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CREDITORS' COMMITTEES UNDER CHAPTER 11
OF THE BANKRUPTCY CODE

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I. INTRODUCTION

The committee of creditors holding unsecured claims (hereinafter "creditors' committee") is an increasingly important component of the reorganization process. In cases under Chapter 11 of the United States Bankruptcy Code (hereinafter the "Bankruptcy Code")¹ when a debtor in possession is responsible for the management of the estate, creditors' committees perform the vital function of balancing the debtor's broad statutory authority by promoting the interests of unsecured creditors generally, investigating the estate's assets and liabilities, and negotiating (and, if necessary, proposing) a plan of reorganization. Moreover, when a Chapter 11 debtor in possession is unable, or unwilling, to carry out its statutory responsibilities, such as objecting to claims or prosecuting actions on behalf of the estate, creditors' committees often assume these duties. While the role of creditors' committees is far less important in cases under Chapters 7 and 9 of the Bankruptcy Code, or in Chapter 11 cases in which a trustee has been appointed, such committees nonetheless can be effective advocates for the interests of their unsecured creditor constituencies.

Relatively little is recorded about the functioning of creditors' committees in bankruptcy cases, such as how often they are appointed and the extent of their contributions to the reorganization process. Indeed, despite the growing importance of creditors' committees, they receive little attention in the academic literature,² which frequently examines the rights of debtors and secured creditors. Nevertheless, it is useful for committee members and their professionals (and for debtors and their professionals as well) to examine the law as applied to creditors' committees under the Bankruptcy Code, and to understand the rights, obligations, and limitations of committees. This is particularly true as unsecured trade creditors and bondholders increasingly desire to assert their influence over the bankruptcy process, rather than to follow the course charted by debtors, trustees, and major secured creditors.

The purpose of this Article is neither to present an empirical study of

1. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (hereinafter the "Bankruptcy Reform Act") (codified in part as amended at 11 U.S.C. §§ 101-1330 (1988 & Supp. IV 1992)).

2. See, e.g., Peter C. Blain & Diane H. O'Gawa, *Creditors' Committees Under Chapter 11 of the United States Bankruptcy Code: Creation, Composition, Powers, and Duties*, 73 MARQ. L. REV. 581 (1990); Andrew DeNatale, *The Creditors' Committee Under the Bankruptcy Code—A Primer*, 55 AM. BANKR. L.J. 43 (1981); see also ANDREW DENATALE ET AL., CREDITORS' COMMITTEE MANUAL (1993).

the effectiveness of creditors' committees in reorganization cases, nor to propose sweeping changes in the statutes and rules governing their existence; rather, it is to survey the existing law with respect to the appointment, operation, authority, and duties of creditors' committees, with particular emphasis on recent developments in case law. Where appropriate, we also offer our own views as to current problems in the statutory and judicially made rules governing creditors' committees and in the practical application of these rules to real-life situations.

Given the relative importance of creditors' committees in Chapter 11 cases in which a trustee has not been appointed, the emphasis of this Article is on that topic. Unless stated otherwise, the reader should assume that each particular discussion herein is geared principally to those Chapter 11 committees, although creditors' committees in cases under Chapter 9 involving municipalities are in many respects similar to those established under Chapter 11 in cases involving the reorganization of private entities. The law governing Chapter 7 creditors' committees differs substantially in many respects from that under Chapter 11, and such committees are addressed only in passing herein.

II. THE ROLE OF CREDITORS' COMMITTEES GENERALLY

A. Committees Under Prior Law

For nearly a century, creditors' committees have maintained an increasingly significant presence in the bankruptcy process. In enacting uniform national bankruptcy laws through the Bankruptcy Act of 1898 (the "Bankruptcy Act"),³ Congress made no mention of creditors' committees. Such committees, however, did exist from the earliest days under the Bankruptcy Act, although they did so only on an informal basis, and the scope of their authority to represent creditor constituencies was somewhat uncertain.⁴ It was not until 1933 that creditors' committees received formal statutory recognition, when Congress amended the Bankruptcy Act to allow committees "supervisory or other control over the debtor's business" in

3. Bankruptcy Act of 1898, Pub. L. No. 55-171, 30 Stat. 544 (codified as amended at 11 U.S.C. § 1 (1976)) (repealed 1978 by Bankruptcy Reform Act § 401(a)).

4. See, e.g., *In re Cass & Daley Shoe Co.*, 11 F.2d 872 (D. Mass. 1926) (recognizing that creditors' committees "may be of great assistance" in some cases if "openly and honestly organized and conducted"); *Parker v. New England Oil Corp.*, 8 F.2d 392 (D. Mass. 1925) (committee could act as a fiduciary for creditors if properly constituted); see also 2A COLLIER ON BANKRUPTCY, § 44.21[1] (14th ed. 1978); DeNatale, *supra* note 2, at 43-44 (citing H.R. REP. NO. 1409, 75th Cong., 1st Sess. 11 (1937)); cf. *In re E.T. Kenney & Co.*, 136 F. 451, 453 (D. Ind. 1905) (holding that committees of creditors representing particular creditor interests, rather than "the interest of general creditors," are "clearly against public policy").

cases in which the debtor received an extension of time to pay its debts.⁵ In 1934 Congress further extended its formal recognition of creditors' committees to Chapter IX cases involving "public debtors" such as municipalities and local taxing districts.⁶

The Chandler Act in 1938⁷ marked the first formal authorization for creditors to establish committees in the vast majority of cases brought under the Bankruptcy Act, although it did not require them to do so. In particular, the Chandler Act gave creditors the authority to select committees and empowered these committees to "consult and advise with the trustee in connection with the administration of the estate, make recommendations to the trustee in the performance of his duties and submit to the court any question affecting the administration of the estate."⁸ Creditors' committees that assisted in the administration of the estate or participated in the development of, or opposition to, a plan in many cases could also petition the court for monetary reimbursement from the estate for their expenses, including the cost of employing professionals.⁹ Nevertheless, under the

5. See Act of March 3, 1933, ch. 204, § 74(h), 47 Stat. 1467, 1469 (repealed 1978 by Bankruptcy Reform Act). Additionally, in cases involving debtor-farmers, the 1933 amendments specifically provided for the appointment of a creditors' committee to assist in taking an inventory of the debtor's assets. *Id.* § 75(f), 47 Stat. at 1471 (expired March 1, 1949 pursuant to Act of April 21, 1948, ch. 225, § 75(c), 62 Stat. 198).

6. Act of May 24, 1934, ch. 345, § 80(b), 48 Stat. 798, 799 (held unconstitutional in *Ashton v. Cameron County Water Improvement Dist.*, 298 U.S. 513 (1936)).

7. Ch. 575, 52 Stat. 840 (1938) (hereinafter the "Chandler Act") (codified as amended at 11 U.S.C. §§ 1-1103 (1976)) (repealed 1978 by Bankruptcy Reform Act).

8. Chandler Act § 44(b), 52 Stat. at 860 (codified as amended at 11 U.S.C. § 72(b) (1976)) (repealed 1978 by Bankruptcy Reform Act); see also Chandler Act § 209, 52 Stat. at 895 (applicable in Chapter X cases) (codified as amended at 11 U.S.C. § 609 (1976)) (repealed 1978 by Bankruptcy Reform Act); Chandler Act § 338, 52 Stat. at 909 (applicable in Chapter XI cases) (codified as amended at 11 U.S.C. § 738 (1976)) (repealed 1978 by Bankruptcy Reform Act); Chandler Act § 456, 52 Stat. at 921 (applicable in Chapter XII cases) (codified as amended at 11 U.S.C. § 856 (1976)) (repealed 1978 by Bankruptcy Reform Act).

9. See Chandler Act §§ 241-242, 52 Stat. at 900 (applicable in Chapter X cases) (codified as amended at 11 U.S.C. §§ 641-642 (1976)) (repealed 1978 by Bankruptcy Reform Act); Chandler Act § 491, 52 Stat. at 925 (applicable in Chapter XII cases) (codified as amended at 11 U.S.C. § 891 (1976)) (repealed 1978 by Bankruptcy Reform Act). In "straight" bankruptcies and rehabilitations under Chapter XI, creditors' committees could obtain a priority claim for costs and expenses incurred in successfully defeating confirmation of an arrangement or in preventing the debtor's discharge. See Chandler Act § 64, 52 Stat. at 874 (establishing procedures for compensating committee professionals and for reimbursement of committee expenses) (codified as amended at 11 U.S.C. § 104 (1976)) (repealed 1978 by Bankruptcy Reform Act); Bankr. R. 11-29(c) (same) (superseded pursuant to 28 U.S.C. § 2075); Bankr. R. 12-28(b) (same) (superseded).

Bankruptcy Act creditors' committees remained the exception rather than the rule, because their creation and ability to participate in the bankruptcy process depended on the initiative of often unorganized and unsophisticated creditor bodies.¹⁰

B. Committees Under the Bankruptcy Code

Due to the sweeping changes to the bankruptcy laws enacted through the Bankruptcy Reform Act of 1978, the role of creditors' committees, particularly in Chapter 11 cases, has increased dramatically during the past decade and a half. This increase is due in large part to the apparent mandatory appointment of a creditors' committee in a Chapter 11 case, although, as discussed further herein, in practice such appointment does not always occur.¹¹ Section 1102(a)(1) of the Bankruptcy Code provides, "As soon as practicable after the order for relief under Chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims"¹²

Once appointed, a Chapter 11 creditors' committee possesses broad authority under Bankruptcy Code section 1103(c) both to promote and to protect the interests of its unsecured creditor constituency. In this regard, section 1103(c) provides that a duly-appointed committee may:

- (1) consult with the trustee or debtor in possession concerning the administration of the case;
- (2) investigate the acts, conduct, assets, liabilities, and financial

10. See Blain & O'Gawa, *supra* note 2, at 581 n.1 (noting that, at least under Chapter XI, "creditors' committees played a very limited role"). The exception involved cases where attorneys, receivers, and credit agencies solicited proxies in connection with the formation of creditors' committees and the selection of committee counsel. In response to widespread criticism of this practice, former Bankruptcy Rule 208 was promulgated to prohibit anyone other than a creditor of the estate from soliciting proxies; the rule specifically barred solicitations by attorneys and collection agencies. See, e.g., *In re Darland Co.*, 184 F. Supp. 760 (S.D. Iowa 1960). Former Rule 208 has been adopted in large part by Rule 2006 of the Federal Rules of Bankruptcy Procedure, which restricts the solicitation of proxies in Chapter 7 cases. However, proxy solicitations are generally not an issue in Chapter 11 cases because creditors do not vote on committee appointments. See *infra* notes 18-21 and accompanying text. Furthermore, proxies have never been authorized in connection with the voting on a plan of reorganization. See FED. R. BANKR. P. 2006 advisory committee's note.

11. See *infra* notes 27-30 and accompanying text.

12. 11 U.S.C. § 1102(a)(1) (1988); see also *id.* § 901 (incorporating § 1102 into Chapter 9 of the Bankruptcy Code). Unless otherwise expressly noted herein, all provisions of Title 11 relating to the appointment and specific responsibilities of creditors' committees apply to cases commenced under both Chapters 9 and 11.

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;

(3) 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;

(4) request the appointment of a trustee or examiner under section 1104 of [title 11] . . . ; and

(5) perform such other services as are in the interest of those represented.¹³

In order to carry out these functions, a creditors' committee appointed pursuant to section 1102 may employ professionals,¹⁴ "may raise and may appear and be heard on any issue" in the case,¹⁵ and may "transact such business as may be necessary and proper" with the trustee or debtor in possession.¹⁶ The Parts of this Article that follow set forth in greater detail the law regarding committee membership, operations, and responsibilities.

III. FORMATION OF CREDITORS' COMMITTEES

A. Appointment of Committees

1. Time for and Method of Appointment

The authority to appoint a creditors' committee in Chapter 11 cases rests principally with the U.S. Trustee. This is a relatively recent development because under the Bankruptcy Act creditors' committees were selected by the creditors themselves.¹⁷ When Congress enacted the Bankruptcy

13. *Id.* § 1103(c); see *infra* notes 177-183 and accompanying text.

14. 11 U.S.C. § 1103(a); see *infra* notes 184-191 and accompanying text.

15. 11 U.S.C. § 1109(b). But see *infra* notes 192-207 and accompanying text.

16. 11 U.S.C. § 1103(d). Although a Chapter 7 committee is far more limited in its responsibilities, it may, pursuant to Bankruptcy Code § 705(b), consult with and make recommendations to the Chapter 7 trustee and the Office of the United States Trustee (hereinafter "U.S. Trustee") with respect to the administration of the estate, and submit to the court or the U.S. Trustee "any question affecting the administration of the estate." *Id.* § 705(b). Section 705(b) is in many respects a carryover from § 44(b) of the Chandler Act. See *supra* note 8 and accompanying text.

17. Under the Bankruptcy Act, any committee representing the interests of more than one creditor in a Chapter X case needed only to file with the court a document evincing the committee's authority to act on behalf of certain creditors and a signed statement setting forth the identity of the committee's members, the nature and amounts of its members' claims, and the circumstances of its formation. See Bankruptcy Act § 209, 11 U.S.C. § 609 (1976) (repealed 1978); see also Bankr. R. 10-211 (superseded). Similarly, in a case under Chapter XII, committees could act on behalf of certain creditors

Code in 1978, it entrusted the bankruptcy courts in most districts with the primary authority to appoint creditors' committees in Chapter 11 cases.¹⁸ The only exception existed in those pilot districts where Congress established the U.S. Trustee on an experimental basis. As to those districts, the U.S. Trustee had authority to appoint Chapter 11 creditors' committees.¹⁹

Although this system was usually adequate, it placed a large administrative burden on the courts and, in some districts, led to lengthy delays in the appointment of creditors' committees. In addition, the court's appointment of creditors' committees, as with its selection of private trustees, gave rise to a question of the court's neutrality in the bankruptcy process when the court would decide disputes between its hand-picked committee and other interested parties. With the expansion of the U.S. Trustee program pursuant to the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986,²⁰ however, these concerns basically became moot. Pursuant to that legislation, Congress transferred the role of appointing creditors' committees to the U.S. Trustee for each judicial district in the United States, except for those in Alabama and North Carolina, where currently there are no U.S. Trustees.²¹

In most cases, it is important that the U.S. Trustee appoint a creditors' committee without delay, preferably within the first few weeks after the filing of the petition. By doing so, the committee can promptly assume its proper role in the reorganization process. In this regard, Bankruptcy Code section 1102(a)(1) provides that the U.S. Trustee should appoint a committee "[a]s soon as practicable after the order for relief under Chapter 11 of

following proper authorization and disclosure. *See* Bankruptcy Act § 456, 11 U.S.C. § 856 (1976) (repealed 1978). Finally, in a case under Chapter XI, unsecured creditors generally were permitted to elect an official creditors' committee of not less than three but no more than eleven creditors at the meeting of creditors. *See* Bankruptcy Act § 338, 11 U.S.C. § 738 (1976) (repealed 1978); *see also* Bankr. R. 11-25 (superseded).

18. Former § 1102(a)(1) provided that "as soon as practicable after the order for relief under this chapter, the court shall appoint a committee of creditors holding unsecured claims." 11 U.S.C. § 1102(a)(1) (1982) (amended by Act of Oct. 27, 1986, Pub. L. No. 99-554, sec. 221, § 1102, 100 Stat. 3088, 3101). In Chapter 7 cases, creditors could continue to select their own committees. *See* 11 U.S.C. § 705(a) (1988):

At the meeting under section 341(a) of [Title 11], creditors that may vote for a trustee under section 702(a) of this title may elect a committee of not fewer than three, and not more than eleven, creditors, each of whom holds an allowable unsecured claim of a kind entitled to distribution under section 726(a)(2) of this title.

19. 11 U.S.C. § 151102(a) (1982) (repealed 1986).

20. Pub. L. No. 99-554, § 111, 100 Stat. 3088, 3090.

21. *See* 28 U.S.C. § 581 (1988). *But cf.* 11 U.S.C. § 1114(c)(2) & (d) (1988) (retiree benefits claimholders' committee to be appointed by court).

this title."²² In voluntary Chapter 11 cases, this requirement often leads to appointment of committees within a week or two of the commencement of the case, as the order for relief is entered on the date the petition is filed.²³ However, in involuntary Chapter 11 cases and cases commenced under Chapter 9, the entry of the order for relief may not occur until several weeks, or even months, after the petition date, thus significantly delaying a committee's appointment.²⁴ Even if a committee is formed prior to the entry of the order for relief, the court may not allow it to employ professionals at the expense of the estate or to otherwise act, at least until such time as the order for relief is entered.²⁵

Although not required to do so, the U.S. Trustee typically makes its committee selections from a list of the twenty largest creditors filed by the debtor at or near the commencement of the case pursuant to Rule 1007(d) of the Federal Rules of Bankruptcy Procedure.²⁶ As further discussed below, the U.S. Trustee usually will not want to appoint anyone other than creditors identified on this list, as the statutory provisions governing committee appointments favor selections from among the largest unsecured creditors.

An interesting question arises when the U.S. Trustee fails to appoint a creditors' committee, or unduly delays in so doing. For example, the U.S. Trustee in a particular case might believe the appointment of a creditors' committee (and the committee's subsequent retention of professionals) would constitute an unnecessary expense to the estate. This could occur where unsecured debt is combined and the principal controversy is between the debtor and secured creditor. Single-asset real estate cases are frequently of this kind. Additionally, the U.S. Trustee might find that the committee would be unable to retain counsel or other necessary professionals due to a

22. 11 U.S.C. § 1102(a)(1).

23. *See id.* § 301.

24. *See id.* §§ 303(h), 921(d).

25. *See In re Colorado Centre Metro. Dist.*, 113 B.R. 25 (Bankr. D. Colo. 1990) (holding that an official bondholders committee as appointed by the U.S. Trustee cannot be formed until after an order for relief has been entered).

26. *See* FED. R. BANKR. P. 1007(d) (providing that Chapter 9 or 11 debtors "shall file with the petition a list containing the name, address and claim of the creditors that hold the 20 largest unsecured claims, excluding insiders"; in involuntary Chapter 11 cases, the list shall be filed "within 2 days after entry of the order for relief"); *see also* FED. R. BANKR. P. 1007(d) advisory committee's note (implying that the list should be used in selecting creditors' committee under Bankruptcy Code § 1102). Query what remedies are available when the debtor inadvertently (or intentionally) fails to identify a large creditor on the list, and, as a result, the U.S. Trustee fails to appoint such creditor to the official creditors' committee. *Cf. infra* note 68 (discussing the propriety of including insiders on a committee, even though insiders should not be included on the Rule 1007(d) list of 20 largest unsecured creditors).

lack of funds in the estate. While these concerns might be justified as a matter of policy in some cases, the Bankruptcy Code does not support the U.S. Trustee's failure to appoint a committee if eligible creditors are willing to serve. The plain language of section 1102(a)(1) suggests that in all cases under Chapter 11, the prompt appointment of at least one creditors' committee is mandatory,²⁷ and the courts and commentators appear generally to support this view.²⁸ Furthermore, the concept of a debtor in possession is premised largely on the existence of an opposing force—the creditors' committee—capable of assuming many of the watchdog functions that would otherwise be performed by a trustee.²⁹ Of course, the U.S. Trustee may be unable to find eligible persons willing to serve on the committee, particularly in small cases with few creditors or unencumbered assets. The U.S. Trustee might decide appropriately not to appoint a committee in such cases.³⁰

If the U.S. Trustee is unwilling or unable to appoint a committee, the burden falls on each individual creditor, the U.S. Trustee, and the court to ensure that the debtor in possession complies with applicable laws and acts in the best interests of the estate. It is unclear whether the lack of a creditors' committee may constitute "cause" for the appointment of a trustee,³¹ although it would seem unfair to penalize the debtor in this manner simply because no creditors are interested in serving on a committee.

27. Section 1102(a) provides, *inter alia*, that "the United States trustee *shall* appoint a committee of creditors holding unsecured claims." 11 U.S.C. § 1102(a) (emphasis added).

28. See, e.g., 5 COLLIER ON BANKRUPTCY ¶ 1102.1[3], at 1102-11 (Lawrence P. King, ed., 15th ed. 1993); *In re Texaco Inc.*, 79 B.R. 560, 566 (Bankr. S.D.N.Y. 1987) ("The appointment of one committee of creditors holding unsecured claims against a Chapter 11 debtor is mandated under 11 U.S.C. § 1102(a)(1) if there are creditors willing to serve.").

29. See 11 U.S.C. § 1103 (1988); see also H.R. REP. NO. 595, 95th Cong., 1st Sess. 235-36 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6194-95.

30. See *In re Lion Capital Group*, 44 B.R. 684, 686 (Bankr. S.D.N.Y. 1984) (stating that U.S. Trustee was unable to form an official committee due to small amount of debt owed to unsecured creditors). Some U.S. Trustees will not appoint a committee unless they can find three or more unsecured creditors willing to become committee members. Although neither the Bankruptcy Code nor its legislative history dictates a minimum (or maximum) size for a Chapter 11 committee, a committee "ordinarily" shall consist of seven members. See *infra* notes 35-37 and accompanying text. No court has decided (at least in a published opinion) whether a committee may consist of only one creditor.

31. See 11 U.S.C. § 1104(a).

2. Committee Membership

Section 1102(b)(1) provides that a committee "shall ordinarily consist" of members who meet four general standards. Generally, committee members: (1) consist of the seven largest unsecured creditors of the debtor, (2) are "persons" as defined by the Bankruptcy Code, (3) hold unsecured "claims" against the debtor, and (4) are "representative" of the body of unsecured creditors.³² Because section 1102(b)(1) is prefaced with the word "ordinarily," the section appears to set guidelines that presumably need not be followed in every case. Some legislative history to the section supports this view, describing section 1102(b)(1) as "precatory" and "nonbinding."³³ In spite of the plain language and legislative history, however, most courts have interpreted three of the four standards in section 1102(b)(1) as mandatory requirements, holding that only the provision favoring the appointment of the seven largest creditors is permissive.³⁴ No textual authority provides a basis for treating certain provisions of section 1102(b)(1) as mandatory and others as permissive. Nevertheless, such treatment is now well established in numerous cases interpreting the section and, as discussed below, appears to balance competing objectives with respect to committee appointments.

32. Specifically, § 1102(b)(1) provides, "A committee of creditors appointed under subsection (a) of this section shall ordinarily consist of persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee" 11 U.S.C. § 1102(b)(1).

33. See H.R. REP. NO. 595, *supra* note 29, at 401, *reprinted in* 1978 U.S.C.C.A.N. at 6357 ("Subsection (b) [of § 1102] contains precatory language directing the [appointment of] the persons holding the seven largest claims against the debtor . . ."); see also 5 COLLIER ON BANKRUPTCY, *supra* note 28, ¶ 1102.01[3] (noting that "the language of section 1102(b)(1) is precatory"). But see H.R. REP. NO. 595, *supra* note 29, at 401, *reprinted in* 1978 U.S.C.C.A.N. at 6357 (under § 1102(b), "[t]he court is restricted to the appointment of persons.") (emphasis added).

34. See, e.g., *In re Altair Airlines*, 727 F.2d 88 (3d Cir. 1984) (stating that person must have "claim" against estate in order to serve on committee); *In re Gates Eng'g Co.*, 104 B.R. 653, 654 (Bankr. D. Del. 1989) (holding that state agency is not "person" eligible to serve on committee); *In re VTN, Inc.*, 65 B.R. 278, 279 (Bankr. S.D. Fla. 1986) (holding committee member must be a "person" as defined under the Code); *In re Bennett*, 17 B.R. 819, 820 (Bankr. D.N.M. 1982) (holding that to be member of unsecured creditors' committee, creditor must hold an unsecured claim). But see *Van Arsdale v. Clemo (In re A.H. Robins Co.)*, 65 B.R. 160, 163 (E.D. Va. 1986) (stating that § 1102(b)(1) does not "impose mandatory requirements on committee composition"), *aff'd* 825 F.2d 794 (4th Cir. 1987); *In re Lion Capital Group*, 44 B.R. at 685 (provision that "persons" sit on committee is "not an absolute bar").

a. Size of Committee and Amount of Members' Claims

As noted, the only discretionary provision in section 1102(b)(1) suggests guidelines for the size of the committee and the amount of its member's claims. Although a committee "shall ordinarily" consist of the estate's seven largest unsecured creditors, the courts and U.S. Trustees routinely adjust the size of creditors' committees. Creditors other than the seven largest may be selected in order to accommodate competing interests, or to reflect the size of the case or the number of creditors willing to serve. It is possible, particularly in large cases with multiple levels of subordinated debt, that more than seven members may be necessary in order to make a creditors' committee truly representative of various creditor interests.³⁵ On the other hand, the U.S. Trustee may not find seven unsecured creditors willing to serve on a committee who could properly represent the interests of all of the committee's constituents.³⁶ In addition, the U.S. Trustee may choose to exclude one or more of the seven largest unsecured creditors in order to provide better balance on the committee, particularly when there are no representatives of the trade among the seven largest unsecured creditors.³⁷

b. "Persons"

The first mandatory requirement of section 1102(b)(1) is that a committee consist of "persons."³⁸ The Bankruptcy Code defines "person" as *including* an "individual, partnership, and corporation."³⁹ Thus, as a

35. Recently, for example, the U.S. Trustee for the Southern District of New York appointed a creditors' committee comprised of nineteen members in the *Orion Pictures* Chapter 11 case. No. 91-B-15635 (BRL) (S.D.N.Y.).

36. 11 U.S.C. § 1102(b)(1). Indeed, as noted *supra* note 30, it is not at all clear that there cannot be a committee consisting of a single creditor, although one might challenge its representativeness if there were many creditors in the unsecured class. *Cf. id.* § 705(a) (mandating that creditors' committees in Chapter 7 cases be comprised of between three and eleven members).

37. *See In re A.H. Robins*, 65 B.R. at 163 (approving committee consisting of five members); *In re Featherworks Corp.*, 25 B.R. 634, 644 (Bankr. E.D.N.Y. 1982) (creditor does not have right to serve on committee simply because it is one of the debtor's seven largest unsecured creditors), *aff'd*, 36 B.R. 460 (E.D.N.Y. 1984).

38. *But see Lion Capital Group*, 44 B.R. at 685.

39. Section 101(41) provides that the definition of "person" includes: individual, partnership, and corporation, but does not include governmental unit, *Provided, however*, That any governmental unit that acquires an asset from a person as a result of operation of a loan guarantee agreement, or as receiver or liquidating agent of a person, will be considered a person for purposes of section 1102 of [Title 11].

general rule, almost any private entity that otherwise meets the qualifications for service on a creditors' committee may so serve if appointed. However, because the definition of "person" generally does not include a "governmental unit" such as a state or federal agency, public entities—including taxing authorities, regulatory agencies, and public utilities—typically are denied committee positions even though otherwise qualified.⁴⁰ The rule against governmental units sitting on official committees applies even when the governmental unit is acting in a manner akin to a private creditor,⁴¹ or when the governmental unit is acting as a trustee for private creditors.⁴²

The sole exception to the rule that governmental units may not be members of an official creditors' committee is that a governmental entity—typically the Federal Deposit Insurance Corporation (hereinafter "FDIC") or the Resolution Trust Corporation (hereinafter "RTC")—may sit on a committee when it acquires a creditor position from a failed financial institution. As part of the Bankruptcy Amendments and Federal Judgeship Act of 1984,⁴³ Congress responded to governmental lobbying pressure by amending the Code's definition of "person" in section 101(41) to include the following: "[A]ny governmental unit that acquires an asset from a person as

11 U.S.C. § 101(41) (Supp. IV 1992).

40. See 11 U.S.C. § 101(27), (41) (Supp. IV 1992). Section 101(27) of the Bankruptcy Code defines a "governmental unit" as:

United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.

11 U.S.C. § 101(27); see *In re Gates Eng'g*, 104 B.R. 653, 654 (Bankr. D. Del. 1989) (state agency precluded from committee membership); *In re VTN*, 65 B.R. 278, 279-80 (Bankr. S.D. Fla. 1986) (public service district not "person" eligible to serve on committee); *In re Baldwin-United Corp.*, 38 B.R. 802, 806 (Bankr. S.D. Ohio 1984) (Federal Deposit Insurance Corporation not eligible for committee membership); *In re American Atomics Corp.*, 2 B.R. 526, 527 (Bankr. D. Ariz. 1980) (school district not "person" eligible to serve on committee); see also H.R. REP. NO. 595, *supra* note 1004, at 401, reprinted in 1978 U.S.C.C.A.N. at 6357 ("The court is restricted to the appointment of persons in order to exclude governmental holders of claims or interests.").

41. See *In re Gates Eng'g*, 104 B.R. at 654 (state agency deemed to have "the same interest as other members of the Committee" nevertheless precluded from committee membership); *In re VTN*, 65 B.R. at 279-80 (holding that merely because private corporation could have been hired to operate sewage treatment plant did not render public service district "person" eligible to sit on committee).

42. See *Mansfield Tire & Rubber Co. v. Pension Benefit Guar. Corp.* (*In re Mansfield Tire & Rubber Co.*), 39 B.R. 974, 976 (N.D. Ohio 1983) (holding Pension Benefit Guarantee Corporation not "person" entitled to sit on committee).

43. Pub. L. No. 98-353, 98 Stat. 333.

a result of operation of a loan guarantee agreement, or as receiver or liquidating agent of a person, will be considered a person for purposes of section 1102 of [Title 11]."⁴⁴ The purpose of this amendment was to overrule cases such as *In re Baldwin-United Corp.*⁴⁵ that had prevented the FDIC's membership on committees. The amendment clearly includes the FDIC or RTC in their capacity as receiver of an insolvent financial institution. It is less clear, however, whether the amendment permits the FDIC or RTC to sit on a creditors' committee when those agencies are acting in their corporate capacities, typically following a purchase of assets from themselves in their capacities as receivers. Also unclear is whether other state and federal governmental units, such as the federal Small Business Administration, may take advantage of this provision when they become creditors due to their guarantees of bad loans, although the plain language of section 101(41) seems to suggest as much.

Nothing in the Bankruptcy Code suggests that a governmental unit is prohibited from serving on an official creditors' committee as a nonvoting member. However, no consensus exists on this issue.⁴⁶ There also does not appear to be any reason why a governmental unit cannot serve on an additional creditors' committee established pursuant to section 1102(a)(2), but a governmental unit cannot serve on an initial equity holders' committee whose membership arguably is restricted to "persons" by section 1102(b).⁴⁷

c. "Claim"
(1) Generally

The courts have interpreted section 1102(b)(1) as requiring the U.S.

44. 11 U.S.C. § 101(41) (Supp. IV 1992).

45. 38 B.R. 802 (Bankr. S.D. Ohio 1984).

46. Compare *In re Gates Eng'g*, 104 B.R. at 654 (allowing governmental agency to serve on committee as nonvoting member), with *Baldwin-United Corp.*, 38 B.R. at 806 (holding governmental unit could not even serve as a nonvoting member of official committee). Sometimes nonvoting members are incorrectly called "ex-officio" members.

47. As discussed *infra*, § 1102(a)(2) authorizes the appointment of additional committees of creditors or equity security holders. 11 U.S.C. § 1102(a)(2) (1988). Although § 1102(b)(1) sets forth the requirements for appointment on an official creditors' committees pursuant to § 1102(a)(1), and § 1102(b)(2) sets forth similar requirements for equity committees, whether by Congressional intent or oversight there is nothing in the Bankruptcy Code that sets forth requirements for membership on an additional creditors' committee appointed pursuant to § 1102(a)(2). See *In re Lion Capital Group*, 44 B.R. 684, 685-86 (Bankr. S.D.N.Y. 1984) (when U.S. Trustee was unable to appoint official committee, governmental creditors were appointed to special committee).

Trustee to appoint to an official creditors' committee only those persons who have unsecured "claims" against the estate or, in some cases, their duly authorized representatives. This requirement generally causes little controversy given the broad definition of "claim" under the Code.⁴⁸ The U.S. Trustee thus may appoint an unsecured creditor even though that creditor's claim against the estate is contingent, disputed, unmatured, or unliquidated.⁴⁹ Any other rule would allow a debtor to control membership of a creditors' committee simply by selectively objecting to claims or by scheduling them as disputed.⁵⁰

(2) Representatives or Agents of Creditors

In certain districts, creditors' committees are commonly comprised not of actual creditors, but rather of their representatives or agents, typically attorneys, financial advisors, and indenture trustees.⁵¹ While the Code does

48. Section 101(5) of the Bankruptcy Code defines "claim" as a:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(5) (Supp. IV 1992).

It is unclear whether a creditor who holds an undersecured, nonrecourse debt may be appointed to a creditors' committee. *See id.* § 1111(b)(1)(A) (1988) (providing that, unless the claim holder elects otherwise, a claim secured by a lien on property of the estate generally "shall be allowed or disallowed . . . the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse."); *see also id.* § 102(2) ("[C]laim against the debtor" includes claim against property of the debtor."). If § 1111(b)(1)(A) gives an undersecured creditor recourse against the debtor, then the creditor would seem to satisfy the requirement of § 1102(b)(1) that it have a "claim" against the debtor. On the other hand, after *Dewsnup v. Timm*, 112 S. Ct. 773 (1992), those courts that do not allow lien stripping, *e.g.* *Taffi v. United States (In re Taffi)*, 144 B.R. 105 (Bankr. C.D. Cal. 1992), may also not allow an undersecured creditor to sit on a committee. In our view, however, *Dewsnup* only applies in Chapter 7 cases and, thus, should not mandate this result.

49. *See In re Laclede Cab Co.*, 145 B.R. 308, 309 (Bankr. E.D. Mo. 1992); *In re Microboard Processing, Inc.*, 95 B.R. 283 (Bankr. D. Conn. 1989); *In re Richmond Tank Car Co.*, 93 B.R. 504, 506 (Bankr. S.D. Tex. 1988); *In re Johns-Manville Corp.*, 57 B.R. 680, 687 (Bankr. S.D.N.Y. 1986); *In re Churchill Coal Corp.*, 31 B.R. 115 (Bankr. S.D.N.Y. 1983); *In re Daig Corp.*, 17 B.R. 41, 43 (Bankr. D. Minn. 1981); *In re Grynberg*, 10 B.R. 256 (Bankr. D. Colo. 1981).

50. *See In re Microboard Processing*, 95 B.R. at 285.

51. *See, e.g., In re First Republic Bank Corp.*, 95 B.R. 58, 60 (Bankr. N.D. Tex.

not expressly prohibit the appointment of representatives or agents of creditors who are not themselves creditors, such practice arguably conflicts with the requirement that committee members be unsecured creditors of the estate. The Code defines "creditor" and "claim" very broadly,⁵² but those definitions do not appear to include the representatives or agents of claim holders who are not themselves creditors. This exclusion may be contrasted with section 1(11) of the Bankruptcy Act, which expressly provided that the term "'creditor' shall include anyone who owns a debt demand, or claim provable in bankruptcy, and may include his duly authorized agent, attorney, or proxy."⁵³

Although the Code's definitions of "creditor" and "claim" suggest that only actual creditors, and not their representatives and agents, may sit on a creditors' committee, cases have permitted noncreditor membership by numerous types of representatives, including: (1) attorneys;⁵⁴ (2) indenture trustees;⁵⁵ and (3) unions representing their employees,⁵⁶ particularly when the union itself also is deemed to have independent claims against the estate.⁵⁷ Nevertheless, even though a court or U.S. Trustee may find that

1988) ("The committee can include the individual creditor or its representative."); *In re M.H. Corp.*, 30 B.R. 266, 267 (Bankr. S.D. Ohio 1983) (holding that attorney of creditor authorized to serve on committee).

52. See 11 U.S.C. § 101(10) (Supp. IV 1992) (defining "creditor"); see also *supra* note 48 (quoting Code section that defines "claim").

53. 11 U.S.C. § 1(11) (1976) (repealed 1978) (emphasis added).

54. See *In re M.H. Corp.*, 30 B.R. at 267 (holding that attorney may be appointed as representative of single creditor, but not of class of creditors). But see *In re Celotex Corp.*, 123 B.R. 917, 922-23 (Bankr. M.D. Fla. 1991) (holding that counsel could not serve on committee without holding claim against the estate); *In re American Fed'n of Television & Radio Artists*, 30 B.R. 772 (Bankr. S.D.N.Y. 1983) (same).

55. See *In re McLean Indus.*, 70 B.R. 852, 862 (Bankr. S.D.N.Y. 1987) (noting that indenture trustees often serve on creditors' committees); *In re Charter Co.*, 42 B.R. 251 (Bankr. M.D. Fla. 1984) (permitting indenture trustee to serve on committee). But see *In re Public Serv. Co.*, 89 B.R. 1014, 1019 (Bankr. D.N.H. 1988) (noting, without resolving, the "building conflict as to whether indenture trustees may or should appropriately be members of creditors' committees in chapter 11 proceedings"). Typically indenture trustees will have their own claim against the debtor for fees and charges under the indenture.

56. See *In re Schatz Fed. Bearings Co.*, 5 B.R. 543 (Bankr. S.D.N.Y. 1980). Note that the union in *Schatz Federal Bearings* subsequently sought, and was granted, leave to withdraw from membership on the committee. See *In re Schatz Fed. Bearings Co.*, 11 B.R. 363 (Bankr. S.D.N.Y. 1981).

57. See *In re Altair Airlines*, 727 F.2d 88 (3d Cir. 1984); *In re Chateaugay Corp.*, 104 B.R. 626, 635 (S.D.N.Y. 1989); *In re Enduro Stainless, Inc.*, 59 B.R. 603 (Bankr. N.D. Ohio 1986); *In re National Equip. & Mold Corp.*, 33 B.R. 574 (Bankr. N.D. Ohio 1983). But see *In re Allied Delivery Sys. Co.*, 52 B.R. 85 (Bankr. N.D. Ohio 1985) (union denied seat on creditors' committee when it failed to show that creditors'

a representative or agent of a claim holder satisfies the "creditor" requirement in section 1102, such a representative or agent may be disqualified from serving on a creditors' committee due to the agent's conflicting loyalties to his or her own client's particular interests and to the constituency of the creditors' committee as a whole.⁵⁸ As a practical matter, there may be merit in restricting committee membership to business persons with a direct economic stake in the outcome of the case, because such persons often would be the best suited to make economic decisions and to participate in the deliberative process. Business persons also could be less likely to prolong the case in an effort to run up fees.⁵⁹

d. A "Representative" Committee
(1) Generally

The final requirement under section 1102(b)(1) is that an official creditors' committee be "representative" of the class of creditors the committee is entrusted to represent. Courts have derived the "representative" requirement not only from section 1102(b)(1) itself, which authorizes the continuation of prepetition creditors' committees that are "representative of the different kinds of claims to be represented," but also from section 1102(a)(2), which authorizes the appointment of additional committees "to assure adequate representation of creditors or of equity security holders."⁶⁰ Whether a creditors' committee is sufficiently "representative" cannot be determined by application of any empirical formula. Rather, the courts pay close attention to the particular facts at hand, and they consider the issue on a case-by-case basis.

Courts generally require only that a creditors' committee be representative of the unsecured creditors whose interests it is charged with protecting; a committee need not be representative of secured creditors and equity security holders of the estate. In addition, although, as discussed below,

committee was unrepresentative of general unsecured creditors and where an adversarial relationship existed between the union and the debtor).

58. See *infra* notes 72-78 and accompanying text.

59. See *In re M.H. Corp.*, 30 B.R. at 267. The court in *M.H. Corp.* noted: [W]ith respect to service of attorneys on creditors committees, it is our policy to encourage creditors to designate persons engaged in their businesses to serve on a creditors committee, our thought being that such persons have greater insight into business affairs and this will be more useful in fulfilling the function of a creditors committee. We do not, however, bar the service on a creditors committee of an attorney if a creditor, aware of the just stated policy suggestion of the court, wishes that such a person be its representative.

Id.

60. 11 U.S.C. § 1102(a)(2) (1988).

each member of a committee represents the interests of constituent unsecured creditors generally, each member need not hold a claim of a kind that is representative of every such creditor, so long as the member's claim can be fairly placed within the constituent class. As one court recently has held, the official creditors' committee need not "faithfully reproduce the exact complexion of the creditor body."⁶¹ Thus, for example, if bank creditors and trade creditors can fairly represent the interests of unsecured creditors generally, the U.S. Trustee could well decide not to appoint tort claimants or warranty claimants where their claims are relatively small or are likely to be treated as not impaired under a plan.

In *In re Microboard Processing Inc.*,⁶² the court found no violation of section 1102 when two of the committee's members were the only two nonvendor creditors of the estate. To the contrary, the court reasoned that, without representatives of nonvendor creditors, the creditors' committee might not satisfy the representativeness requirements of section 1102.⁶³

Likewise, in *In re American Federation of Television & Radio Artists*,⁶⁴ the court held that a creditor holding approximately ninety-eight percent of unsecured claims in a case may sit on a creditors' committee, at least absent any showing of an actual conflict of interest with other creditors. Therefore, while the U.S. Trustee might be wise to avoid appointing persons whose claims are so unique as to create conflicts with other creditors' interests, such as insiders and partially secured creditors, the U.S. Trustee has wide latitude in determining which creditors are best suited for committee membership.

(2) Conflicts of Interest

Even though a creditor's claims otherwise may be representative of those of other unsecured creditors, the U.S. Trustee must not appoint that creditor to an official creditors' committee if an actual conflict of interest exists between that creditor and other unsecured claim holders. Arguably, in many cases every unsecured creditor has a potential conflict of interest with the debtor and other persons asserting claims against the estate, because in anything other than a one hundred-cent case, the existence of any particular creditor usually reduces the amount available for distribution to

61. *In re Hills Stores Co.*, 137 B.R. 4, 7 (Bankr. S.D.N.Y. 1992); see *In re Drexel Burnham Lambert Group, Inc.*, 118 B.R. 209 (Bankr. S.D.N.Y. 1990) (holding that when considering representativeness of committee, court should consider not the uniqueness of claims, but rather how they will be treated under a plan).

62. 95 B.R. 283 (Bankr. D. Conn. 1989).

63. *Id.* at 286.

64. 30 B.R. 772 (Bankr. S.D.N.Y. 1983).

other unsecured creditors.⁶⁵ Of course, such a potential conflict cannot be sufficient to bar a creditor from membership on an official creditors' committee, or there would be no such committees in many cases. For this reason, courts generally will ignore speculative or contingent conflicts and concern themselves only with actual ones instead.

Unfortunately, little case law exists to explain what constitutes an impermissible "actual" conflict of interest. According to one court, an actual conflict arises when a member has breached, or is likely to breach, a fiduciary duty to the committee's constituents.⁶⁶ Under this view, a conflict is measured not by reference to a creditor's status, but rather to the creditor's conduct during the course of the case. However, most courts consider both status and conduct, examining both the pre-existing relationship between the creditor and the estate and any actions that the creditor may take with respect to the same. Until the standards governing impermissible conflicts become better developed, the U.S. Trustee might be well advised to avoid appointing a creditor with any significant potential conflict, if at all possible. Moreover, even though a creditor may not be barred legally from serving on a committee due to a conflict, a creditor with a serious potential conflict should think twice before becoming a committee member. Otherwise, the creditor might ultimately hinder both the committee's ability to represent the interests of its constituents and the creditor's ability to protect its own interests.

The following paragraphs illustrate situations that may create actual conflicts involving creditors' committee membership. It should be noted, however, that courts generally determine conflicts on a case-by-case basis after close examination of the particular facts at hand. With few exceptions noted below, courts rarely establish per se rules against particular types of creditors serving on committees because of conflict of interest concerns.

(a) *Insiders*

The most obvious example of a potential conflict of interest that may rise to the level of an impermissible actual conflict involves the appointment of insiders of the debtor to a committee. The term "insider" as used in the Code includes directors, officers, partners, and affiliates of the debtor, as well as relatives of an individual debtor and relatives of directors and officers of a corporate debtor.⁶⁷ In most cases, the U.S. Trustee will not

65. See *In re Microboard Processing*, 95 B.R. at 285.

66. *Id.*; see also *In re Laclede Cab*, 145 B.R. 308, 309 (Bankr. E.D. Mo. 1992); *In re Map Int'l, Inc.*, 105 B.R. 5, 6 (Bankr. E.D. Pa. 1989) (stating that a competitor of the debtor may serve on committee as long as competitor does not violate fiduciary duties to creditors); Blain & O'Gawa, *supra* note 2, at 588.

67. 11 U.S.C. § 101(31) (Supp. IV 1992). An "affiliate" under the Bankruptcy Code

appoint insiders to a committee for the simple reason that they are required to be excluded from the debtor's list of the twenty largest creditors upon which the U.S. Trustee typically relies in making committee appointments.⁶⁸ Nevertheless, the U.S. Trustee does on occasion appoint insiders, either by choice or inadvertence. While the better practice would appear to be that insiders should never be permitted to serve on committees,⁶⁹ a number of courts allow insiders and former insiders to serve on creditors' committees absent a showing of actual conflict.⁷⁰

(b) Representatives or Agents of Creditors

As discussed previously, although creditors' committees generally are comprised of the estate's largest unsecured creditors, a number of courts express their (sometimes reluctant) approval of the appointment of representatives or agents of actual creditors, even though the representatives

generally includes an "entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor", a subsidiary corporation of which the debtor owns or controls more than 20% of the outstanding voting securities, persons who lease substantially all of their assets to the debtor, and entities who operate substantially all of the debtor's business or property. *Id.* § 101(2).

68. See FED. R. BANKR. P. 1007(d) (providing that the list of 20 largest creditors shall "exclud[e] insiders"); see also *supra* note 26. Query whether Rule 1007(d) is inconsistent with the Bankruptcy Code in that the latter does not prohibit the appointment of insiders to a creditors' committee. Perhaps the better rule would be to require the debtor to list the names and identities of both insiders and noninsiders so that the U.S. Trustee may decide whether to appoint an insider to the committee.

69. See *In re Swolsky*, 55 B.R. 144 (Bankr. N.D. Ohio 1985) (holding that presence on committee of member, whose wife was Chapter 11 debtor's office manager, bookkeeper, and vice-president, presented inherent conflict of interest and thus member could not serve on committee); *In re Glendale Woods Apartments, Ltd.*, 25 B.R. 414 (Bankr. D. Md. 1982) (removing insider from committee due to concerns of confidentiality); *In re Daig Corp.*, 17 B.R. 41 (Bankr. D. Minn. 1981) (holding that relative of principal operating officer of debtor not allowed to serve on committee).

70. See, e.g., *Skulsky v. Nyack Autopartstores Holding Co. (In re Nyack Autopartstores Holding Co.)*, 98 B.R. 659, 661 (Bankr. S.D.N.Y. 1989) (holding that cousin of debtors' principal operating officer was not barred from committee membership); *In re First RepublicBank Corp.*, 95 B.R. 58, 61 (Bankr. N.D. Tex. 1988) ("The Bankruptcy Code does not expressly prohibit a person from serving on a committee because of a lack of disinterestedness or even insider status."); *In re Vermont Real Estate Inv. Trust*, 20 B.R. 33 (Bankr. D. Vt. 1982) (holding that wife of former president and executive manager of debtor could serve on committee, even though husband was defendant in suit brought by debtor, but could not participate in any committee decisions relating to suit against husband).

or agents themselves do not have claims against the estate.⁷¹ Typically, the representative members are attorneys or indenture trustees, but they could also include anyone ranging from union representatives to financial advisors. Even though a court may deem a representative or agent to satisfy the claimholder requirement of section 1102, many courts have expressed concern that such a person's participation on a creditors' committee may lead to serious conflict of interest problems.⁷² Such problems may arise because the representative or agent member must balance his or her fiduciary duties to the committee's entire constituency against the duties owed to the individual or class of creditors that the member represents.

The court in *In re Celotex Corp.*⁷³ best expressed the concern for this type of potential conflict in its holding that it is improper for an attorney employed by certain creditors to represent those same creditors' interests on a committee:

Because in this case committee participation is not by the appointed members but by their legal representatives, an anomaly arises. Each legal representative who sits on the committee has a fiduciary duty to its own client/member as well as a fiduciary duty to the committee and each of its constituents. . . . From this perspective, this Court can observe a potential conflict on the part of those attorneys who sit on the [creditors' committee] as between their client, the committee, [and] its members These legal representatives have different fiduciary duties to their individual clients as distinct from that owed to the constituency of the committee.⁷⁴

Other courts take the position that a creditor representing a special constituency may serve on the committee because the member has only "one vote" and, thus, arguably would be outvoted when acting in its own self-interest.⁷⁵ For example, in *In re Schatz Federal Bearings Co.*,⁷⁶ a credi-

71. See *supra* notes 51-59 and accompanying text.

72. See, e.g., *In re Amatek Corp.*, 755 F.2d 1034, 1043 (3d Cir. 1985) (questioning counsel's representation of class of potential asbestos victims when counsel "formerly aligned with the Creditors' Committee"); *Locks v. United States Trustee*, 157 B.R. 89, 93-94 (W.D. Pa. 1993).

73. 123 B.R. 917 (Bankr. M.D. Fla. 1991).

74. *Id.* at 921-22 (footnote omitted); see also *Johns-Manville Sales Corp. v. Doan* (*In re Johns-Manville Corp.*), 26 B.R. 919 (Bankr. S.D.N.Y. 1983) (finding that a conflict of interest existed when a member of the creditors' committee also represented an asbestos litigant in action against the estate), and 36 B.R. 743, 749 n.3 (Bankr. S.D. N.Y.) (questioning lawyer-members' abilities to represent creditor interests other than those of their clients), *appeal dismissed*, 39 B.R. 234 (S.D.N.Y. 1984).

75. See *infra* notes 253-256 and accompanying text.

76. 5 B.R. 543 (Bankr. S.D.N.Y. 1980).

tors' committee opposed a union's motion for appointment to the committee, contending that there would be a conflict between the fiduciary duty the union owed to its own membership and the duty it would owe to the creditor body as a member of the committee. The committee argued that "in an effort to preserve the estate of the debtor it might be contemplated that drastic reductions in the work force or total liquidation might be in order, whereas the Union has a duty to its membership to preserve jobs and maintain the present operations."⁷⁷ The court refused to deny the union membership on the committee based on this purported conflict of interest:

As a practical matter, the Union may exercise only one vote as a member of the Official Creditors' Committee. Therefore, notwithstanding the size of the Union or the amount of its claim, nine other members of the Committee will have equal standing and weight in expressing their views with regard to the actions of the Committee as a whole.⁷⁸

Arguably, based on the reasoning of the *Schatz* court, no conflict of interest should ever preclude a creditor from committee membership, because the committee's other members could always overrule the conflicted member. This clearly is not, and should not be, the prevailing view. In a close vote, a member whose exercise of fiduciary duty is in question should not decide the outcome of the committee's vote.

(c) *Partially Secured Creditors*

Clearly, secured creditors should not be appointed to the official unsecured creditor's committee.⁷⁹ Nevertheless, while the practice is

77. *Id.* at 548.

78. *Id.*; see also *In re White Motor Credit Corp.*, 18 B.R. 720, 722 (Bankr. N.D. Ohio 1980) (permitting creditors with claims against two separate affiliated debtors to serve on separate committee for one debtor where committee was structured as to vest numerical control in creditors with claims against that debtor only); cf. *In re Altair Airlines*, 727 F.2d 88 (3d Cir. 1984) (permitting union to be appointed to general unsecured creditors' committee); *In re Northeast Dairy Coop.*, 59 B.R. 531, 534 (Bankr. N.D.N.Y. 1986) (permitting union and trustees of pension and welfare funds to serve on unsecured creditors' committee); *In re Charter Co.*, 42 B.R. 251 (Bankr. M.D. Fla. 1984) (permitting indenture trustee to sit on unsecured creditors' committee).

79. The House Report to the Bankruptcy Reform Act of 1978 provides:

The bill does not provide for the inclusion of secured creditors on the committee of unsecured creditors. Because the purpose of a committee is to represent a class that is too large to speak for itself as a whole, inclusion of representatives from other classes would present a potential for conflict within the committee, and the danger of committee action being taken to the

perhaps questionable, it is generally agreed that partially secured creditors may sit on official creditors' committees.⁸⁰ In *In re Walat Farms, Inc.*,⁸¹ for example, the court justified the appointment of a partially secured creditor to the committee by stating that "[s]ince the rights of the undersecured creditor to protect or satisfy its unsecured claim are the same as those of a general unsecured creditor, the undersecured creditor should not be precluded from participating on the creditors' committee."⁸² Of course, if the creditor intends to move for relief from the automatic stay to foreclose on collateral that is vital to the operation of the business, the creditor should resign from the creditors' committee, because the creditor's secured position would likely conflict with the interests of unsecured creditors generally.⁸³

(d) Recipients of Fraudulent Transfers and Preferences

As discussed above, the mere fact that one has a dispute with the debtor regarding the validity of a claim is not in itself sufficient to keep that person off a creditors' committee.⁸⁴ If, however, a high likelihood exists that the estate may have material avoidance actions against a particular creditor either for allegedly fraudulent conveyances or for preferences,⁸⁵ it may be advisable to bar that creditor from committee membership. In particular,

detriment of the class that it is intended to represent. Secured creditors are most often in single-member classes, and thus are able to speak for themselves individually. Nevertheless, the bill continues to permit secured creditors to serve as non-voting members of the unsecured creditor's committee.

H.R. REP. NO. 595, *supra* note 29, at 236, reprinted in 1978 U.S.C.C.A.N. at 6195.

80. See *In re Seascope Cruises, Ltd.*, 131 B.R. 241, 243 (Bankr. S.D. Fla. 1991); *In re Markunes*, 86 B.R. 933 (Bankr. S.D. Ohio 1988); *In re Walat Farms, Inc.*, 64 B.R. 65, 68-69 (Bankr. E.D. Mich. 1986); see also Blain & O'Gawa, *supra* note 2, at 584 (justifying committee membership by partially secured creditors on the ground that under § 506(a) a partially secured creditor may divide its claim into secured and unsecured components; cf. *supra* note 48); *In re America W. Airlines*, 142 B.R. 901, 903 (Bankr. D. Ariz. 1992) (upholding U.S. Trustee's decision to remove partially secured creditors' committee member in part because member would have to make "difficult" choices between representing its unsecured constituents and forwarding its own interests); *In re Glendale Woods Apartments*, 25 B.R. at 415 (finding that partially secured creditor might have conflict of interest with unsecured claimants).

81. 64 B.R. 65 (Bankr. E.D. Mich. 1986).

82. *Id.* at 69.

83. See generally *In re America W. Airlines*, 142 B.R. at 903 (finding partially secured creditor to have inherent conflict with unsecured creditors). But see *In re Seascope Cruises*, 131 B.R. at 243 (permitting creditor who unsuccessfully sought relief from stay to remain on creditors' committee).

84. See *supra* notes 49-50 and accompanying text.

85. See 11 U.S.C. §§ 544, 547, 548 (1988 & Supp. IV 1992).

that creditor should be barred if it appears likely that the committee may be required to play a leading role in the litigation.⁸⁶ Similarly, if litigation between the estate and the member arises after the appointment of a particular committee member, the member should, at the least, be recused from participating in any deliberations regarding that litigation. If the litigation is significant, the member should consider resigning from the committee, or be subject to removal.

(e) Competitors, Vendors, and Customers

Under section 1103(c)(2), a creditors' committee may investigate "the desirability of the continuance of [the debtor's] business."⁸⁷ Competitors and those who conduct business with the debtor often possess views with respect to this issue based upon their own relationships with the debtor, rather than upon an objective view of how to maximize value for unsecured creditors generally. As the court in *In re Tri Manufacturing & Sales Co.*⁸⁸ recognized, "[i]t is all too clear that a competitor of [the] debtor will have a different 'predisposition' in evaluating the desirability of the continuance of [the] debtor's business than will an ordinary creditor."⁸⁹ A competitor may push for a liquidation of the debtor's business even though reorganization would maximize distributions to creditors. Similarly, a customer or supplier may be biased in favor of continued operations even though unsecured creditors as a whole might be better off with a quick liquidation of the debtor.

The courts are split regarding whether a competitor of the debtor may serve on a creditors' committee. The significant concerns include compromising a committee member's duty to promote the general interests of the creditors' committee's constituents and granting a competitor access to trade secrets and other confidential information about the debtor. The majority view appears to be that, absent additional evidence of an actual conflict of interest, competitors may be appointed to committees;⁹⁰ however, the

86. See *infra* notes 194-198 and accompanying text.

87. 11 U.S.C. § 1103(c)(2) (1988).

88. 51 B.R. 178 (Bankr. S.D. Ohio 1985).

89. *Id.* at 180.

90. See, e.g., *In re Map Int'l, Inc.*, 105 B.R. 5, 6 (Bankr. E.D. Pa. 1989) (holding that until committee member takes action that violates his fiduciary duty to creditors, the court should not interfere with committee membership upon mere speculation); *In re Plant Specialties, Inc.*, 59 B.R. 1 (Bankr. W.D. La. 1986) (stating that debtor has burden of showing how competitor's service on creditors' committee will be detrimental to its reorganization efforts); see also *In re Penn-Dixie Indus.*, 9 B.R. 936, 940 (Bankr. S.D.N.Y. 1981) (member of equity holders' committee not removed in spite of member's apparent intention to acquire the debtor).

contrary view is not without ample support and justification.⁹¹ No reported decisions have discussed whether a customer or supplier of the debtor should serve on a committee.

(f) *Minority Viewpoints*

It must be remembered that the creditors' committee is, in fact, a committee. It is not uncommon for creditors' committee members, as a group of individual creditors with potentially diverse and conflicting interests, to differ widely in their opinions regarding the prospects or desirability of the debtor's reorganization. However, the fact that some committee members' views may differ from those of the majority of unsecured creditors is not a ground for excluding such creditors from the committee.⁹²

Because creditors' committee members represent the interests of all of the committee's constituents, often a committee may take positions without the unanimous support of its members. Indeed, it is not uncommon for committee members or constituents to take contrary positions to those expressed by the committee as a whole.⁹³ Committee members may act individually to protect their own interests notwithstanding a contrary position of the committee;⁹⁴ however, committee members should be careful not to let their divergent views interfere with their duties to the unsecured creditors when voting on positions the committee intends to take.

Despite the goal of Chapter 11 debtors to consummate a plan of reorganization, there is no requirement that committee members support the

91. See, e.g., *In re Tri Mfg. & Sales Co.*, 51 B.R. 178 (Bankr. S.D. Ohio 1985) (disqualifying law firm as representative of creditors' committee where firm was representing debtor's former general manager who was then employed by debtor's competitor); *In re Wilson Foods Corp.*, 31 B.R. 272 (Bankr. W.D. Okla. 1983) (holding that "significant competitor" should not serve on committee because "[c]onflicting interests and divided loyalties have no place on a committee of creditors").

92. See *In re Plabell Rubber Prods.*, 140 B.R. 179, 181 (Bankr. N.D. Ohio 1992) (citing *In re Texaco Inc.*, 79 B.R. 560, 567 (Bankr. S.D.N.Y. 1987)); *In re Public Serv. Co.*, 89 B.R. 1014, 1019 (Bankr. D.N.H. 1988) ("[T]he existence of strong and diverse views is not per se a disqualification for service on a creditors' committee in a chapter 11 proceeding.") (citing *In re Baldwin-United Corp.*, 45 B.R. 375, 376 (Bankr. S.D. Ohio 1983); *In re M.H. Corp.*, 30 B.R. 266, 267 (Bankr. S.D. Ohio 1983)).

93. See *In re Central Medical Ctr., Inc.*, 122 B.R. 568, 570-71 (Bankr. E.D. Mo. 1990) (bondholders' committee may oppose confirmation of plan notwithstanding overwhelming vote of its constituents in favor of the plan).

94. E.g., *In re American Fed'n of Television & Radio Artists*, 30 B.R. 772, 775-76 (S.D.N.Y. 1983) (individual committee member entitled to oppose extension of debtor's plan exclusivity period, notwithstanding committee's decision not to oppose the extension).

debtor's efforts to reorganize or support any particular plan of reorganization.⁹⁵ Indeed, so long as no other reason exists why a particular committee member should not serve, "[t]here is nothing in the [Bankruptcy Code] which would prevent service on the creditors committee of a creditor unsympathetic to the efforts of a debtor to reorganize."⁹⁶ While the committee is entitled to "participate in the formulation of a plan,"⁹⁷ it may also seek the appointment of a trustee,⁹⁸ or conversion of the case to one under Chapter 7 for the purpose of liquidating the estate.⁹⁹ Of course, there are limits as to how obstructionist a committee member may be. A committee member who engages in unreasonable conduct to impede the reorganization process or to promote that creditor's own self interests may (and indeed should) be removed from the committee.¹⁰⁰

B. Prepetition Committees

1. Functions

Although creditors' committees generally exist within the context of a case pending under title 11, creditors increasingly are establishing committees before the commencement of a case in order to protect their interests and to negotiate uniformly with the debtor or other creditors. This process is particularly evident in cases involving debtors that underwent leveraged buyouts in the 1980s, resulting in the placement of unsecured or grossly undersecured "junk bonds" with groups of large institutional creditors. Such creditors possess the knowledge and resources to form committees without the assistance of the bankruptcy court and the U.S. Trustee. Also, these creditors often are able to employ professionals without assurances that the

95. *In re Laclede Cab Co.*, 145 B.R. 308, 309 (Bankr. E.D. Mo. 1992); *In re Seascope Cruises, Ltd.*, 131 B.R. at 243; *In re Microboard Processing, Inc.*, 95 B.R. 283, 286 (Bankr. D. Conn. 1989); *In re M.H. Corp.*, 30 B.R. at 267.

96. *In re M.H. Corp.*, 30 B.R. at 267 (citing *In re Schatz Fed. Bearing*, 11 B.R. 363 (Bankr. S.D.N.Y. 1980)).

97. 11 U.S.C. § 1103(c)(3) (1988).

98. *Id.* §§ 1103(c)(4), 1104(a); see *In re Microwave Prods. of Am., Inc.*, 102 B.R. 666 (Bankr. W.D. Tenn. 1989) (granting committee's motion to appoint a trustee as an "extraordinary remedy available to creditors"); *In re Russell*, 60 B.R. 42 (Bankr. W.D. Ark. 1985); *In re L.S. Good & Co.*, 8 B.R. 312, 314-15 (Bankr. N.D.W. Va. 1980). Note, however, that § 1104 is inapplicable in Chapter 9 cases.

99. See 11 U.S.C. § 1112(b) (a "party in interest" may move to have case converted); *id.* § 1109(b) (committee may raise and be heard "on any issue in a case"); see also *In re W.J. Rewoldt Co.*, 22 B.R. 459 (Bankr. E.D. Mich. 1982) (granting committee's motion to convert case from Chapter 11 to Chapter 7); *In re Graf Bros.*, 19 B.R. 269 (Bankr. D. Me. 1982). Section 1112(b) does not apply to Chapter 9 cases.

100. See *In re Public Serv. Co.*, 89 B.R. 1014, 1018-19 (Bankr. D.N.H. 1988).

estate will pay their fees. However, if the prepetition committee's efforts substantially contribute to the debtor's reorganization, the committee's fees and expenses may be reimbursed from the estate.¹⁰¹ Moreover, an organized group of creditors may be able to pressure the debtor into financing the committee's activities, particularly in developing a consensual out-of-court reorganization plan.

When forming a prepetition committee, creditors should be careful to define its constituency. On the one hand, those forming the committee may want to limit its representation to a particular subset of creditors, such as bondholders or trade creditors. This allows the committee to limit its potential liability for breaches of fiduciary duty to creditors as a whole.¹⁰² On the other hand, with a broad constituency, the committee may have more clout in negotiations with the debtor, and it may be more likely to be appointed to serve as the official committee when, and if, the debtor's Chapter 11 case is commenced.

101. Section 503(b)(3) provides an administrative priority for: the actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by --

....
(D) a . . . committee representing creditors or equity security holders other than a committee appointed under section 1102 of [Title 11], in making a substantial contribution in a case under chapter 9 or 11 of [Title 11].

11 U.S.C. § 503(b)(3).

Section 503(b)(4) also provides an administrative priority for: reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under [Title 11], and reimbursement for actual, necessary expenses incurred by such attorney or accountant.

Id. § 503(b)(4).

Pursuant to § 503(b)(3) and (4), it appears that prepetition committees may be reimbursed for their expenses, and their professionals may be compensated, if the committees make a "substantial contribution" to the reorganization process. See *In re Medical Gen., Inc.*, 17 B.R. 13, 14 (Bankr. D. Minn. 1981) (fees allowed when prepetition services contributed to eventual confirmation of plan); cf. *In re Jensen-Farley Pictures, Inc.*, 47 B.R. 557 (Bankr. D. Utah 1985) (denying compensation for professionals' fees incurred by prepetition committee due to committee's failure to show it provided any benefit to the estate). In particular, reimbursement may be warranted when a prepetition committee participates in the development of a "prepackaged" plan of reorganization, which enables the administrative expenses during the case itself to be reduced dramatically.

102. See *infra* notes 234-249 and accompanying text.

*2. Appointment of a Prepetition Committee as the
Official Committee*

While official committees ordinarily are selected by the U.S. Trustee after the commencement of the case, section 1102(b)(1) provides that a committee may consist of "the members of a committee organized by creditors before the commencement of the case under this chapter, if such committee was fairly chosen and is representative of the different kinds of claims to be represented."¹⁰³ As with the appointment of a new committee, the U.S. Trustee initially decides if a prepetition committee should continue to serve during a case. The U.S. Trustee's decision, however, is subject to extensive judicial review pursuant to the procedures set forth in Rule 2007 of the Federal Rules of Bankruptcy Procedure. Rule 2007 provides, *inter alia*, that upon motion by a party in interest, the court shall determine whether a prepetition committee adequately represents that committee's postpetition constituency.¹⁰⁴ A court "may" so find if the committee was

103. 11 U.S.C. § 1102(b)(1).

104. FED. R. BANKR. P. 2007:

(a) *Motion to Review Appointment.* If a committee appointed by the United States trustee pursuant to § 1102(a) of the Code consists of the members of a committee organized by creditors before the commencement of a Chapter 9 or Chapter 11 case, on motion of a party in interest and after a hearing on notice to the United States trustee and other entities as the court may direct, the court may determine whether the appointment of the committee satisfies the requirements of § 1102(b)(1) of the Code.

(b) *Selection of Members of Committee.* The court may find that a committee organized by unsecured creditors before the commencement of a Chapter 9 or Chapter 11 case was fairly chosen if:

(1) it was selected by a majority in number and amount of claims of unsecured creditors who may vote under § 702(a) of the Code and were present in person or represented at a meeting of which all creditors having unsecured claims of over \$1,000 or the 100 unsecured creditors having the largest claims had at least five days notice in writing, and of which meeting written minutes reporting the names of the creditors present or represented and voting and the amounts of their claims were kept and are available for inspection;

(2) all proxies voted at the meeting for the elected committee were solicited pursuant to Rule 2006 and the lists and statements required by subdivision (c) thereof have been transmitted to the United States trustee; and

(3) the organization of the committee was in all other respects fair and proper.

(c) *Failure to Comply With Requirements for Appointment.* After a hearing on notice pursuant to subdivision (a) of this rule, the court shall direct the United States trustee to vacate the appointment of the committee and may order other appropriate action if the court finds that such appointment failed

selected at a meeting for which notice was given to the debtor's 100 largest unsecured creditors or to all unsecured creditors holding claims greater than \$1,000, if all proxies were solicited in accordance with Rule 2006 of the Federal Rules of Bankruptcy Procedure, and if the organization of the committee was in all other respects fair and proper.

It seems strange that while, as discussed further herein, the U.S. Trustee generally has broad discretion in appointing a new creditors' committee postpetition,¹⁰⁵ the U.S. Trustee must nonetheless conduct a searching inquiry into the formation of any prepetition committee that will continue as the official committee during the course of the case. Unfortunately, no court has yet to apply Rule 2007 in a published opinion, so it is unclear what effect this anomaly will have. When a court does attempt to apply Rule 2007, the court will have to consider whether Rule 2007 has any real effect after the repeal in 1986 of former section 1102(c), which provided a means for the judicial challenge of committee appointments.¹⁰⁶ The court also should consider whether Rule 2007 violates 28 U.S.C. § 2075, which requires that the Federal Rules of Bankruptcy Procedure "shall not abridge, enlarge, or modify any substantive right."¹⁰⁷ While the Bankruptcy Rules often establish notice and other procedural requirements, Rule 2007 attempts to define substantive terms in the Code regarding the constitution of a "fairly chosen" committee. After considering these issues, a court may conclude that the U.S. Trustee's decision to continue a prepetition committee should not be subject to any more stringent review than the U.S. Trustee's decision to appoint a new creditors' committee. To obviate the issue, the U.S. Trustee simply may choose to appoint a new committee consisting generally of the members of the prepetition committee.

to satisfy the requirement of § 1102(b)(1) of the Code.

It is questionable whether Bankruptcy Code § 105(a) authorizes a court to conduct sua sponte a hearing pursuant to Rule 2007(c). See 11 U.S.C. § 105(a).

105. See *infra* notes 151-164 and accompanying text.

106. Former § 1102(c) provided:

On request of a party in interest and after notice and a hearing, the court may change the membership or the size of a committee appointed under subsection (a) of this section if the membership of such committee is not representative of the different kinds of claims or interests to be represented.

11 U.S.C. § 1102(c) (1982) (repealed 1986). But see FED. R. BANKR. P. 2020, which continues to provide a means for challenging "any act or failure to act by the United States trustee."

107. 28 U.S.C. § 2075 (1988); see also FED. R. BANKR. P. 9030 (providing that the Federal Rules of Bankruptcy Procedure "shall not be construed to extend or limit the jurisdiction of the courts or the venue of any matters therein"); *In re Roberts*, 68 B.R. 1004, 1006-07 (Bankr. E.D. Mich. 1987) (finding FED. R. BANKR. P. 4001(b) to be invalid due to conflict with 11 U.S.C. § 362(e)).

*C. Multiple Committees**1. Generally*

While section 1102 generally calls for the appointment of a single creditors' committee, Congress recognized that, particularly in large cases, a single committee may not be able to represent adequately the interests of all unsecured creditors.¹⁰⁸ Accordingly, section 1102(a)(1) authorizes the U.S. Trustee to "appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate," such as when more than one distinct group of unsecured creditors exists.¹⁰⁹ In addition, section 1102(a)(2) specifically authorizes the court to order the appointment of additional committees in the event that the U.S. Trustee does not do so. Section 1102(a)(2) states that "[o]n the request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders. The United States trustee shall appoint any such committee."¹¹⁰

While there are advantages to appointing additional committees, these benefits must be weighed against the often significant costs and complexities resulting therefrom. Because an additional creditors' committee appointed pursuant to section 1102(a) appears to enjoy the same rights as the first duly-appointed official creditors' committee,¹¹¹ such a committee can serve as an effective advocate for its specific constituency of creditors. On the other hand, multiple committees can complicate negotiations, delay the reorganization process, and create additional administrative expenses to the

108. As noted in the Senate Report to the 1978 Act, "In the case of a public company there are likely to be several committees, each representing a different class of security holders . . ." S. REP. NO. 989, 95th Cong., 2d Sess. 114 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5900.

109. 11 U.S.C. § 1102(a)(1). For example, it may be appropriate to appoint separate committees for bank, trade, and subordinated debt holders based on their different expectations and relationships with the debtor.

110. *Id.* § 1102(a)(2). It appears that a Chapter 11 debtor may be a party in interest for purposes of requesting the appointment of an additional creditors' committee. *See In re The Bible Speaks*, 69 B.R. 72, 73 (Bankr. D. Mass. 1986).

111. *See In re Wilnor Drilling, Inc.*, 29 B.R. 727, 730-31 (Bankr. S.D. Ill. 1982) (holding that fees and expenses of special investors' committee were entitled to same administrative priority as those of the official creditors' committee); *see also* Blain & O'Gawa, *supra* note 2, at 592 (citing *In re Evans Prods. Co.*, 58 B.R. 572, 575 (Bankr. S.D. Fla. 1985)). *But see In re Cumberland Farms, Inc.*, 142 B.R. 593, 594-96 (Bankr. D. Mass. 1992) (declining to allow "Lenders Committee" representing the interests of 77 secured creditors to employ counsel at estate's expense, on the grounds that counsel's effort would be duplicative of that of the official committee and that any benefit to the estate would be outweighed by the cost).

debtor's estate, particularly in terms of higher professional fees.¹¹² Some courts, however, have admonished that cost alone should not deprive unrepresented creditors of a separate committee.¹¹³ In addition, courts are understandably reluctant to order the appointment of additional committees late in the case, particularly where a plan of reorganization is on file and proceeding toward confirmation.¹¹⁴ Thus, despite the legislative history that seems to encourage the appointment of multiple committees in large cases, "Bankruptcy Courts generally have been reluctant to [order the appointment of] separate committees of unsecured creditors notwithstanding the diverse and sometimes conflicting interest of such creditors in the context of a Chapter 11 proceeding."¹¹⁵ This is particularly troublesome where creditors on the committee have not only different financial motivations, but also claims entitled to different legal priorities. For example, employee claims might be entitled to priority under Bankruptcy Code section 507(a)(3), whereas nonpecuniary loss penalty claims might be subordinated.¹¹⁶ In certain cases, the problem can be severe, such as where both

112. See *Cumberland Farms*, 142 B.R. at 595-96; *In re Sharon Steel Corp.*, 100 B.R. 767, 778-79 (Bankr. W.D. Pa. 1989); *In re Texaco*, 79 B.R. at 567; *Alberto v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 68 B.R. 155, 160 (Bankr. S.D.N.Y. 1986), *appeal dismissed*, 824 F.2d 176 (2d Cir. 1987); *In re Beker Phosphate Corp.*, 55 B.R. 945, 949 (Bankr. S.D.N.Y. 1985); *In re Shaffer-Gordon Assocs.*, 40 B.R. 956, 958 (Bankr. E.D. Pa. 1984).

113. See *In re Hills Stores Co.*, 137 B.R. 4, 6 (Bankr. S.D.N.Y. 1992) ("The potential added cost is not sufficient in itself to deprive the creditors of the formation of an additional committee if one is otherwise appropriate."); *In re Drexel Burnham Lambert Group, Inc.*, 118 B.R. 209, 211 (Bankr. S.D.N.Y. 1990); *In re McLean Indus.*, 70 B.R. at 860 ("Cost alone cannot, and should not, deprive public debt and security holders of representation.").

114. See *Manville Corp. v. Equity Sec. Holders Comm.* (*In re Johns-Manville Corp.*), 801 F.2d 60, 62 (2d Cir. 1986); *Ad Hoc Bondholders Group v. Interco Inc.* (*In re Interco Inc.*), 141 B.R. 422 (Bankr. E.D. Mo. 1992); *In re Eastern Me. Elec. Coop.*, 121 B.R. 917 (Bankr. D. Me. 1990) (holding that it was too late to form additional committees when three competing plans had already been proposed); *In re Public Serv. Co.*, 116 B.R. 344, 345 (Bankr. D.N.H. 1990) (bankruptcy court would not appoint additional committee of equity holders when disclosure statement had already been approved and authorization of additional committee so late in reorganization process would result in unwarranted delay and expense); *In re McLean Indus.*, 70 B.R. at 862-63.

115. *In re Public Serv. Co.*, 89 B.R. 1014, 1020 (Bankr. D.N.H. 1988) (citing *In re Shaffer-Gordon Assocs.*, 40 B.R. 956 (Bankr. E.D. Pa. 1984); *In re Saxon Indus.*, 39 B.R. 945 (Bankr. S.D.N.Y. 1984); *In re Baldwin-United Corp.*, 45 B.R. 375 (Bankr. S.D. Ohio 1983)); see also *In re Hills Stores Co.*, 137 B.R. at 5-6 (court generally will not appoint separate committees except in very large cases).

116. See 11 U.S.C. § 726(a)(4) (1988); *In re Quality Sign Co.*, 51 B.R. 351, 353 (Bankr. S.D. Ind. 1985) (subordinating tax penalty claim).

senior and subordinated debenture holders sit on the committee and the reorganization value of the debtor only covers the senior debt.

Because of the statutorily created dual role played by the courts and the U.S. Trustees in appointing additional creditors' committees, it is somewhat unclear how much weight must be given to a U.S. Trustee's affirmative decision to appoint multiple committees under section 1102(a)(1). In light of the "deems appropriate" language employed in section 1102(a)(1), it appears that, absent a court order requiring multiple committees entered pursuant to section 1102(a)(2), the U.S. Trustee should have broad discretion in deciding whether to appoint additional committees.¹¹⁷ In *In re Sharon Steel Corp.*,¹¹⁸ however, the court vacated the U.S. Trustee's decision to appoint a second committee comprised of debenture holders, holding that the appointment of multiple committees was an "extraordinary remedy" and that there had been an insufficient showing of the benefits of doing so.¹¹⁹ Thus, despite the apparently broad language of section 1102(a)(1) to the contrary, the *Sharon Steel* court seemed to take much of the discretion away from the U.S. Trustee by making the question whether to appoint multiple committees a question of law for the courts to decide.

Sharon Steel appears to be the minority view with respect to the review of the U.S. Trustee's decisions made pursuant to section 1102(a)(1). However, the opinion is consistent with the majority view in respect to the application of section 1102(a)(2), which permits the court to order the appointment of an additional committee notwithstanding any contrary decision by the U.S. Trustee. When a party in interest objects to the U.S. Trustee's decision *not* to appoint a committee, or when the U.S. Trustee simply takes no action, the majority view appears to be that the court need not give the U.S. Trustee's position much, if any, weight or deference in deciding whether to order the appointment of an additional committee pursuant to section 1102(a)(2).¹²⁰ Thus, unlike the U.S. Trustee's appointment of individual committee members under section 1102(a)(1), most courts have agreed that the decision whether to order the appointment of an additional committee under section 1102(a)(2) is a question of law subject to a court's de novo review of the particular facts and circumstances warranting such appointment.¹²¹ Generally, in determining whether to

117. See *In re First RepublicBank*, 95 B.R. 58, 60-61 (Bankr. N.D. Tex. 1988) (U.S. Trustee's decision to appoint an additional creditors' committee reviewed under "arbitrary and capricious" standard).

118. 100 B.R. 767 (Bankr. W.D. Pa. 1989).

119. *Id.* at 778-79.

120. For example, in the *Texaco* case, Judge Schwartzberg held that "the court must arrive at its own judgment, although the court may consider reasons advanced by the United States Trustee in the event that such a request was previously submitted to the United States Trustee." *In re Texaco Inc.*, 79 B.R. 560, 566 (Bankr. S.D.N.Y. 1987).

121. See *Sharon Steel*, 100 B.R. at 776; *In re Texaco Inc.*, 79 B.R. at 566; see also

order a new committee to be formed, a court will consider factors such "as the ability of the committee to function, the nature of the case and the standing and desires of the various constituencies."¹²² However, as noted in the *Sharon Steel* case, most courts should not, and indeed will not, appoint an additional creditors' committee absent a clear need, including evidence that the new committee will not merely duplicate the services already being performed by an existing committee.

2. Specific Types of Additional Committees

a. Generally

Besides committees for the holders of equity securities and certain retiree benefits, the Bankruptcy Code does not identify what other types of additional committees may be appointed during a case. In that respect, the courts and U.S. Trustees have been creative at times, establishing committees to meet the special needs of a case.¹²³ The paragraphs that follow discuss the most commonly appointed kinds of additional committees.

b. Equity Committees

Section 1102(a)(1) authorizes the U.S. Trustee to appoint a committee of equity security holders as it "deems appropriate." As a general matter, equity committees have rights and duties similar to those of creditors' committees, such as the right to employ professionals, but equity committees are far less important because equity holders often have a nominal stake in the outcome of the case. To the extent there is value for equity, courts generally appear to believe—rightly or wrongly—that the debtor should be

In re Public Serv. Co., 89 B.R. at 1021 n.9 (contrasting the U.S. Trustee's broad discretionary authority in initially appointing a committee against the court's power to review changes to the committee structure during the course of a case).

In *Texaco*, the court also considered the interesting question whether a party desiring the appointment of an additional committee must first make a demand upon the U.S. Trustee to appoint one. Judge Schwartzberg held that because § 1102(a)(2) does not create a standard for reviewing the U.S. Trustee's action, but rather grounds for a judicial determination regarding the need for additional committees, there is no administrative exhaustion requirement. 79 B.R. at 566; accord, *In re McLean Indus.*, 70 B.R. at 857-58; cf. *In re First RepublicBank*, 95 B.R. at 60 (no administrative exhaustion requirement for challenging individual committee appointments).

122. *In re Interco*, 141 B.R. at 424 (citing *In re Hills Stores*, 137 B.R. at 5-6; *In re McLean Indus.*, 70 B.R. at 860).

123. See, e.g., *In re A.H. Robins Co.*, 65 B.R. at 163 (committee appointed to represent Dalkon Shield victims with claims against the debtor); *Johns-Manville Corp. v. Asbestos Litig. Group (In re Johns-Manville Corp.)*, 26 B.R. 420 (Bankr. S.D.N.Y. 1983) (committee appointed to represent asbestos victims with claims against the debtor).

looking out for equity's interests, and thus an equity committee rarely is necessary. The role of equity committees in the bankruptcy process is beyond the scope of this Article.

c. Trade Committees

Because the U.S. Trustee ordinarily will select a debtor's seven largest unsecured creditors to serve on a creditors' committee,¹²⁴ trade creditors are often excluded in favor of large institutional bondholders. Thus, appointing a committee based upon size alone may not adequately represent all unsecured creditors. Often, the interests of trade creditors will differ significantly from those of institutional creditors who do not conduct business with the debtor on a day-to-day basis and who may not be particularly interested in the debtor's reorganization. Similarly, small trade vendors may be more interested in a plan that will give them prompt cash distributions at less than one hundred cents on the dollar, rather than receiving securities with higher theoretical returns over longer periods of time. While the U.S. Trustee may account for the interests of trade creditors by appointing a larger official committee or by exercising its discretion to appoint persons other than the seven largest creditors,¹²⁵ the appointment of a separate trade committee may also provide an alternative avenue for trade representation.¹²⁶

d. Secured Creditors' Committees

Although unsecured and undersecured creditors may sit on official creditors' committees absent evidence of an actual conflict,¹²⁷ the requirement of section 1102(a)(1) that the official committee contain "unsecured" creditors means that fully secured creditors may not be members of such committees.¹²⁸ Section 1102(a), however, authorizes the appointment of "additional committees of creditors" without reference to secured or unsecured status.¹²⁹ At present, the case law is unclear whether secured creditors' committees may be appointed, though the majority view does

124. See 11 U.S.C. § 1102(b)(1) (1988).

125. See *supra* notes 35-37 and accompanying text.

126. For example, the court in the *Revco* case appointed a separate trade committee due to the presence of large institutional creditors. See *In re Revco D.S., Inc.*, 118 B.R. 464 (Bankr. N.D. Ohio 1990).

127. See *supra* notes 79-83 and accompanying text.

128. See 11 U.S.C. § 1102(a)(1) (1988) (stating that the official committee shall consist of holders of "unsecured claims"); see also *supra* note 79.

129. See 11 U.S.C. § 1102(a)(1) & (2).

permit them in limited circumstances.¹³⁰ Of course, given that secured creditors generally have interests in discrete items of collateral, their interests often do not align well with other holders of secured claims. Moreover, with the exception of relatively small secured creditors, such as the typical holders of statutory liens, secured creditors often tend to be financial institutions that generally do not need (or want) an official committee to represent their interests. Nevertheless, a secured creditors' committee may be useful in some cases such as those with widely held secured debt.¹³¹

e. Employee Committees

Both current and former employees of the debtor are playing increasingly important roles in the bankruptcy process. This is the result of a number of factors, including increased employee sophistication regarding their rights under the bankruptcy laws and a dramatic growth in the number of employee claims due to an expansion of employee benefit programs and rights of action against their employer. If the court does not authorize the immediate payment of priority prepetition wage claims and employees remain creditors of the estate,¹³² there is nothing in the Bankruptcy Code that prohibits the appointment of a special creditors' committee to represent the employees' interests. With respect to holders of retiree benefits, the appointment of a separate committee may sometimes be required as set forth

130. Compare *In re Wekiva Dev. Corp.*, 22 B.R. 301 (Bankr. M.D. Fla. 1982) (declining to appoint secured creditors' committee) with *In re Diversified Capital Corp.*, 89 B.R. 826 (Bankr. C.D. Cal. 1988) (holding that secured creditors' committee could be appointed after plan confirmation but before plan was consummated); *In re Fidelity Am. Mortgage Co.*, Nos. 81-00386G to 81-00388G, 1981 WL 2100 (Bankr. E.D. Pa. July 29, 1981) (authorizing appointment of secured noteholders' committee); cf. *In re Combustion Equip. Assocs.*, 16 B.R. 354 (Bankr. S.D.N.Y. 1982) (noting without comment the existence of secured creditors' committee); *In re Cumberland Farms*, 142 B.R. at 594-96 (recognizing secured creditors' committee, but not permitting it to employ counsel at the expense of the estate). Frequently, secured creditors will be entitled to assert claims for attorneys' and other professionals' fees against their collateral. See 11 U.S.C. § 506(b). Thus, groups of secured creditors usually are content to function as unofficial committees.

131. See *In re Cumberland Farms*, 142 B.R. at 594 (involving a secured creditors' committee which represented 77 secured lenders); *In re Fidelity Am. Mortgage Co.*, 1981 WL 2100.

132. See 11 U.S.C. § 507(a)(3); see also *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 178-79 (Bankr. S.D.N.Y. 1989) (denying interim payment of priority wages to certain striking and furloughed employees because such payment was not necessary to the reorganization effort).

below.¹³³

Courts have disagreed as to the utility of employee committees in particular cases.¹³⁴ Given the special protections for employee rights under the Bankruptcy Code,¹³⁵ it appears that employee committees generally should not be necessary. Nevertheless, the decision to appoint an employee committee should be made on a case-by-case basis based upon the same factors used in determining whether to appoint other special committees. For example, when there are several distinct employee groups asserting claims, a committee representing their interests may prove particularly useful.

f. Retiree Committees

A specific type of employee-related committee identified in the Bankruptcy Code is one appointed to represent the interests of retired workers. Section 1114 of the Bankruptcy Code provides that a labor union generally shall act as the "authorized representative" of persons who are entitled to receive retirement benefits from a Chapter 11 debtor pursuant to a collective bargaining agreement.¹³⁶ Under section 1114(c)(2) and (d), however, the court (rather than the U.S. Trustee) shall, after notice and a hearing, appoint a committee to represent retirees in the event that the union declines to serve as a representative, the retirees are not represented by a union, or the court determines "that different representation of such persons is appropriate."¹³⁷ A committee appointed pursuant to section 1114 "shall have the same rights, powers, and duties as committees appointed under sections 1102 and 1103" for the limited purpose of representing the rights of retired persons in the case.¹³⁸

133. See 11 U.S.C. § 1114(b)(2) & (d).

134. Compare *In re Mansfield Ferrous Castings, Inc.*, 96 B.R. 779 (Bankr. N.D. Ohio 1988) (authorizing appointment of committee to represent employee creditors) and *United Steelworkers v. Lamp (In re Mesta Mach. Co.)*, 67 B.R. 151, 156 (Bankr. W.D. Pa. 1986) with *In re Salant Corp.*, 53 B.R. 158, 161 (Bankr. S.D.N.Y. 1985) (declining to authorize appointment of employee committee).

135. See, e.g., 11 U.S.C. § 507(a)(3) (priority for certain unpaid wage claims); *id.* § 507(a)(4) (priority for certain contributions to employee benefit plans); *id.* § 1113 (special provisions for the rejection of collective bargaining agreements).

136. *Id.* § 1114(c)(1).

137. See *id.* § 1114(c)(2), (d). Frequently the union will have an actual conflict between its duties to protect jobs for existing workers and benefits for retired workers. A national union may also be more concerned with its own national policy than the interests of retirees in a particular case. In these circumstances, different representation should be required.

138. *Id.* § 1114(b)(2).

D. Appointing a Single Committee for Multiple Debtors

The converse of the question whether multiple committees should be appointed in a single-debtor case is whether a single creditors' committee may be appointed in multiple-debtor cases. At one extreme, some courts have held that separate committees must be appointed for each related debtor entity.¹³⁹ While not going quite that far, Bankruptcy Judge Bufford of the Central District of California has adopted a "presumption" for two or more related cases that, absent substantive consolidation, there must be a separate creditors' committee for each debtor entity under any of the following circumstances:

- (a) Where the debtors' creditors have dealt with such debtors as an economic unit (which may be reflected in guarantees and subordination agreements);
- (b) Where there is substantial creditor overlap;
- (c) Where the affairs of the respective debtors (as reflected in interdebtor accounts, jointly owned assets, guarantees, subordination agreements, or shared officers, directors, or owners) appear to be substantially entangled;
- (d) Where assets have been transferred from one debtor to another in transactions that are not at arms length; or
- (e) Where piercing of the corporate veil of one of the debtors is necessary or advisable to protect the rights of another debtor's creditors.¹⁴⁰

One might wonder whether these grounds also could be used to justify the appointment of a *single* creditors' committee, as each seems to indicate the need for (or the desirability of) substantive consolidation and, thus, only one creditors' committee. It is unclear whether multiple committees, if appointed, should be merged (or perhaps eliminated) in the event of substantive consolidation.

Other courts have expressed concern over appointing separate committees for related debtors absent a clear need.¹⁴¹ These courts have

139. See, e.g., *In re White Motor Credit Corp.*, 18 B.R. 720 (Bankr. N.D. Ohio 1980).

140. *In re Lee*, 94 B.R. 172, 180 (Bankr. C.D. Cal. 1988); see *Gill v. Sierra Pac. Constr., Inc. (In re Parkway Calabasas, Ltd.)*, 89 B.R. 832, 835 n.3 (Bankr. C.D. Cal. 1988).

141. See *In re Orfa Corp.*, 121 B.R. 294 (Bankr. E.D. Pa. 1990) (rejecting per se rule that separate committees are needed for related debtors); *In re McLean Indus.*, 70 B.R. 852, 862 (Bankr. S.D.N.Y. 1988) (noting that the cost of maintaining separate committees "could be extreme"); *In re Salant Corp.*, 53 B.R. 158, 161 (Bankr. S.D.N.Y. 1985).

been motivated by the desire to avoid "the additional and unnecessary administrative costs that would result if another committee and a potential enclave of additional professionals [are] appointed."¹⁴² Given the potential expense and administrative problems associated with multiple committees, it would seem that the better practice would be to appoint a single creditors' committee in most cases, and to rely upon such techniques as employing special counsel, adopting recusal rules, or establishing special subcommittees to deal with situations in which conflicts among the estates arise.¹⁴³

E. Unofficial Committees During the Course of the Case

A group of creditors that is dissatisfied with the existing committee structure, or that desires to enhance its influence over the reorganization process, may form an unofficial committee during the course of a case. Although the Code does not provide for unofficial committees, nothing in the Code prevents them from forming, retaining counsel and other professionals, and seeking reimbursement for expenses to the extent they make a substantial contribution to the case, as permitted by section 503(b) of the Code. Unofficial committee members may have their expenses reimbursed if they meet the requirements of section 503(b)(3)(D), while their professionals' fees and expenses may be reimbursed if they meet the requirements of section 503(b)(4).¹⁴⁴

IV. ALTERING COMPOSITION OF THE COMMITTEE

A. Generally

No issue involving creditors' committees has been the subject of as much concern as the ability to alter the composition of a committee. Unfortunately, no other body of law governing creditors' committees appears to be in such a current state of disarray. With almost no guidance from Congress or the appellate courts, the bankruptcy courts have been left to fashion rules regarding the removal and addition of committee members. As a consequence, the case law does not represent a seamless web, but rather more of a disjointed patchwork of decisions that cannot be reconciled easily. The discussion that follows attempts to identify the few relatively consistent themes in the case law.

Challenges regarding a committee's membership generally fall within one of two categories: (1) that the committee should be expanded to include

142. *In re Orfa Corp.*, 121 B.R. at 299.

143. See, e.g., *In re Vermont Real Estate Inv. Trust*, 20 B.R. 33 (Bankr. D. Vt. 1982) (recognizing recusal as a means to eliminate conflict of interest problems).

144. See *In re Hills Stores Co.*, 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1988).

representatives of particular interests; and (2) that one or more members of the existing committee should be removed because they do not satisfy the standards set by section 1102 for one or more of the previously stated reasons. Prior to the repeal of section 1102(c) in 1986, a party in interest could ask the court to change the membership of a creditors' committee by bringing a motion pursuant to that section.¹⁴⁵ When Congress took the appointment power away from the courts and placed it in the hands of the U.S. Trustee, however, it failed to provide any express mechanism empowering anyone, including the U.S. Trustee, to change the composition of the committee;¹⁴⁶ nor did Congress specify a means for challenging the U.S. Trustee's initial decisions to appoint, or not to appoint, particular creditors to a committee.

While the law is by no means certain, it appears that the proper method for requesting a change in committee membership is by bringing a motion pursuant to Rule 2020 of the Federal Rules of Bankruptcy Procedure.¹⁴⁷ Rule 2020, however, is merely a procedural device to challenge the U.S. Trustee's actions, stating that such challenges are to be treated as contested matters under Rule 9014. The rule does not confer any substantive rights, nor does it establish an appropriate standard of review. Indeed, as discussed below, it is unclear what standard a court will employ in reviewing the U.S. Trustee's decisions to appoint or remove committee members, and whether, assuming a change in membership is warranted, the court will be willing to undertake such action on its own.¹⁴⁸

One point is clear: a motion to challenge the U.S. Trustee's initial appointment of members to an official committee should be brought as soon as possible after the committee is formed. Similarly, a motion to alter the membership of a committee during the course of a case should be made as soon as the moving party becomes aware of the circumstances justifying

145. See *In re Gates Eng'g*, 104 B.R. 653, 654 (Bankr. D. Del. 1989). Prior to its repeal, former § 1102(c) provided that:

On request of a party in interest and after notice and a hearing, the court may change the membership or the size of a committee appointed under subsection (a) of this section if the membership of such committee is not representative of the different kinds of claims or interests to be represented.

11 U.S.C. § 1102(c) (1982) (repealed by Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 221(2), 100 Stat. 3088, 3101).

146. See *In re Public Serv. Co.*, 89 B.R. 1014, 1020-21 (Bankr. D.N.H. 1988).

147. Rule 2020 provides, "A proceeding to contest any act or failure to act by the United States Trustee is governed by Rule 9014." FED. R. BANKR. P. 2020. Rule 9014, in turn, governs the procedures applicable to contested matters. See FED. R. BANKR. P. 9014.

148. See *In re Columbia Gas Sys., Inc.*, 133 B.R. 174, 176 (Bankr. D. Del. 1991).

such a change. Otherwise, the court may find the motion to be untimely because the committee already may have taken significant action in the case, such as retaining professionals, developing and negotiating reorganization strategies, or filing a plan and disclosure statement with the court.¹⁴⁹

While it may be good practice to bring any concerns about committee membership to the attention of the U.S. Trustee first, there is no administrative exhaustion requirement.¹⁵⁰ Thus, a party in interest seeking to alter a committee's membership may bring a motion without first requesting the U.S. Trustee to act.

*B. Standard of Review for Challenging the U.S. Trustee's
Appointment Decisions*

As discussed above, section 1102 provides that an official creditors' committee must consist of persons who are representative of the committee's constituency. Also, members must either hold unsecured claims against the estate or, in some cases, represent persons that hold such claims against the estate. Because compliance with section 1102 is a question of both fact and law, a court ordinarily would consider such a matter *de novo*, relying upon its own fact-finding and interpretations of the appropriate legal standards. However, the U.S. Trustee's role in committee selection has created much controversy regarding the court's power to determine whether the requirements of section 1102 have been satisfied and, particularly, whether the

149. See *Van Arsdale v. Clemo*, 825 F.2d 794 (4th Cir. 1987) (holding motion to challenge committee appointments untimely when brought seven weeks after appointment, by which time important decisions were made on such issues as appointment of committee attorneys and formulation of negotiation strategy); see also *In re Drexel Burnham Lambert Group, Inc.*, 118 B.R. 209, 211 (Bankr. S.D.N.Y. 1990) ("A motion under section 1102 should be made promptly."); *In re Public Serv. Co.*, 116 B.R. 344, 345 (Bankr. D.N.H. 1990) (party requesting appointment of new committee should not delay in making such a request).

150. As stated by the court in *In re First RepublicBank Corp.*:

The United States trustee has not provided for administrative review of its committee membership decisions. Administrative review would be cumbersome, burdensome, wasteful and unnecessary given the court's authority under § 105(a). Under § 105(a) this court may on motion of a party in interest or on its own motion review the United States trustee's decision on the question of committee membership to determine if the trustee acted arbitrarily and capriciously.

95 B.R. 58, 60 (Bankr. N.D. Tex. 1988) (citing *In re McLean Indus.*, 70 B.R. 852, 856-58 (Bankr. S.D.N.Y. 1988) (holding that exhaustion of administrative remedies not required)). Of course, routine administrative matters within the U.S. Trustee's jurisdiction generally should be brought first to the attention of the U.S. Trustee, not the court. See *id.*

court must defer to the U.S. Trustee's conclusions.

The cases generally adopt one of three different standards for reviewing the U.S. Trustee's appointment decisions: Total deference to the U.S. Trustee's appointment decisions, under which the court is precluded from taking any corrective action;¹⁵¹ partial deference to such decisions, under which the court will uphold the U.S. Trustee's decisions so long as they are reasonable and not arbitrary or capricious;¹⁵² and no deference to such decisions, under which the court reviews appointment decisions *de novo*.¹⁵³ The apparent trend among recently reported decisions appears to be toward partial deference. As discussed below, however, even the courts that have agreed to give the U.S. Trustee's decisions some deference have disagreed as to the precise terms of that standard.¹⁵⁴

Courts that follow the recent trend of partial deference generally rely upon the fact that, in appointing a creditors' committee, the U.S. Trustee is performing an administrative task similar to that of any executive branch official.¹⁵⁵ Although Congress's repeal of section 1102(c) transferred the

151. See *In re Hills Stores Co.*, 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992) ("While I may order the appointment of additional committees under § 1102(a)(2) of the Code, the statute no longer permits the addition or deletion of members of committees by the court . . .").

152. See *Locks v. United States Trustee*, 157 B.R. 89, 92 (W.D. Pa. 1993) (employing "abuse of discretion" standard); *In re Columbia Gas Sys., Inc.*, 133 B.R. 174 (holding that although a bankruptcy court cannot change the official committee membership by substituting its judgment for that of the U.S. Trustee, the court may review the U.S. Trustee's refusal to appoint a creditor to the committee under an abuse of discretion standard); *In re Gates Eng'g*, 104 B.R. 653, 654 (Bankr. D. Del. 1989) (finding the U.S. Trustee acted "appropriately" in excluding a creditor from the committee); *In re First RepublicBank*, 95 B.R. at 60 (requiring that the U.S. Trustee's appointment decisions be upheld unless "arbitrary and capricious"); *In re Public Serv. Co.*, 89 B.R. 1014, 1021 n.9 (Bankr. D.N.H. 1988) (characterizing the U.S. Trustee's initial appointment of a creditors' committee as an "administrative function"). Note that, as discussed *infra* notes 154-167 and accompanying text, the partial deference standard appears still to be in the development stage, and its application from case to case is not entirely consistent.

153. *In re Sharon Steel Corp.*, 100 B.R. 767, 786 (Bankr. W.D. Pa. 1989); *In re Texaco Inc.*, 79 B.R. 560 (Bankr. S.D.N.Y. 1987). In *Texaco*, Judge Schwartzberg reasoned that "the concept of adequate representation is a legal issue which must be resolved judicially," and, therefore, the U.S. Trustee's appointment decisions are entitled to no deference. 79 B.R. at 566 (following *In re McLean Indus.*, 70 B.R. at 859). "[T]he court must arrive at its own judgment, although the court may consider reasons advanced by the United States Trustee in the event that [a request to change the committee] was previously submitted to the United States Trustee." *Id.*

154. Note that the decision to appoint (or not to appoint) a particular committee member is final for purposes of appellate jurisdiction. *In re Amatex Corp.*, 755 F.2d 1034, 1041 (3d Cir. 1985).

155. See, e.g., *In re First RepublicBank*, 95 B.R. at 60 ("The United States trustee

principal authority to determine committee membership to the U.S. Trustee, the majority view is that the courts have retained their authority to review the U.S. Trustee's decisions as they would any other administrative act—specifically to determine whether the U.S. Trustee acted “arbitrarily and capriciously.”¹⁵⁶

Given that a number of courts treat the U.S. Trustee's appointment power as an administrative function, it is not surprising that at least two bankruptcy courts have held that the U.S. Trustee's Office is an “agency” within the scope of the Administrative Procedure Act (the “APA”).¹⁵⁷ The courts have disagreed, however, about the extent to which the APA governs the U.S. Trustee's actions. In *Sharon Steel*, the court interpreted section 554(a)(1) of the APA¹⁵⁸ as making that statute applicable only to those agency decisions where Congress has required an agency hearing to be held “on the record.”¹⁵⁹ Because the statutory language and legislative history of section 1102(a) are silent regarding whether the U.S. Trustee must hold a hearing when selecting committee members, the court concluded that no such hearing is required, and that the APA did not apply.¹⁶⁰ Accordingly, the *Sharon Steel* court held that the U.S. Trustee's appointments to a committee are subject to de novo review.¹⁶¹

While *Sharon Steel* is correct in holding that the U.S. Trustee need not conduct a formal hearing prior to appointing a committee, it does not follow that the U.S. Trustee's actions are entitled to no deference. As recognized by the court in *In re Vance*, section 706 of the APA¹⁶² provides that a court generally should defer to an agency's informal decision making unless it is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”¹⁶³ Thus, contrary to the holding in *Sharon Steel*, the existence of formal proceedings is not a prerequisite to according judicial deference to the U.S. Trustee's administrative decisions. Although *Vance* involved the U.S. Trustee's decision whether to conclude a section 341(a)

has administrative authority over committee membership.”) (citing H.R. REP. NO. 764, 99th Cong., 2d Sess. 28 (1986), reprinted in 1986 U.S.C.C.A.N. 5227, 5241).

156. *Id.*

157. Pub. L. No. 89-554, 80 Stat. 378 (1966) (codified as amended at 5 U.S.C. §§ 551-706 (1988)); see *In re Vance*, 120 B.R. 181, 186 (Bankr. N.D. Okla. 1990); *In re Sharon Steel Corp.*, 100 B.R. at 785; see also *In re Drexel Burnham Lambert Group, Inc.*, 118 B.R. 209, 211 n.1 (Bankr. S.D.N.Y. 1990) (suggesting, without deciding, that the APA may apply to committee appointment decisions).

158. 5 U.S.C. § 554(a)(1) (1988).

159. 100 B.R. at 785-86.

160. *Id.* at 786.

161. *Id.*

162. 5 U.S.C. § 706 (1988).

163. 120 B.R. 181, 195-96 (Bankr. N.D. Okla. 1990).

meeting of creditors, its interpretation of the APA also supports the application of the arbitrary and capricious standard to the U.S. Trustee's committee appointments.¹⁶⁴

C. Challenging the Committee's Composition During the Case

Even if there are no objections to the U.S. Trustee's appointments at the commencement of the case, during the course of a case it may be advisable to change the composition of the creditors' committee. Often, this is because a member resigns, a creditor seeks membership on the committee, or questions arise regarding an existing member's status as an adequate representative of the committee's constituency. For example, in the *America West Airlines* case,¹⁶⁵ Kawasaki, a large trade creditor, was included among the eight initial members of the official creditors' committee. About six months after Kawasaki's appointment to the committee, it loaned the debtor \$23 million in debtor in possession financing, secured by liens on substantially all of the debtor's assets. The debtor also assumed significant aircraft finance agreements with Kawasaki, potentially giving Kawasaki substantial administrative claims against the estate in the event of a default on the financing arrangement. In response to the concerns of other committee members that Kawasaki might be more interested in its secured and administrative priority claims than in the welfare of unsecured creditors generally, the U.S. Trustee removed Kawasaki from the committee. In upholding the U.S. Trustee's decision, the bankruptcy court applied an abuse of discretion standard, determining that the decision to remove Kawasaki was not arbitrary and capricious.¹⁶⁶ The *America West Airlines* decision is consistent with the emerging trend that, as with challenges to the U.S. Trustee's initial appointments to a creditors' committee, the removal or appointment of additional committee members during the course of the case is within the limited discretion of the U.S. Trustee.¹⁶⁷

164. Unfortunately, there have been few reported decisions demonstrating how the "arbitrary and capricious" standard applies in the bankruptcy context, or how it differs in application from de novo review. One example of arbitrary and capricious judgment on the part of the U.S. Trustee might be the failure to remove a committee member who has a clear conflict of interest. See *In re First Republic Bank*, 95 B.R. 58, 61 (Bankr. N.D. Tex. 1988). However, such a situation probably would lead to the same result under either standard of review. In practice, the distinction between the two standards may be analogous to the difference between the evidentiary standards of preponderance and clear and convincing—the difference being shades of gray rather than black and white.

165. *In re America W. Airlines*, 142 B.R. 901 (Bankr. D. Ariz. 1992).

166. *Id.* at 902-03.

167. See, e.g., *In re Wheeler Technology, Inc.*, 139 B.R. 235, 238-39 (Bankr. 9th

One of the most common grounds for seeking to remove a committee member is breach of duty, as claimed in *In re Public Service Co.* when the U.S. Trustee removed an uncooperative member of the committee at the request of various other committee members.¹⁶⁸ An actual conflict of interest, as cited in *America West*, is a second ground for removal. The most common ground for adding a member is that the existing committee does not adequately represent a particular type of creditor interest.¹⁶⁹

If a court determines that committee membership should be altered during the course of the case, what can the court do about it? If the issue involves an objection by a party in interest to an entity who is serving on the committee, the court should be able to order the U.S. Trustee to remove that individual; otherwise, judicial review would be meaningless. Conceivably, the court might be able to hold the U.S. Trustee in civil contempt until the creditor in question is removed. Unfortunately, the courts have not always been willing to provide a remedy in such cases.¹⁷⁰

An even more difficult question arises when the court believes that the creditors' committee needs additional representatives of a particular creditor group in order to satisfy section 1102's representativeness requirements. On the one extreme, some courts have held that section 105(a) gives the court the power to order the U.S. Trustee to appoint a specific creditor to a committee, even after the repeal of section 1102(c).¹⁷¹ On the other

Cir. 1992); *In re Columbia Gas Sys., Inc.*, 133 B.R. 174, 175-76 (Bankr. D. Del. 1991); *In re Public Serv. Co.*, 89 B.R. 1014, 1020-21 (Bankr. D.N.H. 1988).

168. *In re Public Serv. Co.*, 89 B.R. at 1019.

169. See, e.g., *id.* at 1020-21.

170. Compare, e.g., *In re Wheeler Technology, Inc.*, 139 B.R. at 238-39 (determining that a court cannot remove committee member as a sanction for violating an automatic stay); *In re Hills Stores Co.*, 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992) ("While I may order the appointment of additional committees under § 1102(a)(2) of the Code, the statute no longer permits the addition or deletion of members of committees by the court . . ."); *In re Drexel Burnham Lambert Group, Inc.*, 118 B.R. 209, 211 (Bankr. S.D.N.Y. 1990) (concluding that the issue of inadequate representation is to be resolved by creation of new committee, not by the court's appointment of new members to an existing committee); *In re Gates Eng'g*, 104 B.R. 653, 654 (Bankr. D. Del. 1989) with, e.g., *In re Texaco Inc.*, 79 B.R. 560, 566 (Bankr. S.D.N.Y. 1987) (holding that a court's power to alter committee membership survived the repeal of § 1102(c)); see also *In re American W. Airlines*, 142 B.R. 901 (U.S. Trustee has authority to remove committee members).

171. See, e.g., *In re Plabell Rubber Prods.*, 140 B.R. 179 (Bankr. N.D. Ohio 1992) (holding that court has power under § 105(a) to add labor union to committee); *In re Columbia Gas Sys., Inc.*, 133 B.R. at 176 (holding that, although bankruptcy court could not substitute its judgment for that of the U.S. Trustee regarding composition of official committee of unsecured creditors, court could review for abuse of discretion U.S. Trustee's refusal to appoint creditor and could order appropriate relief pursuant to §

extreme, some courts have held that the repeal of section 1102(c) eliminated the court's authority to order the appointment or removal of committee members in all circumstances. These courts have found that the only avenue available for a court faced with an unrepresentative committee is to order the appointment of an additional committee pursuant to section 1102(a)(2).¹⁷²

Taking what might be considered the "middle ground," the court in *In re Public Service Co.* held that it could order the U.S. Trustee to alter committee membership, but should, nevertheless, allow the U.S. Trustee discretion when deciding how to make an existing creditors' committee more representative.¹⁷³ The court reasoned that, if it had the authority to create a new committee, it certainly had the power to provide the "lesser" remedy of directing the U.S. Trustee to alter the composition of an existing creditors' committee.¹⁷⁴ The court was careful not to identify specific persons who should be added to the committee. Instead, the court ordered the U.S. Trustee to name two additional debenture holders, leaving the U.S. Trustee "full discretion in determining those individuals to be appointed."¹⁷⁵ Based on these authorities, one could conclude that a court's power to fashion an appropriate remedy is limited by the standard of review and the deference to be afforded the decision of the U.S. Trustee; the greater the deference, the less authority the court will have to order the U.S. Trustee to fashion a particular remedy.

D. Debtor's Standing to Seek to Alter the Committee's Membership

Since the creditors' committee represents only the interests of its constituents—the unsecured creditors—the question arises as to whether the debtor has standing to challenge the committee's composition. Section 1109(b), which gives the debtor and other parties in interest the right to be

105); *In re First RepublicBank*, 95 B.R. at 60.

172. See, e.g., *In re Hills Stores Co.*, 137 B.R. at 8; *In re Drexel Burnham Lambert Group, Inc.*, 118 B.R. 209. In *Drexel*, two joint liquidators of a British-based subsidiary of the debtor requested that the U.S. Trustee appoint them to the creditors' committee in the parent's case in New York. When the U.S. Trustee refused, the liquidators moved the bankruptcy court to order their appointment pursuant to § 1102(a). Relying on the plain language of § 1102(a), Bankruptcy Judge Buschman held that Congress had vested the authority to select members of a committee with the U.S. Trustee alone, and that "inadequate representation is to be addressed by a court through the creation of another committee." 118 B.R. at 211.

173. 89 B.R. at 1020-21.

174. *Id.* at 1021. It is by no means clear that this constitutes a "lesser" remedy.

175. *Id.* The court, however, did try to offer some helpful advice by encouraging the U.S. Trustee to appoint persons "with prior Chapter 11 experience if at all possible." *Id.*

heard "on any issue in a case," appears to grant the debtor the right to challenge committee membership. The courts have generally acknowledged this right.¹⁷⁶ Even if the debtor has the right to challenge the committee's makeup, one can certainly question its motives in doing so. The debtor often has an incentive to desire a weak creditors' committee; therefore, the debtor's real interest in seeking to alter the committee's membership may be to make it less effective. Nevertheless, the debtor's input may be useful when the debtor has information regarding a conflict of interest, or when the debtor and the committee have reached an impasse in negotiations.

V. THE COMMITTEE'S FUNCTIONS AND OPERATIONS

A. Powers and Duties of the Committee

1. General Committee Powers

As the official representative of the unsecured creditors, the creditors' committee must have the means available to it to have a significant impact on the course of the case. Recognizing this, Congress drafted the Bankruptcy Code to provide a long list of actions that a creditors' committee may take in fulfilling its fiduciary responsibilities to its constituents. Under section 1103, a creditors' committee may perform the following duties: select and authorize the employment of attorneys, accountants, or other professionals or agents to represent or perform services for the committee; "consult with the trustee or debtor in possession concerning the administration of the case"; investigate the debtor's financial condition, the operation of the debtor's business, and other matters relevant to the case or the formulation of a plan; participate in the formulation of a plan and advise its constituents regarding the desirability of a plan; "request the appointment of a trustee or examiner"; and "perform such other services as are in the interest of those represented."¹⁷⁷ Under section 1109(b), the committee also "may raise and may appear and be heard on any issue in a case."¹⁷⁸

Nevertheless, in spite of a committee's broad statutory powers, the authority of debtors-in-possession under section 1107 to carry out nearly all of the powers and duties of a trustee significantly tempers the committee's role in carrying out actions on behalf of the estate. The committee may make its views known, but it generally may not take over the day-to-day

176. See *In re Plant Specialties, Inc.*, 59 B.R. 1 (Bankr. W.D. La. 1986) (discussing debtors' rights to challenge appointment of person to committee who will be detrimental to reorganization efforts); *In re M.H. Corp.*, 30 B.R. 266, 267 (Bankr. S.D. Ohio 1983); see also *In re Penn-Dixie Indus.*, 9 B.R. 936, 938-39 (Bankr. S.D.N.Y. 1981) (stating that Chapter 11 debtor has standing to challenge composition of equity security holders' committee).

177. 11 U.S.C. § 1103 (1988).

178. *Id.* § 1109(b).

business operations of the debtor.¹⁷⁹ During the case, it is the debtor in possession who is the legal representative of the estate.¹⁸⁰ As the party charged principally with managing the affairs of the estate, the debtor in possession may assume and reject contracts,¹⁸¹ propose asset sales, enter into financing agreements, recover preferences and fraudulent conveyances, and sue on behalf of the estate. While the committee's opinions on these matters generally are entitled to some weight, particularly when there is little chance of equity retaining any interests in the case,¹⁸² the debtor's business judgment decisions usually are entitled to substantial deference. The creditors' committee, however, will still be busy carrying out its principal tasks of protecting and promoting the interests of its constituents and attempting to maximize any recoveries from the estate for them.¹⁸³ Moreover, as discussed further herein, the committee may sometimes be authorized to carry out certain functions generally done by the debtor when the debtor is unable or unwilling to perform such duties.

2. *Employment of Professionals*

As one of its first official acts, a creditors' committee typically will select its counsel and other professionals, such as accountants or financial advisors. An official creditors' committee, as well as any other committee appointed pursuant to section 1102, may, with the bankruptcy court's approval, employ one or more attorneys, accountants, or other professionals at the expense of the estate.¹⁸⁴ To do so, the committee must comply with

179. See *id.* § 1107(a) (debtor in possession generally has powers of a trustee); *id.* § 1108 (trustee is authorized to operate debtor's business); see also *In re Structurlite Plastics Corp.*, 91 B.R. 813, 819 (Bankr. S.D. Ohio 1988) ("[A] creditors' committee's functions do not include an involvement in the debtor in possession's day-to-day operations.").

180. See 11 U.S.C. §§ 323(a), 1107(a).

181. At least one court has held that a creditors' committee has standing under § 1109(b) to move to reject a collective bargaining agreement. *In re Parrot Packing Co.*, 42 B.R. 323, 328-30 (N.D. Ind. 1983). While unusual, this result is not surprising, especially because a collective bargaining agreement may be rejected as part of a creditors' plan of reorganization. See 11 U.S.C. § 1123(b)(2). Section 1113(a), however, generally allows only trustees and debtors-in-possession to reject collective bargaining agreements in Chapter 11 cases outside the context of a plan.

182. See *In re After Six, Inc.*, 154 B.R. 876, 882-83 (Bankr. E.D. Pa. 1993).

183. See *In re Lifschultz Fast Freight, Inc.*, 140 B.R. 482, 488-89 (Bankr. N.D. Ill. 1992) (stating that a creditors' committee is "entitled to represent its constituents by seeking to administer [the] estate in a manner different than that favored by the trustee"); *In re AKF Foods, Inc.*, 36 B.R. 288, 289 (Bankr. E.D.N.Y. 1984) (stating that creditors' committee "is to act as a watchdog on behalf of the larger body of creditors which it represents").

184. Section 1103(a) provides that:

Rule 2014 of the Federal Rules of Bankruptcy Procedure, which requires that an application be filed with the court and, except in cases under Chapter 9, be transmitted to the U.S. Trustee. The application must (1) set forth specific facts demonstrating the need for the employment, (2) identify the professional to be employed, (3) set forth the reasons why that professional was selected, (4) discuss the nature of the services to be rendered, (5) disclose any proposed arrangement for compensation, and (6) disclose any potential conflicts of interest, such as pre-existing relationships with the debtor or individual creditors.¹⁸⁵ The fact that the professional represents one or more creditors within the same class represented by the committee does not constitute a per se impermissible conflict barring employment by the committee.¹⁸⁶ Nevertheless, courts should be careful to ensure the professional's impartiality where an individual committee member's professional also acts on behalf of the committee.¹⁸⁷

At a scheduled meeting of a committee appointed under section 1102 of . . . title [11], at which a majority of the members of such committee are present, and with the court's approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.

11 U.S.C. § 1103(a); see *In re Sunshine Precious Metals, Inc.*, 142 B.R. 918, 921 (Bankr. D. Idaho 1992) (denying committee's application to employ accountant in part because of committee's failure to comply with § 1103(a)); see also *infra* notes 252-255. Similarly, § 328(a) provides, *inter alia*, "[A] committee appointed under section 1102 of . . . title [11], with the court's approval, may employ or authorize the employment of a professional person under [11 U.S.C. § 1103] . . . on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis."

11 U.S.C. § 328(a); cf. *In re Sunshine Precious Metals*, 142 B.R. at 920-21 (denying committee's application to employ accountant to investigate debtor's affairs, in part due to lack of showing of need); *In re Drexel Burnham Lambert Group, Inc.*, 140 B.R. 367 (Bankr. S.D.N.Y. 1992) (denying committee's motion to employ financial advisor for lack of sufficient information regarding the retention); *In re The Bible Speaks*, 67 B.R. 426 (Bankr. D. Mass. 1986) (denying committee's application to employ two co-counsel on the ground that the committee failed to demonstrate the need for multiple legal representation); *In re UNR Indus.*, 42 B.R. 94 (Bankr. N.D. Ill. 1984).

185. FED. R. BANKR. P. 2014(a).

186. 11 U.S.C. § 1103(b); see, e.g., *In re Rusty Jones, Inc.*, 107 B.R. 161 (Bankr. N.D. Ill. 1989) (holding that counsel for certain individual unsecured creditors could also serve as counsel for creditors' committee). But see *In re Electro-Optix, U.S.A., Inc.*, 130 B.R. 621 (Bankr. S.D. Fla. 1991) (ordering committee counsel removed and fees disallowed because, *inter alia*, counsel continued to represent major creditor individually).

187. See *In re Whitman*, 101 B.R. 37, 38 (Bankr. N.D. Ind. 1989) (holding that counsel for partially secured creditor could not act as counsel for the unsecured creditors'

As with the debtor's professionals, professionals employed by the creditors' committee may be compensated pursuant to Bankruptcy Code sections 330 and 331.¹⁸⁸ While professionals' fee issues are generally beyond the scope of this Article, there is one point relating specifically to creditors' committees worth noting here. Although the rule is not clear, it appears that the committee may be entitled to retain and pay professionals, even though it is unlikely that any distributions will be made to unsecured creditors.¹⁸⁹ In this regard, one court has reasoned that the creditors' committee is at least entitled to an opportunity to have its professionals determine whether there are sufficient assets in the estate to make distributions to unsecured creditors.¹⁹⁰ Nevertheless, courts must make sure the committee's professionals economize and do not take advantage on behalf of a client who is not "in the money." Finally, at least one court has suggested that a committee may be able to recover expenses and obtain compensation for its professionals pursuant to section 506(c), which generally provides reimbursement to a trustee of "the reasonable, necessary costs and expenses of preserving, or disposing of, [property securing an obligation] to the extent of any benefit to the holder of [the secured] claim."¹⁹¹

3. Committee's Standing

As discussed above, sections 1103 and 1109 grant creditors' committees broad authority to represent the interests of their constituents and to "appear and be heard on any issue in a case."¹⁹² Nevertheless, some controversy

committee, reasoning that the interests between secured and unsecured creditors are "dramatically different").

188. 11 U.S.C. §§ 330, 331 (1988). By contrast, committees in Chapter 7 cases generally may not employ professionals at the expense of the estate. *In re Dominelli*, 788 F.2d 584, 586 (9th Cir. 1986).

189. See *Citibank, N.A. v. Official Creditors' Comm. of Wilson Freight Co.* (*In re Wilson Freight Co.*), 21 B.R. 398 (S.D.N.Y. 1982); *In re Joyanna Holitogs, Inc.*, 19 B.R. 406 (Bankr. S.D.N.Y. 1982). But see *In re Chips'N Twigs, Inc.*, 58 B.R. 109, 111 (Bankr. E.D. Pa. 1986) (denying compensation to a committee's professionals where there were insufficient funds to pay in full all other administrative expenses).

190. *In re Joyanna Holitogs, Inc.*, 19 B.R. at 408.

191. 11 U.S.C. § 506(c) (1988), cited in *In re Codesco, Inc.*, 15 B.R. 354, 355-56 (Bankr. S.D.N.Y. 1981). But see *In re S & S Indus.*, 30 B.R. 395, 397 (Bankr. E.D. Mich. 1983) (holding that secured creditor is not required to pay committee's legal fees absent clear consent); *In re New England Carpet Co.*, 28 B.R. 766, 771 (Bankr. D. Vt.) (holding that attorney for unsecured creditor's committee was not entitled to award of attorney's fees where attorney's efforts toward reorganization did not benefit secured creditors), *aff'd*, 38 B.R. 703 (D. Vt. 1983), *aff'd*, 744 F.2d 16 (2d Cir. 1984).

192. 11 U.S.C. § 1109(b) (1988).

exists as to when a creditor's committee may commence an adversary proceeding, and when such a committee may intervene in an adversary proceeding commenced by the debtor or a trustee.

a. Standing to Commence an Adversary Proceeding

While creditors' committees generally may raise matters arising in the case itself,¹⁹³ courts have shown some reluctance to permit committees to commence adversary proceedings on behalf of the estate, at least when the debtor is able and willing to do so.¹⁹⁴ Typically such proceedings are to avoid fraudulent and preferential transfers, to recover damages for breaches of fiduciary duty by the debtor's directors and officers, and to subordinate insider claims pursuant to section 510.

To file an adversary proceeding on the estate's behalf, the creditors' committee usually must demonstrate that (1) a colorable claim exists that the debtor has not pursued, (2) the committee made a demand upon the debtor to bring the action, and (3) the debtor unjustifiably refused to pursue the action following the demand.¹⁹⁵ This showing may have to be made at a hearing prior to the filing of the committee's complaint,¹⁹⁶ even when the committee's members are financing the litigation at no expense to the

193. See, e.g., *United States v. Unsecured Creditors' Comm. (In re C-T of Virginia, Inc.)*, 977 F.2d 137 (4th Cir. 1992) (allowing creditors' committee to object to tax claim without any discussion of standing issue); *Unsecured Creditor's Comm. v. Marepcon Fin. Corp. (In re Bumper Sales, Inc.)*, 907 F.2d 1430 (4th Cir. 1990) (holding that committee had standing to challenge secured creditor's motion to condition use of cash collateral); *In re Metropolitan Hosp.*, 110 B.R. 731 (Bankr. E.D. Pa. 1990) (holding that bondholders' committee had standing to challenge proposed setoff of prepetition obligations), *aff'd*, 131 B.R. 283 (E.D. Pa. 1991).

194. See, e.g., *Louisiana World Exposition, Inc. v. Federal Ins. Co.*, 858 F.2d 233, 247 (5th Cir. 1988); see also *Official Unsecured Creditors Comm. v. U.S. Nat'l Bank (In re Suffola, Inc.)*, 2 F.3d 977, 979 n.1 (9th Cir. 1993) (recognizing "a qualified implied authorization" to commence adversary proceedings in limited circumstances). At least one court, however, has held that the creditors' committee has a "duty" to sue on behalf of the estate when the debtor unjustifiably fails to do so. *In re First Capital Holdings Corp.*, 146 B.R. 7, 11 (Bankr. C.D. Cal. 1992). But cf. *In re Overmyer*, 30 B.R. 123 (Bankr. S.D.N.Y. 1983) (holding that trustee was not bound by committee's failure to bring action on behalf of the estate because committee had no duty to bring such an action).

195. A creditors' committee may not bring a particular action on behalf of the debtor's estate if the debtor has already done so. See, e.g., *In re First Capital Holdings*, 146 B.R. at 10 (citing *Official Comm. of Unsecured Creditors v. First Union Nat'l Bank (In re Florida Group, Inc.)*, 123 B.R. 923, 924 (Bankr. M.D. Fla. 1991)).

196. *Hansen v. Finn (In re Curry & Sorenson)*, 57 B.R. 824, 828 (Bankr. 9th Cir. 1986).

estate.¹⁹⁷ This prerequisite ensures that decisions regarding the administration of the estate are first left to the debtor.¹⁹⁸

Although the law may differ among jurisdictions, the three steps for bringing a creditors' committee action noted above generally should not be regarded as rigid requirements; courts may permit committee-initiated actions without first going through the formalities. For example, questions regarding the committee's ability to sue on behalf of the estate usually arise when the committee seeks to pursue avoiding power causes of action against insiders. When such an action is brought against an insider, the creditors' committee may be allowed to pursue colorable claims on behalf of the estate without first making a demand upon the debtor, as such a demand would be "futile" should the debtor be inclined to protect insiders.¹⁹⁹ This "futility exception" for suits against insiders may be analogous to that in derivative shareholder actions.²⁰⁰ Just as some courts have yet to embrace the futility exception in shareholder suits, it is unclear whether courts will uniformly embrace the exception for committee actions on behalf of the estate. Therefore, the prudent practice might be for a committee always to make a demand upon the debtor. Doing so, however, may be impractical when quick action is necessary. In order to forestall committee action, the debtor may establish an independent committee or employ independent counsel for the stated purpose of investigating the matter, but with the unstated intent of indefinitely delaying a creditors' suit.

Following confirmation of a plan, the creditors' committee also may obtain standing to pursue claims or causes of action as "representative of the estate" if so provided in a plan of reorganization.²⁰¹ Such a provision generally would eliminate any further demand requirement prior to the commencement of an action.

197. See *Unsecured Creditors Comm. of STN Enters. v. Noyes (In re STN Enters.)*, 779 F.2d 901, 906 (2d Cir. 1985).

198. Indeed, in *In re Fugazy*, 150 B.R. 103 (Bankr. S.D.N.Y. 1993), the court required a full hearing on the merits of a settlement proposed by the debtor before it would permit the creditors to commence their own action on behalf of the estate.

199. See *Louisiana World Exposition, Inc.*, 832 F.2d at 1397-98; *In re First Capital Holdings*, 146 B.R. at 13.

200. *In re First Capital Holdings*, 146 B.R. at 11-13.

201. *Nordberg v. Sanchez (In re Chase & Sanborn Corp.)*, 813 F.2d 1177, 1180 n.1 (11th Cir. 1987); *Creditor's Comm. v. Parks Jagers Aerospace Co. (In re Parks Jagers Aerospace Co.)*, 129 B.R. 265 (M.D. Fla. 1991); see 11 U.S.C. § 1123(b)(3)(B) (1988); cf. *Foster Dev. Corp. v. Morning Treat Coffee Co. (In re Morning Treat Coffee Co.)*, 77 B.R. 62, 66-68 (Bankr. M.D. La. 1987) (holding that trustee's avoidance rights are not property of the estate and, therefore, cannot be transferred pursuant to a plan of reorganization).

b. Standing to Intervene in an Adversary Proceeding

Substantial controversy exists concerning when a creditors' committee may intervene in an adversary proceeding already commenced by the debtor in possession or the trustee. This controversy has resulted principally from different interpretations of section 1109(b), which provides: "A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."²⁰²

Some courts, including the Court of Appeals for the Third Circuit in *Official Unsecured Creditors' Committee v. Michaels (In re Marin Motor Oil, Inc.)*,²⁰³ have held that section 1109(b) gives a creditors' committee an unconditional right to intervene in an adversary proceeding, reasoning that such a proceeding comes within the broad meaning of "case" as used in the statute.²⁰⁴ Thus, while a committee's right to commence an adversary proceeding on behalf of the estate is restricted substantially, the right to participate in an action already commenced by the debtor or a trustee may be unconditional.

Other courts, however, including the Court of Appeals for the Fifth Circuit in *Fuel Oil Supply & Terminaling v. Gulf Oil Corp.*,²⁰⁵ have held that section 1109(b) does not apply to adversary proceedings and, therefore, that creditors' committees do not have an absolute statutory right to intervene. According to the latter view, whether a creditors' committee may intervene in an adversary proceeding depends on whether the a committee would be permitted to do so under Rule 24 of the Federal Rules of Civil Procedure, which applies specifically to adversary proceedings through Rule 7024 of the Federal Rules of Bankruptcy Procedure. Thus, a creditors' committee may intervene only if the interests of the committee are not adequately represented therein,²⁰⁶ or if, in the court's discretion, the

202. 11 U.S.C. § 1109(b) (1988).

203. 689 F.2d 445 (3d Cir. 1982), *cert. denied*, 459 U.S. 1206 (1983).

204. *Id.* at 450; *see also* Sarah R. Neuman Found., Inc. v. Garrity (*In re Neuman*), 124 B.R. 155, 159-60 (S.D.N.Y. 1991); *In re Parrot Packing Co.*, 42 B.R. 323 (N.D. Ind. 1983); Official Comm. of Unsecured Creditors of Allegheny Int'l, Inc. v. Mellon Bank, N.A. (*In re Allegheny Int'l, Inc.*), 107 B.R. 518 (W.D. Pa. 1989) (holding that equity committee possessed unconditional right to intervene in adversary proceeding commenced by creditors' committee).

205. 762 F.2d 1283 (5th Cir. 1985); *see also* Kenan v. FDIC (*In re George Rodman, Inc.*), 33 B.R. 348 (Bankr. E.D.N.Y. 1980).

206. Rule 24(a) of the Federal Rules of Civil Procedure provides, in relevant part: Upon timely application anyone shall be permitted to intervene in an

grounds for intervention outweigh any prejudice or delay caused by such intervention.²⁰⁷

4. Committee's Role in the Plan Process

One of the principal duties of a creditors' committee is to "participate in the formulation of a plan."²⁰⁸ Before a committee may contribute meaningfully to the plan process, it must exercise due diligence in assembling the necessary data on which plan negotiations can be based. Thus, as discussed above, the committee often will want to retain professionals such as attorneys, accountants, or investment advisors to represent it in analyzing the debtor's financial condition and the operation of the debtor's business.²⁰⁹ These professionals should coordinate to analyze the debtor's basic financial condition by examining the debtor's balance sheets, income statements, cash flow projections, and, if one is available, business plan. The committee's professionals also should work with the debtor's professionals to generate whatever additional information is needed depending on the size and complexity of the debtor's business. Committee members should, however, carefully review their professionals' work and circumscribe the tasks that may be undertaken. Otherwise, professional costs may quickly spiral out of control, possibly consuming most unencumbered assets of the estate.

While the debtor might cooperate with the committee's professionals to

action . . . when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately represented by existing parties.

FED. R. CIV. P. 24(a).

207. Rule 24(b) of the Federal Rules of Civil Procedure provides, in relevant part:

Upon timely application anyone may be permitted to intervene in an action . . . when an applicant's claim or defense and the main action have a question of law or fact in common. . . . In exercising its discretion the court shall consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties.

FED. R. CIV. P. 24(b).

208. 11 U.S.C. § 1103(c)(3) (1988); *see also* *Manville Corp. v. Equity Sec. Holders Comm.* (*In re Johns-Manville Corp.*), 801 F.2d 60, 62 (2d Cir. 1986) (stating that the committee's power to exercise a voice in the formulation of a plan "is clearly a desideratum under the program laid down by the Bankruptcy Code."); *In re Structurlite Plastics Corp.*, 91 B.R. 813, 819 (S.D. Ohio 1989) ("[P]articipation in the formulation of a plan represents the foremost of a committee's functions."). Participation in the plan is also the principal purpose of an equity committee.

209. *See* 11 U.S.C. § 1103(a) & (c)(2).

evaluate the debtor's business as a going concern, the debtor is likely to be less cooperative in providing information that would facilitate liquidation or merger and acquisition transactions. Nevertheless, the committee and its professionals must consider the best means of maximizing value for the creditors represented with or without the debtor's support. This might consist of selling parts of the business as distinct units, or piecemeal at auction. On the other hand, value might be maximized by putting the entire enterprise "in play" so new investors can seize control of ownership and management of the business. The committee may instruct its professionals to assemble a data base accessible to bona fide acquirors or investors on a confidential basis. If the debtor is cooperative, confidentiality agreements will be required of the committee, its professionals, and the potential acquirors or investors. On the other hand, if the debtor is uncooperative, Rule 2004 examinations, orders to produce documents, or other forms of discovery may be necessary.²¹⁰

If the debtor and the committee agree on a course of action, the result may be a plan proposed by the debtor that is acceptable to the committee, or a joint plan of reorganization where the committee is a co-proponent. If the debtor refuses to cooperate, however, the committee may desire to do more than simply obtain data through discovery. For example, the committee might seek the appointment of a trustee or examiner under section 1104.²¹¹ This is rarely done, however, because in most cases the incremental cost outweighs the benefits of having a trustee or examiner.²¹²

210. See FED. R. BANKR. P. 2004, 7026-7037; see also *In re Structurlite Plastics*, 91 B.R. at 819-20 (court ordered debtor to permit committee review of drafts of asset sale agreements so that committee could develop an "informed position" on the proposed sale); *In re McLean Indus.*, 70 B.R. 852, 860 (Bankr. S.D.N.Y. 1987) (holding that the "committee is . . . to be given notice of, and is expected to respond to, various requests . . . on which a committee position is crucial, such as sales of property out of the ordinary course of business"); cf. *In re Sunshine Precious Metals, Inc.*, 142 B.R. 918 (D. Idaho 1992) (denying committee permission to employ accountant to investigate debtor's affairs).

211. Section 1104(a) provides that "on request of a party in interest" the court may, after notice and a hearing, order the appointment of a trustee "for cause" or if such appointment is in the best interests of creditors and equity security holders. 11 U.S.C. § 1104(a). Similarly, § 1104(b) provides that "a party in interest" may request the appointment of an examiner, which the court may order after notice and a hearing, "to conduct such an investigation of the debtor as is appropriate." *Id.* § 1104(b).

212. On the other hand, some courts have held that failure to move for the appointment of a trustee diminishes the committee's ability to object to the debtor's activities. See, e.g., *In re After Six, Inc.*, 154 B.R. 876, 883 (Bankr. E.D. Pa. 1993) ("Having neither sought to convert this case to a Chapter 7 case nor to appoint a trustee, the committee has relegated its constituency to a position where, under the Code, its views must be subjected to the deference to the Debtor's wishes."); cf. *In re St. Mary*

Another option is conversion or dismissal of the case under section 1112(b).²¹³ Such a motion, however, is seldom in the best interest of the committee because maximization of value rarely lies down this path.²¹⁴ Ultimately, the committee may conclude that the best way to maximize creditor value is to pursue a creditors' plan of reorganization or liquidation.

A committee's ability to propose and confirm a plan is limited while the debtor retains the exclusive right to propose a plan under section 1121.²¹⁵ If the creditors' committee is successful in terminating the plan exclusivity period, or if exclusivity expires because the debtor fails to file a plan, to obtain acceptances, or to obtain an extension in a timely fashion, it is possible for the committee to be a proponent of a creditors' plan of reorganization or liquidation.²¹⁶ Debtors often will do whatever is necessary to file a plan before exclusivity expires. Therefore, committees frequently make bargaining for termination of exclusivity a top priority when it appears that the debtor is no longer cooperating with the committee. A premature termination of exclusivity, however, may not be in the committee's best interest, because it could lead to the filing of a plan by a secured creditor who would seek to foreclose on the debtor's assets and leave the unsecured creditors with little or nothing. Thus, on rare occasions,

Hosp., 86 B.R. 393, 396-97 (Bankr. E.D. Pa. 1988) (debtor's discretion in setting the direction of a case is diminished where a motion for appointment of a trustee is pending).

213. 11 U.S.C. § 1112(b).

214. If the creditors' committee successfully converts or dismisses the case, the committee ceases to function as an official committee. Thereafter, the debtor cannot be compelled to compensate the committee's professionals. If the case is converted to one under Chapter 7, creditors may elect a new committee under § 705 at the § 341(a) meeting of creditors, but there is no authority for the Chapter 7 committee to employ professionals. As noted, the duties of the Chapter 7 committee are more narrowly circumscribed than those of a Chapter 11 committee.

215. 11 U.S.C. § 1121. The debtor may agree to file a plan of reorganization along with the committee as co-proponent; doing so, however, will not terminate the debtor's exclusive right. See generally *In re Texaco Inc.*, 76 B.R. 322 (Bankr. S.D.N.Y. 1987).

216. See 11 U.S.C. § 1121(c):

Any party in interest, including . . . a creditors' committee, . . . may file a plan if and only if—

- (1) a trustee has been appointed under this chapter;
- (2) the debtor has not filed a plan before 120 days after the date of the order for relief under this chapter; or
- (3) the debtor has not filed a plan that has been accepted, before 180 days after the date of the order for relief under this chapter, by each class of claims or interests that is impaired under the plan.

11 U.S.C. § 1121(c); see also *Jasik v. Conrad (In re Jasik)*, 727 F.2d 1379 (5th Cir. 1984) (holding that debtor's right to propose a plan was no longer exclusive where the debtor failed to file a plan within the statutory period, failed to petition for an extension, and failed to propose a plan before the trustee was appointed).

a creditors' committee has persuaded the bankruptcy court to terminate exclusivity on a selective basis whereby only the debtor or the creditors' committee could propose a plan.²¹⁷ While such a result might be desirable, it does not appear to be authorized by the Bankruptcy Code, which by its plain language appears to treat exclusivity as an all-or-nothing proposition.²¹⁸ Therefore, in most cases, the committee has to confront competing plans as the price for being able to file its own plan.

In formulating and negotiating a plan, a committee typically relies extensively on its professional advisors for assistance. Often, a large committee will also form a smaller plan-negotiation subcommittee to devote the substantial time necessary to negotiate and confirm a creditors' plan. A committee may consult with its principal constituents regarding the terms of a plan,²¹⁹ although the committee cannot solicit actual votes until after a disclosure statement has been approved by the court and disseminated with the plan or a plan summary.²²⁰

Creditors' committees may also be concerned about assembling the substantial body of information needed to prepare a disclosure statement to accompany their plan. Experience teaches, however, that the professionals can prepare an adequate disclosure statement, following the establishment of a bar date for filing proofs of claim and any necessary discovery,²²¹ and the burden to object to the disclosure statement at the hearing will be on the debtor. If the debtor has been uncooperative in supplying information to the committee, the court will probably order the debtor and its professionals to provide language that will satisfy the debtor's objections. Moreover, the committee may rely upon information contained in the debtor's own disclosure statement if one is on file.

When the debtor has already filed a plan, it frequently will object to the creditors' disclosure statement on the basis that the disclosure statement fails to compare adequately the competing plans. This objection should be overruled, however, because section 1125(a)(1) clearly states that a

217. See, e.g., *In re Texaco Inc.*, 76 B.R. 322; *In re United Press Int'l, Inc.*, 60 B.R. 265 (Bankr. D.D.C. 1986).

218. See 11 U.S.C. § 1121.

219. See *Century Glove, Inc. v. First Am. Bank*, 860 F.2d 94, 100-03 (3d Cir. 1988); *Texas Extrusion Corp. v. Lockheed Corp.* (*In re Texas Extrusion Corp.*), 844 F.2d 1142, 1162-63 (5th Cir.), cert. denied, 488 U.S. 926 (1988).

220. See 11 U.S.C. § 1125(b).

221. See *supra* note 210 and accompanying text. Discovery may be required to assemble an adequate data base to analyze claims. Without discovery, the committee may not be able to prove that its plan meets the feasibility requirements of § 1129(a)(11), because the total amount of allowed unsecured claims will be unknown. Discovery is probably unnecessary, however, in the context of a "pot plan", in which a fixed amount of cash, securities, and other property will be distributed pro rata to creditors.

disclosure statement "need not include such information about any other possible or proposed plan".²²²

Once the committee's disclosure statement is approved, the committee may solicit acceptance of its plan and proceed toward confirmation. Obtaining confirmation of a creditors' plan is usually difficult and time consuming. The creditors' committee should be prepared to present evidence supporting each confirmation requirement of section 1129(a) and, if necessary, of section 1129(b). For example, to prove that the plan is feasible, the creditors' committee may need to conduct a claims analysis. This may not be easy, however, if the debtor's books and records are in disarray or if the court refuses to establish a bar date. Also, as a practical matter, the creditors' committee must be prepared to accomplish an orderly transition of control of the debtor's business. This can be accomplished by establishing a shadow management and drafting a detailed plan and confirmation order dealing with custody of the debtor's books, records, and other assets. The Bankruptcy Code contains broad powers regarding the implementation of a plan that the creditors' committee should be prepared to utilize on short notice if necessary.²²³

At this point it is not uncommon for the debtor to file a competing plan, if one has not already been filed. The committee may encounter particular difficulty when a debtor's plan is competing for confirmation. If both plans meet the confirmation requirements of section 1129,²²⁴ the court must consider, but is not bound by, the "preferences" of creditors and equity security holders. In most cases, courts seem inclined to confirm the plan that is in the best interest of the creditors regardless of the votes of equity holders.²²⁵ It is interesting to note that the creditors do not always prefer

222. 11 U.S.C. § 1125(a)(1); *see, e.g.*, *Kirk v. Texaco Inc.*, 82 B.R. 678, 684 (S.D.N.Y. 1988). This language was added to § 1125(a)(1) in 1984. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, sec. 509, §1125(a), 98 Stat. 333, 385. This amendment was in response to decisions that required information about competing plans to be included in a disclosure statement. *See, e.g.*, *In re Werth*, 29 B.R. 220, 222 (Bankr. D. Colo. 1983) (requiring discussion of the differences between two competing plans proposed by the debtor in possession).

223. 11 U.S.C. § 1142. State corporation laws may also aid the transition of corporate governance. *See, e.g.*, DEL. CODE ANN. tit. 8, § 303 (1991); CAL. CORP. CODE § 1400 (West 1990).

224. 11 U.S.C. § 1129(c).

225. *See, e.g.*, *In re Texas Extrusion Corp.*, 844 F.2d at 1159 ("It must be remembered that in the bankruptcy context, the interests of creditors not the debtors are paramount."); *In re Sound Radio, Inc.*, 93 B.R. 849, 858 (Bankr. D.N.J. 1988) ("While it is necessary to consider the various competing interests carefully, the court must take all of them into account and proceed with what is in the best interest of the creditors."). Rule 3018(c) of the Federal Rules of Bankruptcy Procedure permits preferences to be expressed only if acceptances are cast for more than one plan. Form 14 of the Official

a creditors' plan over the debtor's plan, particularly when the committee proposes a plan that is better suited to the interests of its own members than of the unsecured creditors as a whole.²²⁶

If the debtor gets a late start in the plan process, it may bring a motion under Federal Rule of Bankruptcy Procedure 7042 to consolidate hearings on the confirmation of competing plans.²²⁷ In most cases, however, such a motion will be unnecessary because the bankruptcy court, on its own motion, will set a scheduling order to conduct simultaneous confirmation hearings. Indeed, an argument can be made that such a result is mandated because the Bankruptcy Code requires the court to consider the "preferences" of creditors and equity security holders with respect to competing plans. This was the typical practice under Chapter X of the Bankruptcy Act, where courts often felt compelled to submit all approved plans (*i.e.*, plans that were fair, equitable, and feasible) to the creditors and equity holders for their consideration.²²⁸ On the other hand, at least one court has held that it is not necessary to delay confirmation of the creditors' plan to allow the debtor time to catch up. Such a delay can prove fatal if the creditor's plan involves a time-of-the essence acquisition or investment.²²⁹ Nevertheless, in the interests of judicial economy and in order to give creditors a choice, most competing plans will proceed concurrently toward confirmation.

Sometimes debtors challenge creditors' liquidating plans on the basis that the plans are not proposed in good faith as required by section 1129(a)(3).²³⁰ The court will not refuse to confirm a creditors' liquidating plan when the creditors have a firm offer to purchase and when the debtor's competing plan offers creditors a higher price but is based on a contingent contract.²³¹ The court may even confirm a creditors' plan that transfers

Forms contains a similar restriction on the ballot used with competing plans. However, even if a creditor rejects both plans, the creditor should be permitted to express a preference if both plans are nevertheless confirmable. Rule 9009 of the Federal Rules of Bankruptcy Procedure permits the ballot to be altered to accommodate such a situation.

226. See, *e.g.*, *In re Rolling Green Country Club*, 26 B.R. 729 (Bankr. D. Minn. 1982) (where unsecured creditors' committee objected to bank's plan but withdrew objections to debtor's plan, the court confirmed debtor's plan rather than bank's plan).

227. This was done, for example, in an unreported opinion in the *Kendavis* case. *In re Kendavis Indus. Int'l*, No. 385-30348-M-11 (Bankr. N.D. Tex. 1986); for the underlying facts of this case, see *In re Kendavis Indus. Int'l*, 91 B.R. 742, 745 (Bankr. N.D. Tex. 1988).

228. *In re Imperial "400" Nat'l, Inc.*, 374 F. Supp. 949, 952 (D.N.J. 1974).

229. See *In re Harcom, Inc.*, 79 B.R. 137 (Bankr. D.N.H. 1987). Likewise, the committee cannot be assured that the court will delay confirmation of the debtor's plan to permit the committee to catch up, particularly when to do so would simply negate the timing advantage Congress purposefully gave debtors through exclusivity.

230. 11 U.S.C. § 1129(a)(3).

231. *In re Holywell Corp.*, 54 B.R. 41 (Bankr. S.D. Fla. 1985), *aff'd sub nom.*

control of the business to the creditors and settles lawsuits against the creditors who are proponents of the plan.²³²

In sum, a creditors' committee can achieve, in certain cases, confirmation of a creditors' plan. The committee's professionals must be careful, however, to conduct a campaign to confirm the creditors' plan with utmost care. Otherwise, the committee's members and its professionals could be subjected to liability, as discussed below.²³³ Where the committee represents creditors in several affiliated cases, the committee may need to retain separate professionals to represent "subcommittees" for each estate where interstate conflicts exist. Committee professionals, especially attorneys who operate under the adversary system's rules of ethics, must also avoid interstate conflicts of interest. A similar situation arises when the same committee represents senior and subordinated debt. Committee professionals must steer clear of intra-committee disputes and make sure that decisions affecting substantive rights are made by the committee itself, not by its professionals.

B. Fiduciary Duties of Committee Members

1. Scope of Fiduciary Duties

It is well established that creditors' committee members are to be treated as fiduciaries: "[M]embers of a creditors' committee are obligated to act in a fiduciary capacity and may not use their positions as committee members to advance only their individual interests."²³⁴ As a fiduciary, a committee member owes duties of care, loyalty, and obedience to the committee's constituents.²³⁵ The duty of obedience requires the member to act within the constraints of the applicable statutes and rules; the duty of loyalty precludes self-dealing; and the duty of care requires the member to act as a prudent person. As the court in the *Johns-Manville* case noted:

Holywell Corp. v. Bank of N.Y., 59 B.R. 340 (S.D. Fla. 1986).

232. See, e.g., *In re Evans Prods. Co.*, 65 B.R. 31 (Bankr. S.D. Fla.), *aff'd*, 65 B.R. 87 (S.D. Fla. 1986).

233. See *Luedke v. Delta Air Lines*, 159 B.R. 385 (S.D.N.Y. 1993); *Central Transp., Inc. v. Roberto (In re Tucker Freight Lines)*, 62 B.R. 213 (Bankr. W.D. Mich. 1986); *In re Ligon*, 50 B.R. 127 (Bankr. M.D. Tenn. 1985); see also *infra* notes 234-249 and accompanying text.

234. *In re Map Int'l, Inc.*, 105 B.R. 5, 6 (Bankr. E.D. Pa. 1989) (citing *In re Enduro Stainless, Inc.*, 59 B.R. 603 (Bankr. N.D. Ohio 1986)); *In re National Equip. & Mold Corp.*, 33 B.R. 574 (Bankr. N.D. Ohio 1983).

235. *United Steel Workers v. Lampl (In re Mesta Mach. Co.)*, 67 B.R. 151, 159 (Bankr. W.D. Pa. 1986) (committee breached duty by proposing modifications to plan to reduce distribution to class); *In re National Equip. & Mold Corp.*, 33 B.R. 574.

In the case of reorganization committees, . . . fiduciary duties are crucial because of the importance of committees. Reorganization committees are the primary negotiating bodies for the plan of reorganization [representing] those classes of creditors from which they are selected. They also provide supervision of the debtor and execute an oversight function in protecting their constituents' interests Accordingly, the individuals constituting a committee should be honest, loyal, trustworthy and without conflicting interests, and with undivided loyalty and allegiance to their constituents.²³⁶

Courts have held, almost uniformly, that a committee member owes duties only to members of the creditors' class that the committee represents.²³⁷ These holdings follow the United States Supreme Court's decision in *Woods v. City Nat'l Bank & Trust Co.*,²³⁸ which held that a committee owes no duties to the debtor or to the estate in general. Thus, committee members usually need only be concerned with the interests of unsecured creditors generally, and need not be concerned with how the committee's actions may affect other parties in interest. Moreover, a number of courts have held that committee members are entitled to a "qualified" or "limited" immunity from liability resulting from actions taken within the scope of their statutory duties.²³⁹ As long as the committee's actions in connection with

236. *Johns-Manville Corp. v. Doan (In re Johns-Manville Corp.)*, 26 B.R. 919, 925 (Bankr. S.D.N.Y. 1983). Note that although a committee member must advance the interests of the committee's constituents in committee meetings, the member may nonetheless take positions contrary to those of the committee while acting in its capacity as an individual creditor. See *In re Central Medical Ctr., Inc.*, 122 B.R. 568, 570-71 (Bankr. E.D. Mo. 1990); *In re American Fed'n of Television & Radio Artists*, 30 B.R. 772, 775-76 (S.D.N.Y. 1983).

237. *Official, Unsecured Creditors' Comm. v. Stern (In re SPM Mfg. Corp.)*, 984 F.2d 1305, 1315 (1st Cir. 1993); *In re Seascope Cruises, Ltd.*, 131 B.R. 241 (Bankr. S.D. Fla. 1991); *In re First Republic Bank Corp.*, 95 B.R. 58 (Bankr. N.D. Tex. 1988); *United Steelworkers v. Lampl (In re Mesta Mach. Co.)*, 67 B.R. 151 (Bankr. W.D. Pa. 1986); *In re Tucker Freight Lines*, 62 B.R. at 216; cf. *Luedke v. Delta Air Lines*, 159 B.R. 385 (S.D.N.Y. 1993) (committee may owe duties to all parties in interest as a plan proponent).

238. 312 U.S. 262, 268-69 (1941).

239. See *Luedke v. Delta Air Lines*, 159 B.R. at 391-93; *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 717, 722 (Bankr. S.D.N.Y.), *aff'd*, 140 B.R. 347 (S.D.N.Y. 1992); *In re Tucker Freight Lines*, 62 B.R. at 216; cf. *Prince v. Zazove*, 959 F.2d 1395, 1401 (7th Cir. 1992) (committee members will not be held liable for the tortious acts of committee counsel, absent evidence of direct involvement in the tortious conduct by committee members).

In *Tucker Freight Lines*, the debtor's sole shareholder, which was also an unsecured creditor, filed suit against the committee members, alleging that the members tortiously caused a denial of the debtor's plan and the eventual conversion of the debtor's case to

the administration of the estate do not rise to the level of willful misconduct, its members generally should be shielded from liability. This rule serves the important purposes of encouraging creditors not only to serve on committees, but also to take an active role in the case.²⁴⁰

Despite the weight of authority that appears to be geared toward protecting committee members from liability, a recent decision from the Southern District of New York may cause unsecured creditors to pause before accepting a committee appointment. In *Luedke v. Delta Air Lines*,²⁴¹ former Pan Am employees filed an action against Delta Air Lines ("Delta") for lost wages, benefits, and other monetary losses stemming from Delta's alleged breach of an agreement to support Pan Am's reorganization efforts. Delta filed a third-party complaint against, *inter alia*, the Pan Am creditors' committee and its individual members for contribution and indemnity, alleging that the committee's members "thrust themselves into the center of the negotiation and contracting process to such an extent that they usurped the roles of Pan Am as debtor in possession."²⁴² Delta further alleged that the committee through its actions had become a "joint proponent" of Pan Am's plan and had used its position to thwart the reorganization process. According to Delta:

the Committee and its members acted beyond the scope of their statutory duties and in breach of the duties they assumed as joint proponents of the Joint Plan . . . by manipulating the reorganization process without regard for the viability of a reorganized Pan Am or the feasibility of the proposed plan of reorganization so as to improve at any cost their potential recovery. Such conduct by the Committee and its members allegedly had the effect of causing, in whole or in substantial part, Pan Am's inability to continue operations and to reorganize.²⁴³

In denying a motion to dismiss for failure to state a claim by the

Chapter 7. The committee members moved for summary judgment, contending that they were immune from liability for their actions while serving on the committee. Although recognizing a "limited immunity" for committee members, the court held that such immunity would not apply to reckless or intentional conduct, as was alleged in the action. 62 B.R. at 216. In reaching this decision, the court relied in part on the fact that the Bankruptcy Code protects committee members who participate in the plan solicitation process from liability under the securities laws, provided that the members act in good faith. *See id.* (citing 11 U.S.C. § 1125(e) (1988)).

240. *But see* *Luedke v. Delta Air Lines*, 159 B.R. at 393 n.4 ("[T]he absence of immunity is unlikely to discourage creditors from volunteering for committees in view of creditors' economic incentives to increase recovery on their claims.").

241. 159 B.R. 385 (S.D.N.Y. 1993).

242. *Id.* at 388 (internal quotations omitted).

243. *Id.* at 389 (internal quotations omitted).

committee and its members, the court held that by becoming a plan proponent, the committee assumed fiduciary duties to all parties to Pan Am's reorganization, not just the unsecured creditors. The court further held that, assuming Delta's allegations that the committee interfered with the plan process were true, the committee's members would not be entitled to immunity for their "wilful misconduct and other *ultra vires* actions."²⁴⁴

Although *Luedke v. Delta Air Lines* involved claims for monetary damages, the Code provides a number of other possibilities to remedy a committee member's breach of duty, including designation and exclusion of the member's vote on a plan,²⁴⁵ or equitable subordination of the member's claims.²⁴⁶ Moreover, as discussed above, the U.S. Trustee may force a member to resign or may remove a member from the committee.²⁴⁷ These remedies, however, prescribe no penalty if the committee member liquidates its entire position. In addition, while such remedies may serve the goals of deterrence or, perhaps, punishment for improper conduct, they often will do little or nothing to compensate those directly injured by the breach of duty. Thus, in many cases, awards for monetary damages may constitute the best remedy available despite the obvious chilling effect this may have on committee membership.

Because the scope of their potential liability is uncertain, committees frequently seek to include provisions in plans of reorganization exculpating committee members from anything other than willful misconduct. Courts have confirmed many plans that exculpate the committee and its members, and at least one court in a reported opinion has overruled objections to such an exculpation.²⁴⁸ Moreover, it appears that committee members may benefit from the "safe harbor" provision in section 1125(e) for good-faith solicitation of acceptances or rejections of a plan and participation in securities transactions contemplated by a plan.²⁴⁹

244. *Id.* at 394 (internal quotations omitted).

245. 11 U.S.C. § 1126(c), (e) (1988).

246. *Id.* § 510(c).

247. *See supra* text accompanying notes 165-169.

248. *See In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 717 (Bankr. S.D.N.Y.), *aff'd*, 140 B.R. 347 (S.D.N.Y. 1992) (confirming plan that both released members of equity committee from liability except for willful misconduct and enjoined suits for any reason against committee members).

249. Section 1125(e) provides:

A person that solicits acceptance or rejection of a plan, in good faith and in compliance with the applicable provisions of this title, or that participates, in good faith and in compliance with the applicable provisions of this title, in the offer, issuance, sale, or purchase of a security, offered or sold under the plan, of the debtor, of an affiliate participating in a joint plan with the debtor, or of a newly organized successor to the debtor under the plan, is not liable,

2. *Special Problems of Claims Trading*

An issue receiving significant attention in recent years is whether committee members may purchase or sell claims against the debtor.²⁵⁰ The concerns are not only that committee members will often have a trading advantage due to their access to significant, nonpublic information, but also that a committee member's votes might be influenced by its claims trading activities. No reported decisions exist under the Code considering the merits of claims trading by committee members. Members, however, would be well advised against engaging in activity that suggests profiting from their position of trust. For members in the regular business of trading securities for their client's accounts, this may place an insurmountable burden on committee membership. While no court has considered the issue in a reported decision, a committee member who is trading securities for its customers may possibly do so without breach of duty if the member employs a proper information-blocking device and files evidence of the device with the bankruptcy court.²⁵¹

C. *Committee Decision Making*

Although the Bankruptcy Code and Rules set forth many of the committee's rights and responsibilities, they say little about how the committee should carry out its tasks. In larger cases creditors' committees routinely meet about once a month, possibly with subgroups working on specific projects during the interim. However, with the exception of section 1103(a), which provides limited procedures for the selection of committee

on account of such solicitation or participation, for violation of any applicable law, rule, or regulation governing solicitation of acceptance or rejection of a plan or the offer, issuance, sale, or purchase of securities.

11 U.S.C. § 1125(e).

250. See *In re Allegheny Int'l, Inc.*, 118 B.R. 282 (Bankr. W.D. Pa. 1990) (persons who are privy to inside information should not engage in claims trading for purpose of controlling reorganization process). Members who sell all of their claims should resign from the creditors' committee immediately. No right exists that allows the purchaser of a member's claims to assume that member's seat on the committee; if the purchaser is to serve on the committee, the U.S. Trustee must appoint the purchaser.

251. *In re Federated Dep't Stores, Inc.*, No. 1-90-00130, 1991 WL 79143 (Bankr. S.D. Ohio Mar. 7, 1991); cf. *In re Midland United Co.*, 64 F. Supp. 399, 417 (D. Del. 1946), *aff'd*, 159 F.2d 340 (3d Cir. 1947) (committee members not disqualified from receiving compensation when customers of brokerages in which members were partners traded securities of debtor).

professionals,²⁵² neither the Code nor the Rules specify when and where committee meetings should take place, or how decisions should be made at those meetings.

One of the first concerns of any creditors' committee should be the adoption of by-laws. Committee by-laws may govern such matters as the rights of nonvoting members, the duties of committee officers, meeting times and locations, persons permitted to attend meetings, voting procedures, and expense reimbursement guidelines. By deciding these matters early, a committee may avoid conflict at a time when the committee should be presenting a united front in its negotiations with the debtor and secured creditors.

Although the courts generally steer clear of internal committee affairs, they have, on occasion, resolved disputes among committee members, typically involving disagreements over voting. In light of congressional concern for "representative" committees expressed in section 1102, some courts have imposed minimum quotas or super-majority voting requirements for critical committee decisions. For example, in *In re Outdoor Displays Welding & Fabrication, Inc.*²⁵³ the court considered whether committee counsel was properly selected when a majority of the committees' members voted in favor of employing counsel, but the holders of a majority of the claims held by committee members voted against counsel's retention. The court imposed a "double majority" requirement in the form of a "general rule that for purposes of committee action to select counsel, the votes of a majority in number of creditors present holding more than one-half in amount of claims represented at the meeting will be required."²⁵⁴ The court tempered its holding, however, by noting that in any given case "the final test of the sufficiency of a vote must rest with the Court, and must be tailored to the facts in each case."²⁵⁵

One might wonder whether the *Outdoor Displays* holding makes sense, given that each committee member is obligated to act as a representative of all creditors and not on behalf of its own pecuniary interests. For that reason, the weight of a committee member's vote should not depend on the magnitude of that member's claims. In practice, seasoned committee counsel

252. Section 1103(a) provides:

At a scheduled meeting of a committee appointed under section 1102 of this title, at which a majority of the members of such committee are present, and with the court's approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.

11 U.S.C. § 1103(a).

253. 76 B.R. 860 (Bankr. S.D. Ga. 1987).

254. *Id.* at 862.

255. *Id.*

provides voting rules in the committee's by-laws that are almost always adopted unanimously. Experience teaches that "one person, one vote," regardless of the size of claim, is the standard adopted in most cases.²⁵⁶

Finally, committees should form subcommittees, particularly for negotiating a plan of reorganization. In most cases, it is simply too cumbersome to have an entire committee negotiate a plan directly with the debtor and other parties in interest. As a consequence, often the committee's professionals, rather than its members, set the negotiating strategy for the committee without sufficient input from their client. By creating a plan negotiation subcommittee, at least some committee members can actively participate in the negotiation process, adding both insight and accountability to the committee's position.

D. Committees and the Attorney/Client Privilege

The need for frank and competent legal representation necessitates that communications between a committee's attorney and its members be subject to the attorney/client privilege. Whether such communications are privileged, however, has only occasionally been addressed by the courts, most recently by the Court of Appeals for the Ninth Circuit in *In re Subpoenas Duces Tecum*.²⁵⁷ In that case, the Ninth Circuit vacated a civil contempt judgment against counsel for a creditors' committee imposed after counsel refused to produce documents relating to communications with the committee. Following what appears to be the majority view, the court held that, at least when a committee is in the midst of adversarial litigation, communications between committee members and committee counsel may be subject to the attorney/client privilege.²⁵⁸

256. See *In re Schatz Fed. Bearings Co.*, 5 B.R. 543, 548 (Bankr. S.D.N.Y. 1980) (implying that one person, one vote rule is appropriate).

257. 978 F.2d 1159 (9th Cir. 1992).

258. *Id.* at 1161; see *In re Century Glove, Inc.*, 74 B.R. 952, 957 (Bankr. D. Del. 1987) (finding that a letter drafted by committee counsel to committee members was privileged communication), *aff'd in part, rev'd in part sub nom.* First Am. Bank v. Century Glove, Inc., 81 B.R. 274 (D. Del. 1988), *aff'd in part*, 860 F.2d 94 (3d Cir. 1988); see also *In re Drexel Burnham Lambert Group, Inc.*, 133 B.R. 13, 31 (Bankr. S.D.N.Y. 1991) (finding that time record entries referring to privileged communications may be excised from a committee professional's record); *In re Baldwin-United Corp.*, 38 B.R. 802, 804-05 (Bankr. S.D. Ohio 1984) (communications between creditors' committee counsel and members may be subject to privilege); *In re Jensen-Farley Pictures, Inc.*, 47 B.R. 557, 583 n.29 (Bankr. D. Utah 1985) (same). But see *In re Christian Life Ctr. First Assembly of God*, 16 B.R. 35, 37 (Bankr. N.D. Cal. 1981) ("It would thus seem where the committee does not have the power to act or the title of a trustee that it wouldn't need or deserve the attorney-client privilege since they should make their activities known to the other creditors and to the Court."), *overruled, at least*

A more difficult question is whether the attorney/client privilege applies to communications with creditors who are constituents of the creditors' committee but who are not members of the committee, or who are merely nonvoting (or ex-officio) members. Courts have held that the creditors' committee's attorney has at least a fiduciary, and perhaps an attorney/client relationship with all members of the creditor class that the committee represents.²⁵⁹ If so, communications between committee counsel and unsecured creditors arguably are subject to the attorney/client privilege, at least when such communications can reasonably be expected to remain confidential.

In *In re Baldwin-United Corp.*,²⁶⁰ the creditors' committee sought to exclude nonvoting members from its meetings because the nonvoting members were not necessary to the committee's functions. The creditors' committee reasoned that the presence of nonvoting members during committee deliberations would destroy the attorney/client privilege. The nonvoting members countered that no such privilege existed to destroy, because committee members had a fiduciary responsibility to communicate openly with all creditors.²⁶¹ Recognizing the committee's duties to its constituents, the *Baldwin-United* court nevertheless found the attorney/client privilege to apply:

While we are cognizant of the fiduciary responsibilities which a creditors' committee owes to those it represents, we are unconvinced that the attorney/client privilege is inherently antagonistic to those responsibilities. The purposes underlying the privilege have no less applicability to a creditors' committee than they do to any other entity, at least when disclosure of privileged communications is sought by those who are not represented by the committee, or who stand in an adversarial relationship with it. If the committee cannot engage in "full and frank communications" with its attorneys without fear of disclosure to such outsiders, then its work may be seriously hampered, to the detriment of those it represents.²⁶²

The court also found that the presence of nonvoting members would not

in part, by *In re Subpoenas Duces Tecum*, 978 F.2d at 1161-62.

259. See *In re Celotex Corp.*, 123 B.R. 917, 921 (Bankr. M.D. Fla. 1991); *Pension Benefit Guar. Corp. v. Pincus, Verlin, Hahn, Reich & Goldstein Professional Corp.*, 42 B.R. 960, 963 (E.D. Pa. 1984).

260. 38 B.R. 802 (Bankr. S.D. Ohio 1984).

261. Cf. *In re Christian Life Ctr.*, 16 B.R. at 37 (suggesting that because the committee owes duties to all creditors, it must make its activities known to creditors and the court).

262. 38 B.R. at 804-05.

destroy the privilege.²⁶³ In dictum, however, the court tempered its decision by recognizing that, regardless of the privilege, a committee's constituents have limited rights of access to otherwise privileged communications: "While the privilege may be absolute as to those who are not represented by the creditors' committee, we believe that a narrower construction of the privilege is required where disclosure is sought by those who are so represented."²⁶⁴

Perhaps the most difficult question is whether the attorney/client privilege, or some other privilege, applies to communications between the debtor in possession and the creditors' committee. Frequently in the course of plan negotiations, the debtor in possession must share confidential information with the committee. In such cases, the debtor in possession will usually request that members of the committee sign a confidentiality agreement as a condition to dissemination of confidential information. The information may even include analyses from counsel for the debtor in possession with respect to a plan of reorganization. Does dissemination of such information to the committee result in a waiver of the attorney/client privilege so that the information may be obtained by a third-party litigant? This issue was addressed in an unpublished order in *Norfin, Inc. & Snellman v. AM Int'l, Inc. (In re AM Int'l, Inc.)*,²⁶⁵ in which District Judge Bua held that "[b]ecause of the common legal interest of AM International, Inc. and the unsecured creditors' committee in this litigation, the sharing of information among AM International, the Committee and their respective counsel is privileged from discovery."²⁶⁶ It remains to be seen whether other courts will recognize a claim of privilege when attorney/client privileged documents are disseminated from the debtor in possession, trustee, or examiner to the creditors' committee.²⁶⁷

263. *Id.* at 806. The result may be different, however, where the nonvoting member has not been officially appointed to the committee, particularly if the nonvoting member is a secured creditor.

264. *Id.* at 805; see also *In re Subpoenas Duces Tecum*, 978 at 1160 (appearing to reserve the question whether a committee's attorney/client privilege could be asserted against those who have a "fiduciary relation to the Committee or its counsel").

265. No. 80-C-6824 (N.D. Ill. June 26, 1984).

266. *Id.* (citing *United States v. McPartlin*, 595 F.2d 1321 (7th Cir. 1979)); cf. *In re Christian Life Ctr.*, 16 B.R. at 38 (holding that there is no "work-product privilege of the individual members of the Creditors' Committee").

267. In *Official Unsecured Creditor's Comm. v. Canadian Pac. Forest Prods., Ltd. (In re Gibson Group, Inc.)*, 158 B.R. 101 (Bankr. S.D. Ohio 1993), the court denied a request for a protective order limiting the scope of discovery regarding a transaction between the debtor and a member of the committee. There was no suggestion in that case, however, that the transactions involved a privileged communication between the debtor and the committee.

Outside the bankruptcy context, some courts have found a "business strategy"

Given that committee counsel has an attorney/client relationship with committee members, it logically follows that ethical rules governing communications with adverse parties restrict the debtor's counsel from communicating with committee members without prior approval of committee counsel. In *In re Snyder*,²⁶⁸ the debtor and his counsel invited creditors and, specifically, members of the creditors' committee to attend a meeting regarding the debtor's various proposals for plans of reorganization. Counsel for the committee objected to the meeting on the ground that it violated the restrictions on solicitation under section 1125(b) and that it constituted an improper communication between debtor's attorney and the committee members. While finding no violation of section 1125(b) on the facts of the case, the court did find that debtor's counsel had committed an ethical violation by communicating directly with committee members.²⁶⁹ In so holding, the court relied upon Rule 7-104(A)(1) of Utah's version of the Model Code of Professional Responsibility and, by analogy, Rule 4.2 of the Model Rules of Professional Conduct.²⁷⁰ While this holding appears correct, what follows in the *Snyder* court's decision is highly troubling:

Where the creditors' committee has employed an attorney pursuant to 11 U.S.C. § 1103(a), this Court holds that *the debtor may not communicate with members of the committee without the prior consent of the committee's attorney or an order of the Court*. The debtor's attorney is

privilege to apply to communications of strategic business plans, proposals, or alternatives prepared in connection with a contest for corporate control. See, e.g., *Jefferson-Pilot Corp.*, 141 F.R.D. 408, 418-20 (M.D.N.Y. 1992); *Temple Holdings Ltd. v. Sea Containers Ltd.*, 131 F.R.D. 360, 360-61 (D.D.C. 1989); *BNS, Inc. v. Koppers Co.*, 683 F. Supp. 455, 457-58 (D. Del. 1988). It remains to be seen whether the bankruptcy courts will adopt the "business strategy" privilege to negotiations between committees and debtors-in-possession. Subject to safeguards such as the opportunity for *in camera* review, such a privilege could help to facilitate plan negotiations.

268. 51 B.R. 432 (Bankr. D. Utah 1985).

269. *Id.* at 439.

270. Rule 7-104 of the ABA Model Code of Professional Responsibility provides, in relevant part:

(A) During the course of his representation of a client a lawyer shall not:

(1) Communicate or cause another to communicate on the subject of the representation with a party he knows to be represented by a lawyer in that matter unless he has the prior consent of the lawyer representing such other party or is authorized by law to do so.

MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-104 (1980). Rule 4.2 of the ABA Model Rules of Professional Conduct provides: "In representing a client, a lawyer shall not communicate about the subject of the representation with a party the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized by law to do so." MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.2 (1983).

also precluded from communicating with individual creditors without obtaining the prior consent of their respective attorneys.²⁷¹

While the court may have had good intentions, the emphasized language that bans *both* the debtor and its attorney from communicating with committee members is at odds with the statutory right of the committee to consult with the debtor in possession regarding case administration²⁷² and appears not to be followed in practice. In fact, if the debtor is a public corporation, the securities laws may require communications with creditors who are securities holders. In any event, it seems both unnecessary and unreasonable to hold debtors to the same ethical rules regarding communications as their attorneys in this context.

E. Reimbursement of Committee Members

Creditors' committee members clearly are not entitled to compensation for their time or services while serving on a committee. A split of authority exists, however, concerning whether members of an official creditors' committee are entitled to reimbursement from the debtor's estate for members' out-of-pocket expenses. Prior to the enactment of the Code, the expenses of creditors' committee members could be recovered from the estate in Chapter XI cases under former Bankruptcy Rule 11-29(c). Today, however, there is no provision in the Code or in the Federal Rules of Bankruptcy Procedure expressly authorizing such reimbursement. Section 503(b)(3)(D) provides that a committee "other than a committee appointed under section 1102" may receive compensation for its "actual, necessary expenses" if it makes a "substantial contribution" to the case.²⁷³ Additionally, section 330(a)(1) enables the professionals employed by an official committee to be compensated from the estate.²⁷⁴ Neither of these provisions, however, plainly authorizes reimbursement of expenses of committees formed pursuant to section 1102.

The courts which have held that committee members are not entitled to any reimbursement of expenses have generally relied upon the plain language of sections 330 and 503, as well as the general principle that Congress must expressly provide for the payment of monies from the estate.²⁷⁵ The reasoning is that sections 330 and 503(b)(3)(D) illustrate that

271. 51 B.R. at 439 (emphasis added).

272. See 11 U.S.C. § 1103(c)(1) (1988).

273. *Id.* § 503(b)(3)(D).

274. *Id.* § 330(a)(1).

275. See *In re UNR Indus.*, 736 F.2d 1136, 1141 (7th Cir. 1984) (denying compensation under § 330 only); *In re Southern Commodity Corp.*, 96 B.R. 392, 396

Congress knew how to authorize reimbursement when it wanted to. Therefore, some courts have concluded, Congress decided not to provide for reimbursement to members of official committees.

Notwithstanding the absence of express statutory authority to reimburse committee members, the apparent trend is toward allowing such reimbursement. Courts have generally reasoned that if professionals and members of unofficial committees not appointed under section 1102 are entitled to reimbursement of expenses, members of official committees should likewise be entitled.²⁷⁶

Perhaps the most reasoned approach to allowing such payment has been expressed by the Court of Appeals for the Sixth Circuit, which considered the issue not once but twice in *In re George Worthington Co.*²⁷⁷ The latter opinion came after the Sixth Circuit vacated its first effort at resolving this

(Bankr. S.D. Fla. 1989) (denying compensation under any section of the Code); *In re Mason's Nursing Ctr., Inc.*, 73 B.R. 360, 362-63 (Bankr. S.D. Fla. 1987) (same); *In re Beck-Rumbaugh Assocs.*, 68 B.R. 882, 885-86 (Bankr. E.D. Pa. 1987) (holding that any request for compensation not expressly authorized by the Code would be denied), *aff'd*, 84 B.R. 369 (E.D. Pa. 1988).

In *UNR Indus.*, the Seventh Circuit considered whether committee members who employed their own attorneys were entitled to reimbursement under § 330. The committee in *UNR Indus.* sought reimbursement pursuant to Rule 2016(a) of the Federal Rules of Bankruptcy Procedure, which outlines procedures for professionals seeking compensation under § 330. The advisory committee's note to Rule 2016(a) states that the rule's provisions apply to, *inter alia*, reimbursement for a committee.

Declining to follow the advisory committee's note, the Seventh Circuit held that Rule 2016(a) merely sets forth the requirements for making an application for reimbursement of expenses under § 330. According to the court, § 330 provides a substantive basis only for reimbursement of the compensation of professionals employed by the committee, not for reimbursement to the members of an official creditors' committee. Thus, the Seventh Circuit correctly held that, because the substantive basis for reimbursement of creditors' committee expenses does not appear in § 330, Rule 2016(a) may not be relied upon to provide such a basis. 736 F.2d at 1141; *see also* 28 U.S.C. § 2075 (1988); FED. R. BANKR. P. 9030. The Seventh Circuit expressly declined to consider whether the members' expenses could be reimbursed as general administrative expenses under § 503(b) of the Bankruptcy Code. 736 F.2d at 1139.

276. *See In re George Worthington Co.*, 921 F.2d 635 (6th Cir. 1990); *In re J.E. Jennings, Inc.*, 96 B.R. 500, 504 (E.D. Pa. 1989); *In re Evans Prods. Co.*, 62 B.R. 579 (S.D. Fla. 1986) (equity committee); *In re National Enters.*, 140 B.R. 871 (Bankr. E.D. Va. 1992); *In re Northeast Dairy Coop. Fed'n, Inc.*, 76 B.R. 914, 916 (Bankr. N.D. N.Y. 1987); *In re Aviation Technical Support, Inc.*, 72 B.R. 32 (Bankr. W.D. Tex. 1987); *see also In re Windsor Communications Group, Inc.*, 54 B.R. 504 (Bankr. E.D. Pa. 1985) (allowing reimbursement, but only when committee members provide services to the estate far beyond mere service on the committee).

277. 913 F.2d 316 (6th Cir. 1990) [hereinafter *George Worthington I*]; 921 F.2d 626 (6th Cir. 1990) [hereinafter *George Worthington II*].

issue. In *George Worthington* committee members incurred expenses of about \$17,000 during the course of the case, principally related to travel. A majority of the Sixth Circuit panel first affirmed the bankruptcy court's decision to deny reimbursement, holding that no payments may be made from the estate without "clear and specific authority in the Bankruptcy Code."²⁷⁸ Following a petition for rehearing and amicus briefs filed by the official committee in the *Allied Stores/Federated* cases and the Securities and Exchange Commission, the Sixth Circuit vacated its opinion. On rehearing the court held that, while the Code did not explicitly provide for reimbursement of committee expenses, reimbursement could be justified as falling within section 503(b)(1)(A)'s definition of "actual, necessary costs and expenses of preserving the estate."²⁷⁹

VI. POSTCONFIRMATION COMMITTEES

Just as the Code is silent on when the debtor in possession ceases to exist, so too is the Code silent on when the creditors' committee ceases to function. While the cases are not entirely clear, it appears that the committee dissolves upon conversion or dismissal of the case, rather than on confirmation of a plan.²⁸⁰ A well-crafted plan of reorganization should resolve this issue by specifying when the committee ceases to exist.²⁸¹ This is particularly important when a plan permits a committee to serve postconfirmation as "representative of the estate."²⁸²

VII. CONCLUSION

Although the courts have considered many issues with respect to

278. *George Worthington I*, 913 F.2d at 325.

279. *George Worthington II*, 921 F.2d at 632.

280. See *Creditors' Comm. v. Parks Jagers Aerospace Co. (In re Parks Jagers Aerospace Co.)*, 129 B.R. 265 (M.D. Fla. 1991) (holding that creditors' committee does not automatically dissolve at the time Chapter 11 plan is confirmed, but dissolves when case is dismissed or converted; committee may act after confirmation and may obtain compensation for necessary legal work performed between time plan is confirmed and consummated); *Official Unsecured Creditors' Comm. v. Siskind (In re Erie Hilton Joint Ventures)*, 137 B.R. 165 (Bankr. W.D. Pa. 1992) (creditors' committee has standing to sue to compel capital infusions required by Chapter 11 plan); *Unsecured Creditors Comm. of Butler Group v. Butler (In re Butler)*, 94 B.R. 433 (Bankr. N.D. Tex. 1989) (once bankruptcy case is dismissed, statute under which committee was created during bankruptcy no longer applies, and the committee automatically dissolves).

281. See 11 U.S.C. § 1123(b)(5) (1988).

282. *Nordberg v. Sanchez (In re Chase & Sanborn Corp.)*, 813 F.2d 1177, 1180 n.1 (11th Cir. 1987); see 11 U.S.C. §§ 1103(c)(5), 1123(b)(3)(B).

creditors' committees during the first fifteen years of practice under the Bankruptcy Code, the courts have yet to develop much jurisprudence concerning many important issues involving the committee's membership, operation, and duties. Perhaps the sophistication of the committee's members and professionals accounts for this paucity of case law. While the law will continue to evolve and answer some of the questions posed by this Article, it may be several years before all of these questions are addressed at the bankruptcy court level, much less by the courts of appeals. Until then, much of the law regarding creditors' committees will remain unreported and uncertain.