access to and information about the debtor. Committees are often privy to confidential financial information and are the first to learn of important developments in the case. This enables the committee member to maximize the opportunity to have a continuing business relationship with the debtor. In addition, committee members have the opportunity to meet and interact with other creditors involved in the same business.

Sharing of Costs

Committees are permitted to hire counsel and other professionals who are paid by the debtor's estate, not directly by the creditors. This provides two distinct benefits. First, creditors may have claims that are not large enough to justify hiring independent counsel. Sometimes, the cost of educating an attorney about a large case, and taking positions on important issues, will cost more than a single creditor is willing or wants to spend. However, when a single counsel is protecting the rights of all creditors, the services become cost effective. Second, committee members do not have to contribute directly to the cost of counsel, although such costs will affect their ultimate distribution from the estate. The risk that the debtor's estate will not have sufficient assets to pay for professional fees is ordinarily borne by the professionals, not the committee members. Lastly, although members are not compensated for the time they spend in meetings, reviewing the case, or participating in the bankruptcy process, they can recover the direct costs associated with committee membership, such as travel, phone, copying and postage costs.

Who is Eligible to Serve on a Committee?

Any unsecured creditor – barring extraordinary conflicts – is eligible to become a member of a creditor's committee, although usually those with the largest claims against the debtor are chosen. For other types of committees, the size of the claim or interest also is important but not necessarily the ultimate factor. The U.S. Trustee ordinarily begins the appointment process for the creditors' committee by contacting the parties that the debtor lists as holding the 20 largest unsecured claims against the estate. Most committees consist of five to seven members. If a large number of creditors express interest, the U.S. Trustee will either distribute a questionnaire or interview parties in some other fashion. In addition, the Bankruptcy Code provides that members of a committee formed prior to filing the bankruptcy petition can be appointed to the committee if the pre-petition

committee is representative of the constituency. If a creditor has a strong interest in serving on the committee, it is a good idea to ask bankruptcy counsel how to present his/her interest to the U.S. Trustee. It is possible to increase the chance of being chosen to serve on the committee by bringing certain factors to the U.S. Trustee's attention, such as any unique knowledge of the industry or a type of claim that is not well represented among the largest claims.

The U.S. Trustee rarely appoints additional committees on its own initiative. If constituencies wish to form committees other than a creditors' committee, the request usually comes from the constituency. Therefore, it is important for such groups to organize early so that they may present the rationale for appointment to the U.S. Trustee. Courts have approved the appointment of committees comprising groups such as tort claimants, secured creditors, priority creditors, employee creditors, physician claimants holding contingent claims, franchisee creditors, landlords, and bondholders.

When Should a Creditor Take Action Regarding a Committee?

A creditor should take action to form a committee, or to become a member of a committee, as soon as possible – even ***before*** a bankruptcy filing if the creditor has notice that a case will be filed. The earlier the U.S. Trustee or court is approached, and the more organized and knowledgeable the creditor is at the time he/she contacts the U.S. Trustee, the better the chances for participation in the committee process.

Formation at the Outset of the Case

In most large Chapter 11 cases, one of the first significant events after the petition is filed is the formation of a creditors' committee. The U.S. Trustee's office will often begin contacting potential members within days of a filing, and may set a formation meeting within a week or two of the filing. This allows the committee to be in place and comment on the important issues that are often addressed at the beginning of the case, such as compensation to insiders and the use of cash collateral. Therefore, a person interested in serving must respond to such inquiries immediately. It is very important for unsecured creditors to provide input to the court at this stage because decisions regarding financing often involve requests by the secured creditors, which could have long term consequences for the case. An alert and organized committee can enhance the return to unsecured creditors as well as increasing the possibility of a successful reorganization.

Formation Prior to the Filing

Sometimes creditors become aware that a bankruptcy filing is imminent before a bankruptcy petition is filed, either because of leaked information or because the debtor decides to alert some creditors for tactical reasons. In particular, some debtors will solicit creditors they believe will be helpful to serve on the committee. In extremely well-organized cases – sometimes called "pre-packaged" bankruptcies – debtors may even approach creditors with a proposed plan prior to filing, hoping to obtain sufficient plan support prior to the filing so as to facilitate a quick and efficient plan confirmation.

Creditors can also take the initiative to organize an unofficial committee prior to a bankruptcy filing. One of the advantages of organizing prior to the filing is that it enables the involved creditors to present a strong basis to the U.S. Trustee for their appointment on an official committee. Also, organizing before the filing gives creditors the ability to function immediately after the filing to address any issues raised in the first few days of the case.

Formation After the Case Has Commenced

It is never "too late" to form a committee. As noted above, sometimes no committee is formed at the outset of a case, either because of insufficient interest or because there does not appear to be sufficient assets. However, if at a later date creditors choose to become involved, they may petition the U.S. Trustee for the formation of a committee. The U.S. Trustee tends to view requests for committees liberally; therefore, it is almost always useful to ask. The actual request for a committee usually does not require extensive briefing, and can be accomplished quickly and inexpensively.

Sometimes after a committee has been formed, it becomes apparent that the committee is not adequately representing the interests of a particular group. In that case, parties can petition the U.S. Trustee to either expand the membership of the current committee, or to create a special committee as discussed above.

Where are Committees Active?

Committees are active in chapter 11 cases throughout the country, however a disproportionate number of very large bankruptcy cases are filed in Delaware or the Southern District of New York. This does not mean that the creditors themselves must be located in the jurisdiction where the case is filed. In fact, in large cases with creditors located nationwide or worldwide, geographical diversity in the committee membership can

be an advantage. Also, as we discussed above, other than telephonically, committee members are rarely required to attend court hearings.

How Does a Committee Work?

Committees perform two different functions. First, they analyze the actions proposed by other parties. Whenever the debtor, or another party in interest, proposes to affect the rights of creditors, such as by entering into an agreement outside the ordinary course of business or disposing of assets, court authority must be obtained. Before the court rules on the wisdom of the proposed action, a committee will ordinarily be given the opportunity to express its opinion to the court. Counsel will explain to the committee the ramifications of proposed actions, and the committee's options if they choose to oppose such proposals.

As noted above, the committee also has the ability to take a proactive role in the case by investigating the debtor, examining the assets, proposing a plan of reorganization, or even bringing actions against third parties to increase the value of the estate. A committee's decision as to how active a role to play is dependent on the peculiarities of each particular case, including the composition of the committee, and its relationship with the debtor.

For most committees, the objective is to maximize recovery for the constituency they represent. The committee must be run efficiently so that it stays informed and does not impose excessive time demands upon committee members.

The first thing a committee usually does is elect a chair. The chair is often given the authority to speak for the committee on matters too minor to present to the entire committee. In addition, the chair often works most closely with the professionals hired by the committee to set meeting agendas and perform other administrative functions. Committee meetings should be held when needed. Normally, this would be once every two to four weeks, subject to change according to events in the case. Many meetings can be held via conference call, which saves time and expense. In cases with unstable or depreciating assets, or where serious actions, such as replacing management or selling the business, must be addressed immediately, more meetings will be required in the early days of the case.

The role of the chair – as well as rules regarding the amount of notice required for a meeting, meeting attendance, and other procedures – are usually set out in by-laws established by the committee at one of the earliest meetings. Counsel to the committee can prepare the by-laws, and the committee can then review and adopt the procedures it believes will be the

most useful.

It also can be useful to have counsel prepare minutes of committee meetings. This formalizes corporate governance procedures and committee actions.

Committees often are given access to confidential information about the debtor. To protect the debtor, committees may enter into confidentiality agreements, which require them to keep all information they obtain confidential.

Depending on the size of the committee and other factors, another way to streamline committee proceedings is through the use of subcommittees, which are composed of only a few of the committee members and deal with specific areas of the case, such as litigation and sale of assets. In sum, there is no set formula for how a committee should function, and creditors should not be discouraged from joining committees based upon anecdotal evidence of how a committee acted or what a committee achieved in another case. Each case and each committee is different.

Conclusion

Bankruptcy committees present an opportunity for parties affected by a bankruptcy filing to maximize their impact in the bankruptcy case with the least amount of direct costs. Although serving on a committee may benefit everyone differently, there are many instances when it can be extremely advantageous. In order to recognize and maximize the opportunities, it is important that any entity or individual faced with a bankruptcy filing explore the possibility of serving on a committee. Your assessment should be made as early as possible, and counsel should be contacted to explain the relative benefits of your service.

The Ito Law Group is available to provide this analysis and to assist in every aspect of committee representation, from helping a creditor to be appointed, to representing the committee itself.

For further information please contact:
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Peter W. Ito

Possessing substantive and significant experience in large and middle market cases, Mr. Ito has represented, both in and out of court, clients in bankruptcies and workouts across the United States. His client representations are varied and include creditors' committees, secured and unsecured creditors, debtors-in-possession, bankruptcy trustees, buyers of distressed businesses, and receivers. On behalf of these clients, Mr. Ito's industry experience encompasses, among others areas, finance (subprime mortgages, subprime credit card receivables, and collateralized investments), real estate (golf courses and residential home developers), oil and gas, telecommunications (festooned fiber optic cable, cellular phone manufacturer and servicer, and FCC licenses), manufacturing (pre-engineered steel buildings, twist-off bottle cap tops, aircraft insulation blankets) and gaming. He has spoken at bankruptcy/insolvency conferences both nationally and internationally, and is the author of several bankruptcy-related articles. He can be reached at: peter@itolawgroup.com.