

THE SOURCE

Volume 12, No. 3

Creditors' Committees: *Powerful Tools for Unsecured Creditors*

by [Howard M. Ehrenberg](#)

Your worst fears are confirmed. You have just received the plan of reorganization from Acme Widget Manufacturing, your customer who has been in Chapter 11 bankruptcy for 18 months. The plan offers you only pennies on the dollar for your claim. The customer had assured you that you would have nothing to worry about because after restructuring the secured debts, cash flow will be great and everyone, including you, would be paid.

After reading the disclosure statement accompanying the plan of reorganization, you learn that the company actually had entered into a post-petition borrowing agreement with the same bank that had threatened to shut the company down. This agreement pledged to the bank any assets, which had not already been secured by the bank's claim, including machinery.

Unfortunately, the company continued to lose money throughout the Chapter 11 proceedings. Optimistically, the disclosure statement claims that the company recently negotiated several new contracts with key customers and expects to become profitable upon its emergence from Chapter 11.

However, to make matters worse, no creditor' committee was ever formed. Now, the debtor declares to the unsecured creditors that it believes that its proposed plan of reorganization is the only viable alternative for you and the other unsecured creditors. Let's consider the options:

- If Acme Widget Manufacturing is liquidated, you will not receive any payment
- If you support Acme's plan, perhaps they will pull themselves out of debt and remain a customer in the future (and pay the tiny dividend over time).
- How do you decide . . . become a member of the Official Creditors' Committee?

What Are Your Options?

As an unsecured creditor, unless your claim is particularly large, there is very little incentive to play an active role in a Chapter 11 case. The time and expense involved for a single creditor to become thoroughly familiar with the debtor, the bank, and other parties involved often is not justified by the expected return. For this reason, bankruptcy code provides for the appointment of the aforementioned committee to represent the interests of unsecured creditors.

Creditor's committees are formed near the beginning of a Chapter 11 case by the Office of the U.S. Trustee, who normally will appoint five to seven members from the 20 largest unsecured creditors. The creditors' committee is charged with the responsibility of representing the interest of all unsecured creditors in the Chapter 11 proceedings. The Committee instantly becomes one of the major players in the case, with standing to be heard in the matter.

How is a Committee Empowered?

Bankruptcy code specifically allows the committee to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business, and desirability of the continuance of such business". They also establish that the committee will "participate in the formulation of a plan" and "advise those represented by the committee of the committee's determinations as to any plan formulated." A committee can even propose its own plan of reorganization if it can't get the debtor to agree to the committee's requests, or the committee can ask the court to convert the case to Chapter 7 liquidation or to appoint a trustee to take control.

The committee acts as a fiduciary for the unsecured creditors and as a watchdog for the case. Accordingly, courts often are heavily influenced by the committee's position in their decision making. The committee's influence with the court and other unsecured creditors in turn gives it considerable leverage with the debtor.

The situation described in the beginning of this article may have been aided by the participation of the creditor's committee. An effective committee would have investigated the debtor's affairs, monitored business operations, demanded that the debtor pursue causes of action against the bank and insiders (or taken on those actions on behalf of the estate), participated in the negotiation of the borrowing agreement, and placed pressure on the debtor to accelerate the reorganization process. Most importantly, the committee always negotiates the best possible payment plan for unsecured creditors, not simply one in which unsecured creditors receive barely more than they would get in a liquidation.

Unfortunately, all too often, the Office of the U.S. Trustee is unable to appoint a creditors' committee due to lack of interest by the unsecured creditors. Sometimes, when one is appointed, it does not act effectively, because of lack of knowledge by its members of their rights and obligations, or the inability or unwillingness of the committee members to play an active role. In order to avoid these and other potential pitfalls, the code specifically allows the committee to employ counsel and other needed professionals, such as accountants or specialized consultants, at the expense of the bankruptcy estate (thereby spreading the cost evenly). The committee can also be reimbursed for out-of-pocket expenses incurred by its members.

Get Involved!

Most trade associations are making efforts to encourage the participation of their members on creditors' committees. Get involved. Learn how to utilize this option. Doing so will not only result in your company receiving a larger distribution more quickly, but may also provide valuable education that will aid you in your future credit decisions.

In order to learn more, contact your bankruptcy attorney. Often, they will provide you with a free consultation or even make a presentation to your credit department or trade association.

Some have said that it is the unsecured creditor's duty as a good corporate citizen to serve on the committee when asked. If each trade creditor were armed with the knowledge of how to be an

effective creditors' committee member, and were to take his or her turn in serving on a committee, it is almost certain that returns to unsecured creditors as a group would be significantly enhanced. Frustration and loss could be replaced with hope and satisfaction. Get involved with creditors' committees and learn how they can be used as a powerful collection tool. If you were a member of the creditors' committee in the Acme Widget Manufacturing bankruptcy case, you could have played a meaningful role in maximizing your return.