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Collier Handbook for Creditors' Committees

DAVID S. KUPETZ
Locke Lord LLP
Los Angeles, California

Richard Levin and Henry J. Sommer
COLLIER EDITORS-IN-CHIEF

2023

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About the Author

DAVID S. KUPETZ

DAVID S. KUPETZ is a partner with Locke Lord LLP. He is an expert in troubled transactions, crisis avoidance consultation, workouts, restructurings, reorganizations, bankruptcies, receiverships, assignments for the benefit of creditors and other nonbankruptcy insolvency proceedings. He represents debtors (in restructurings and workouts and in chapter 11 reorganization cases), secured creditors, unsecured creditors' committees, assignees for the benefit of creditors, buyer/sellers of businesses/assets in distressed circumstances and other entities in insolvency and bankruptcy situations. Mr. Kupetz has written many articles on bankruptcy and insolvency topics. He served as a contributing author to *Collier Forms Manual* for many years. Mr. Kupetz is a graduate of the University of California, Santa Barbara (B.A., 1983) and the University of California, Hastings College of the Law (J.D., 1986). Mr. Kupetz was admitted to the California Bar in 1986.

CHAPTER 1

Introduction and Scope of Handbook

This *Handbook* is intended for use primarily by representatives of creditors or interest holders who serve on chapter 11 committees and counsel for committees. Since the representatives will frequently not be lawyers, the chapters of this *Handbook* directed toward committee members have been kept as nontechnical. This *Handbook* is not designed as a treatise on chapter 11 of the Bankruptcy Code. Rather, it is designed to serve two primary functions in aid of committee members: first, to present procedural and organizational suggestions to enable a creditors' committee or equity security holders' committee to function effectively; second, to provide an overview of the role, duties and powers of such committees in a chapter 11 case. Additionally, this *Handbook* provides guidance to and forms for use by counsel for committees.

The procedural and organizational chapters of this *Handbook* are Chapter 7, convening the first meeting of a committee; Chapter 8, organizing a committee; Chapter 9, by-laws for a committee; Chapter 10, rules of procedure for a committee; and Chapter 12, accommodating disparate interests within a chapter 11 creditors' committee. These procedural or organizational chapters are essentially "how-to" in nature and are not encumbered by extensive legal citations.

In the balance of the *Handbook*, Chapters 2, 13 and 14 discuss the role, duties and powers of chapter 11 creditors' committees. Chapter 3 deals with eligibility to serve on a committee; Chapters 4, 5, 6 and 22 with the creation, composition and termination of committees. Chapters 15 and 16 cover the confidentiality of nonpublic information and, in general, fiduciary responsibilities of committee members. Chapter 17 provides guidelines for plan negotiations through a presentation of the statutory requirements of plan content, plan acceptance and plan confirmation. Chapters 18, 19, 20 and 21 deal with matters of compensation and expense reimbursement. These chapters of the *Handbook* are more technical in nature. They contain a great deal of information and should be of assistance to lawyers as well as nonlawyers dealing with the problems discussed. These chapters, of neces-

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sity, contain numerous legal citations and quotations to give insight into how the legal problems presented have been decided by the courts, as well as how some have been addressed by Congress.

Although the *Handbook* is primarily for those who serve on and represent chapter 11 creditors' and equity interest holders' committees, the chapters on creditors' committees in chapter 7 liquidation cases, creditors' committees in chapter 9 municipal debt adjustment cases, and creditors' committees in nonbankruptcy workouts are provided to round out the complete subject matter of the *Handbook*.

CHAPTER 2

The Role of a Chapter 11 Creditors' Committee

SYNOPSIS

¶ 2.01 In General

The first questions usually asked by committee members not familiar with chapter 11 cases or proceedings thereunder are, "Why am I here?," "What is expected of me?" and "What role will this chapter 11 committee be expected to play in the chapter 11 case?" The answers to these questions will normally be given by a representative of the United States trustee at the informal status conference of the 20 largest creditors or at the time the creditors' committee is first convened. The role of a creditors' committee in chapter 11 cases may be explained in many different ways; perhaps the best explanation was given in the House Report issued in connection with the House version of the Bankruptcy Reform Act of 1978.[1] The House Report stated that

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¶ 2.01

[1] H. Rep. No. 95-595, 95th Cong., 1st Sess. 401 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender 16th ed.).

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chapter 11 committees will be the primary negotiating bodies for the formulation of a plan of reorganization. They will represent the various classes of creditors and equity security holders from which they are selected. They will also provide supervision of the debtor in possession and of the trustee, and will protect their constituents' interests.

From the foregoing statement, the two primary functions of a chapter 11 committee are discernible. The role of a committee is to investigate the affairs of the debtor and negotiate a plan. Put another way, a chapter 11 committee polices the case, recommending the respective distribution of the debtor's reorganization value among the different classes of creditors and equity security holders. This involves a determination by the committee of the viability of the debtor's management and business plans. When the committee is armed with the facts uncovered as a result of its investigation, the committee is in a position to engage in meaningful negotiation with the debtor in possession or trustee relative to the terms of a plan of reorganization that would equitably distribute the economic interests of the debtor among the different competing classes of creditors and equity security holders or, if necessary, that would liquidate the business of the debtor and distribute fairly the proceeds of such liquidation. When the roles of the debtor in possession or trustee and the various chapter 11 committees are properly carried out, the reorganization process will be moved forward as expeditiously and economically as possible, avoiding unnecessary, time consuming and expensive litigation.

The role of a creditors' committee in chapter 11 will vary from case to case and depend on the size and complexity of the case and also on whether a trustee or examiner has been appointed.[2] Nevertheless, the fundamental role remains the same: to ascertain the facts and negotiate a plan, if that is possible. "Creditor Committees have the responsibility to protect the interest of the creditors; in essence, the function of a creditors' committee is to act as a watchdog on behalf of the larger body of creditors which it represents."[3]

In *In re Seascape Cruises, Ltd.,*[4] the court pronounced that "the creditors' committee is not merely a conduit through which the debtor speaks to and negotiates with the creditors generally; an effective committee must necessarily be adversarial if it is to fulfill its role as watchdog in a chapter 11

---

[2] 7 Collier on Bankruptcy, ¶ 1103.05[1][a] (Matthew Bender 16th ed.).

[3] Ritchie Capital Mgmt., L.L.C. v. Kelley, 785 F.3d 273, 280–81 (8th Cir. 2015), quoting Loop Corp. v. United States Tr., 379 F.3d 511, 519 (8th Cir. 2004) (internal quotation marks omitted).

[4] 131 B.R. 241 (Bankr. S.D. Fla. 1991).

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case."[5] So, too, the court in *In re General Homes Corp.*[6] stated that "committees play an active and vital role in the administration of a Chapter 11 case and the development of a viable plan of reorganization."[7] On the other hand, that court also held that "it is necessary to the reorganization process that a committee exercise its role carefully and judiciously, and not bring to the attempted reorganization tactics invoked for the improper purposes of harassment or delay."[8] "The primary job of the Creditors' Committee in a Chapter 11 case is to represent the interests of unsecured creditors."[9]

If a plan is not feasible, the creditors' committee may recommend liquidation of the debtor so that the interests represented by the creditors' committee are maximized. However, the creditors' committee may not just function as a liquidation advisor.[10]

To play its proper role in a chapter 11 case, the members of the creditors' committee must be prepared to devote time, effort and intelligence to the representation of the interests of the committee's constituency.

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[5] *In re* Seaescape Cruises, Ltd., 131 B.R. 241, 243 (Bankr. S.D. Fla. 1991).

[6] 34 C.B.C.2d 215, 181 B.R. 898 (Bankr. S.D. Tex. 1995).

[7] *In re* General Homes Corp., 34 C.B.C.2d 215, 221, 181 B.R. 898, 902 (Bankr. S.D. Tex. 1995).

[8] *In re* General Homes Corp., 34 C.B.C.2d 215, 221, 181 B.R. 898, 902 (Bankr. S.D. Tex. 1995). The court refused to permit a compromise of an adversary proceeding initiated by the creditors' committee one day prior to the plan confirmation hearing that sought equitable subordination of secured claims and other relief. The court noted that in advocating the compromise the parties sought to avoid expenses and (to some) professional embarrassment. Ultimately, the court found that these considerations, as well as others such as probability of success on the merits, potential difficulty in collecting a judgment, and complexity and expense of litigation, were outweighed by the need to offer guidance to creditors' committees in light of the dearth of guidance that statutory and case law thus far has provided. For further discussion, *see* ¶ 14.10 *infra*.

[9] *In re* Cascade Acceptance Corp., 2011 Bankr. LEXIS 752, at *1 (Bankr. N.D. Cal. Mar. 1, 2011) ("In many Chapter 11 cases, the Committee is an ally of the debtor in possession supporting efforts to reorganize, often in the face of opposition from secured creditors. That was not the case here. The Committee was a thorn in the side of the Debtor in this case from its inception.").

[10] *In re* Lyons Transp. Lines, 123 B.R. 526, 24 C.B.C.2d 1438 (Bankr. W.D. Pa. 1991).

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¶ 2.02 Small Business Cases

The Bankruptcy Reform Act of 1994[1] amended various sections of chapter 11 of the Bankruptcy Code to permit an expedited and less expensive procedure for reorganizing a "small business," which was defined as a person engaged in commercial or business activities (other than those relating primarily to owning or operating real estate), with noncontingent, liquidated debts of $2 million or less.[2] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[3] deleted the definition of small business and replaced it with definitions of "small business case" and "small business debtor."[4] Section 101(51C) defines a "small business case" as a case filed under chapter 11 in which the debtor is a small business debtor. Section 101(51D) defines a "small business debtor" as follows:

> The term "small business debtor"—
>
> (A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning or operating real property or activities incidental thereto) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition or the date of the order for relief in an amount not more than $2,725,625[5] (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to

---

¶ 2.02

[1] Pub. L. No. 103-394 (1994), *reprinted in* Vol. E. Collier on Bankruptcy, App. Pt. 9(a) (Matthew Bender 16th ed.).

[2] Former 11 U.S.C. § 101(51C), added by the 1994 Act, defined a small business as follows:

> "small business" means a person engaged in commercial or business activities (but does not include a person whose primary activity is the business of owning or operating real property and activities incidental thereto) whose aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition do not exceed $2,000,000.

[3] Pub. L. No. 109-8 (2005), *reprinted in* Vol. E-2, Collier on Bankruptcy, App. Pt. 10(a) (Matthew Bender 16th ed.).

[4] Added by Pub. L. No. 109-8, § 432(a) (2005).

[5] This amount applies in cases commenced on or after April 1, 2019. For cases commenced on or after April 1, 2016, and before April 1. 2019, the dollar amount is $2,566,050.

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provide effective oversight of the debtor; and

(B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $2,725,625[6] (excluding debt owed to 1 or more affiliates or insiders)[.]

Prior to the enactment of the Small Business Reorganization Act of 2019 ("SBRA"),[7] section 1102(a)(3) provided that "[o]n request of a party in interest in a case in which the debtor is a small business debtor and for cause, the court may order that a committee of creditors not be appointed." Under the 2019 amendment, section 1102(a)(3) was changed to provide that "[u]nless the court for cause orders otherwise, a committee of creditors may not be appointed in a small business case . . . ." The "cause" for which the court may order that a committee be appointed is uncertain. One example could be where a prepetition committee was in place. If a representative committee can be and is appointed and functions actively, the case will not meet the definitions of "small business case" or "small business debtor" and the small business rules will not apply. The creditors' committee role will be the same as in other chapter 11 cases.

As a result of the then-emerging impact of the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act was enacted on March 27, 2020.[8] The CARES Act expanded application of the SBRA. Before the enactment of the CARES Act, a company or an individual engaged in commercial or business activities with less than $2,725,625 in total non-contingent liquidated debt, including secured and unsecured claims, could elect to file under subchapter V of chapter 11. Under that CARES Act, that debt limit was raised to $7,500,000 for one year through March 27, 2021. Subsequently, the COVID-19 Bankruptcy Relief Extension Act of 2021 signed by President Biden on March 27, 2021, extended the increased debt ceiling through March 27, 2022.[9]

However, there was a delay in further extending the increased debt limit. Ultimately, on June 21, 2022, President Biden signed the Bankruptcy

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[6] This amount applies in cases commenced on or after April 1, 2019. For cases commenced on or after April 1, 2016, and before April 1. 2019, the dollar amount is $2,566,050.

[7] Pub. L. No. 116-54 (2019), effective February 19, 2020.

[8] Pub. L. No. 116-136 (2020), effective March 27, 2020.

[9] Pub, L. No. 117-5 (2021).

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Threshold Adjustment and Technical Corrections Act[10] into law, which raised the debt limit back to $7.5 million for businesses electing treatment under the Small Business Reorganization Act, codified under subchapter V of chapter 11. The act was originally approved by the U.S. Senate on April 7, 2022, and later approved by the U.S. House of Representatives on June 7, 2022, before being sent to the president for signature. The act's two-year sunset provision will run on June 21, 2024.

Earlier in 2022, the $7.5 million limit was reduced to just over $3 million after the prior version of the law, under the March 2020 CARES Act, expired on March 27, 2022. The act also retroactively applies the $7.5 million debt threshold to all cases filed between March 27, 2022 and June 21, 2022.[11]

The chapter 11 process under subchapter is designed to be streamlined (with both certain procedural and substantive requirements that apply in other chapter 11 cases eliminated or only applicable subject to court imposition) and less costly. There is no appointment of a creditors' committee in a subchapter V case, unless the court orders otherwise.[12] Further, in subchapter V, unlike in other chapter 11 cases. only the debtor may file a plan, there is no disclosure statement requirement (unless the court orders otherwise), the absolute priority rule is inapplicable, and the requirement that at least one impaired consenting class accept a plan that impairs a class of claims is eliminated so long the plan is fair and equitable and does not discriminate unfairly, but "fair and equitable" is defined differently in subchapter V cases to permit a debtor to retain an interest in the business after confirmation.[13]

In *Lear Capital, Inc.,*[14] the court approved a settlement that provided for the formation of a committee to represent the debtor's customers. The court issued an order providing that "[p]ursuant to 11 U.S.C. §§ 1181(b), 1102(a)(2), and 1102(a)(3), the United States Trustee is directed to appoint an official committee of customer creditors in this case" and that section "1103 is applicable in the . . . case."[15] Section 1102 regarding appointment of committees and section 1103 providing the powers and duties of committees do not apply in subchapter V cases, unless the court orders

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[10] Pub. L. No. 117-151 (2022)

[11] Pub. L. No. 117-151 § 2(h) (2022).

[12] 11 U.S.C. § 1181(b).

[13] 11 U.S.C. § 1181(a) and (b).

[14] Case No. 22-10165 (BLS) (Bankr. D. Del. 2022).

[15] Case No. 22-10165 (BLS) (Bankr. D. Del. 2022), docket no. 254 (June 27, 2022).

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otherwise, as it did in *Lear Capital*. Accordingly, in what likely will be a small minority of subchapter V cases, creditors' committees may be appointed.

In *In re Bonert*,[16] a chapter 11 case commenced prior to the enactment of SBRA, the bankruptcy court approved the debtor's amendment of its chapter 11 petition to elect treatment under subchapter V. Over the objection of the creditors' committee, the court approved this request, stating that "[t]he Court finds re-designation to Subchapter V to be appropriate on the specific facts of this case. However, it is important for the Court to emphasize that re-designation will not necessarily be proper in all Chapter 11 petitions commenced prior to the effective date of SBRA."[17] The court further explained that it would allow the creditors' committee to continue in existence "if it can demonstrate that its continued existence will improve recovery to creditors, will assist in the prompt resolution of this case, and is necessary to provide effective oversight of the Debtors."[18]

¶¶ 2.03–2.50 [Reserved]

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[16] 2020 Bankr. LEXIS 1783 (Bankr. C.D. Cal. June 3, 2020).

[17] 2020 Bankr. LEXIS 1783, at *7–8.

[18] 2020 Bankr. LEXIS 1783, at *8–9.

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¶ 2.51 Form: Motion for Order That a Creditors' Committee Not Be Appointed.

UNITED STATES BANKRUPTCY COURT
. . . . . DISTRICT OF . . . . . .

	Chapter 11
In re	Case No. . . . .
. . . . . ,	Date: . . . . .
Debtor.	Time: . . . . .
	Place: . . . . .

Motion for Order That a Creditors' Committee Not Be Appointed

The motion of . . . . . respectfully represents:

1. Movant is the United States trustee for the district in which the above-captioned case is pending and, as such, has standing to bring this motion.

2. The debtor is a small business debtor within the definition of 11 U.S.C. § 101(51D) of the Bankruptcy Code. The debtor is engaged in commercial or business activity, and the debtor's primary activity is not the owning or operating of real property and activities incidental thereto. The debtor's aggregate, noncontingent, liquidated, secured and unsecured debts as of the date of the petition initiating the above-captioned case do not exceed $2 million. No committee of unsecured creditors has been appointed herein.

3. Cause exists for the court to make its order that a committee of creditors not be appointed herein. To wit as shown by the declaration of . . . . . attached no hereto:

a. The debtor has only . . . . . unsecured creditors who might otherwise qualify to serve on an official committee of creditors holding unsecured claims. All (but . . . . .) of such creditors have stated that they would not serve on a committee of creditors in this case.

b. Appointment of an official creditors' committee in this case is not necessary to secure adequate representation of the unsecured creditors.

WHEREFORE, movant requests that this court, pursuant to section

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1102(a)(3) of the Bankruptcy Code, make its order that a committee of creditors not be appointed in this case.

Dated: . . . . . .

By: . . . . . .
Attorney for Movant

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¶ 2.52 Form: Declaration in Support of Motion for Order That a Creditors' Committee Not Be Appointed.

UNITED STATES BANKRUPTCY COURT
. . . . . DISTRICT OF . . . . . .

	Chapter 11
In re	Case No. . . . .
. . . . . ,	Date: . . . . .
Debtor.	Time: . . . . .
	Place: . . . . .

Declaration of . . . . . in Support of Motion for Order That a Creditors' Committee Not Be Appointed

I, ... , declare under penalty of perjury as follows:

1. I am a case analyst in the office of the United States trustee assigned to this case and have personal knowledge of the facts stated herein and, if called as a witness, could competently testify thereto.

2. On . . . . . (date) . . . . . , I spoke by telephone with . . . . . , creditors holding unsecured claims in the above-captioned case who would otherwise be eligible to serve on an official creditors' committee and inquired whether . . . . . would be willing to serve on such a committee, if formed. . . . . informed me that he/she would not be willing to serve and stated his/her belief that an unsecured creditors' committee would not be necessary to secure adequate representation of unsecured creditors in this case.

3. As shown by the schedules of the debtor, there are only . . . . . unsecured creditors of the debtor and, to my knowledge, they are acquainted with one another and are in communication without the need of an official committee of creditors.

Dated: . . . . . .

0011 [ST: 1] [ED: 100000] [REL: 2023] **Composed:** Tue Jan 24 20:37:19 EST 2023
XPP 9.4.1.0 SC_00219 nllp 231 [PW=432pt PD=648pt TW=336pt TD=528pt]
VER: [SC_00219-Master:06 Jan 23 02:10]**[MX-SECNDARY:** 01 Mar 21 12:00]**[TT-:** 29 Jul 21 00:02 loc=usa unit=00231-ch0002] **0**

By: . . . . . .

0012 [ST: 1] [ED: 100000] [REL: 2023] **Composed:** Tue Jan 24 20:37:19 EST 2023
XPP 9.4.1.0 SC_00219 nllp 231 [PW=432pt PD=648pt TW=336pt TD=528pt]
VER: [SC_00219-Master:06 Jan 23 02:10]**[MX-SECNDARY:** 01 Mar 21 12:00]**[TT-:** 29 Jul 21 00:02 loc=usa unit=00231-ch0002] 0

¶ 2.53 Form: Notice of Motion for Order That a Creditors' Committee Not Be Appointed and Opportunity to Object.

UNITED STATES BANKRUPTCY COURT
. . . . . DISTRICT OF . . . . . .

	Chapter 11
In re	Case No. . . . .
. . . . . ,	Date: . . . . .
Debtor.	Time: . . . . .
	Place: . . . . .

Notice of Motion for Order That a Creditors' Committee Not Be Appointed and Opportunity to Object

TO ALL PARTIES IN INTEREST IN THE ABOVE-CAPTIONED CASE, INCLUDING ALL PARTIES WHO HAVE REQUESTED SPECIAL NOTICE:

PLEASE TAKE NOTICE that the United States trustee has on . . . . . (date) . . . . . filed a motion for an order that a committee of creditors not be appointed in this case. A copy of said motion is attached hereto. Unless an objection is filed by a party within . . . . . days from the date of this notice, the court may enter its order granting the motion and ordering that a creditors' committee not be appointed in this case.

Dated: . . . . . .

By: . . . . . .
Attorney for Movant

0013 [ST: 1] [ED: 100000] [REL: 2023] **Composed:** Tue Jan 24 20:37:20 EST 2023
XPP 9.4.1.0 SC_00219 nllp 231 [PW=432pt PD=648pt TW=336pt TD=528pt]
VER: [SC_00219-Master:06 Jan 23 02:10]**[MX-SECNDARY:** 01 Mar 21 12:00]**[TT-:** 29 Jul 21 00:02 loc=usa unit=00231-ch0002] 0

¶ 2.54 Form: Order That a Committee of Creditors Not Be Appointed.

UNITED STATES BANKRUPTCY COURT
. . . . . DISTRICT OF . . . . . .

	Chapter 11
In re	Case No. . . . .
. . . . . ,	Date: . . . . .
Debtor.	Time: . . . . .
	Place: . . . . .

Order That a Committee of Creditors Not Be Appointed

The United States trustee for this district having filed a motion requesting that the court make its order that a committee of creditors not be appointed in this case, and it appearing from the notice of motion and proof of service filed with the court that adequate notice has been duly given to all parties in interest, including all parties who have requested special notice; and it further appearing that no objection to the granting of said motion has been filed.

Now, good cause appearing from the allegations of the motion and the declaration of . . . . . attached thereto, it is

ORDERED that a committee of creditors, otherwise authorized by section 1102 of the Bankruptcy Code, not be appointed in this case.

Dated: . . . . . .

By: . . . . . .
Bankruptcy Judge