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**The Formation and Functioning of a Creditors'
Committee: *Making Sausage or Baking a Soufflé?***

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THE FORMATION AND FUNCTIONING OF A CREDITORS COMMITTEE: MAKING SAUSAGE OR BAKING A SOUFFLE?

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Unsecured creditors' committees perform a vital role in the reorganization process of chapter 11 cases. The scheme adopted by the Bankruptcy Code in 1978 removed the bankruptcy judge from administration of the estate and gave preference to leaving the debtor in possession of its assets and affairs. Accordingly, this change created a need for a watchdog to monitor the debtor's operations and assist in the formulation of a plan of reorganization. *See* Alan N. Resnick & Henry J. Sommer, 5 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 83.01 (17th ed. rev. 2015). The drafters of the Bankruptcy Code intended creditors' committees to provide supervision of the debtor in possession or trustee and represent the class of creditors from which they are selected, and to protect their constituents' interests and be the primary negotiating bodies for the formulation of a plan of reorganization. H.R. REP. NO. 95-595, at 401 (1977).

A smoothly operating committee in a reorganization case can serve a function similar to that of a board of directors, helping to guide the debtor in possession through post-petition business issues and the formulation of a plan. Members of the committee can bring valuable institutional and industry knowledge to assist the debtor in returning to profitability. A dysfunctional or "captive committee" on the other hand can hinder the reorganization, waste valuable estate resources, or force the company into an unnecessary liquidation.

Under the provisions of the Bankruptcy Code, the Office of U.S. Trustee has been given an important role in the appointment of creditors' committees, the appointment of members to the committee and monitoring the adherence of committee members to their fiduciary duties. The U.S. Trustee is required to appoint a committee of unsecured creditors and has the discretionary authority to appoint additional committees to protect the rights of other classes of creditors. The role of counsel to an unsecured creditors committee is also very important and, in some larger bankruptcy cases, can be quite lucrative. The competition for these engagements can be very fierce and can raise ethical issues for prospective counsel.

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I. COMMITTEE FORMATION

A. Role of U.S. Trustee

The drafters of the Bankruptcy Code removed the administrative function of forming creditors' committees from the bankruptcy judges and placed this task in the hands of the newly-created Office of U.S. Trustee. Section 1102(a)(1) of the Bankruptcy Code² requires the U.S. Trustee to appoint a committee of creditors holding unsecured claims in all chapter 11 cases "as soon as practicable after the order for relief" 11 U.S.C. § 1102(a)(1).³ Chapter 11 cases can move quite rapidly. With "first-day motions" and accelerated hearings, the court often must make decisions on post-petition financing and, in many cases, decisions on the sale of the debtor's assets within the first few weeks of a chapter 11 filing. Therefore, the input of a creditors' committee can be invaluable. This also means that the U.S. Trustee must move quickly on the appointment of a committee.⁴

While the Code provides the U.S. Trustee with some guidance as to the appropriate composition and membership of the committee (i.e., the committee shall "ordinarily" consist of those willing persons that hold the seven largest claims against the debtor, *see* 11 U.S.C. § 1102(b)(1)), the U.S. Trustee generally has broad discretion in this appointment process, and can appoint any creditor that it determines will adequately represent holders of unsecured claims, regardless of the size of the claim.⁵ In most cases, the U.S. Trustee solicits prospective committee members from the list of the twenty largest unsecured creditors but may also look beyond this list. U.S. Trustees typically solicit creditors by letter and questionnaire. Committees in smaller cases are often formed after telephone inquiries or conference calls, while in-person formation meetings are more common in larger cases.⁶

In addition to making objective determinations on potential disqualifying facts, the U.S. Trustee must subjectively gauge (i) a creditor's genuine willingness to serve on the committee for legitimate reasons and (ii) the creditor's willingness to act as a fiduciary to the entire unsecured creditor constituency. Roberta A. DeAngelis & Nan Robert Eitel, *Committee Formation and Reformation: Considerations and Best Practices* (2011).⁷

² Unless otherwise specified, "section" refers to sections of the U.S. Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*

³ On request of a party in interest and for "cause", the court may order that a creditors committee not be appointed in a small business case. 11 U.S.C. § 1102(a)(3); *see also* § 101(51C), (51D) (providing definitions of a small business case and small business debtor).

⁴ Creditors sometimes organize a committee prior to the commencement of a bankruptcy case. If such a committee was fairly chosen and is representative of the various kinds of claims in the case, the U.S. Trustee will give strong consideration to the appointment of the members of the pre-petition committee to the official committee. United States Trustee Program Policy and Practices Manual ("Trustee's Manual"), at 3-4.9.

⁵ Use of the term "ordinarily" in Section 1102(b)(1) suggests that such language is intended to provide general guidance but not to create an immutable requirement. *See* Alan N. Resnick & Henry J. Sommer, 7 COLLIER ON BANKRUPTCY ¶ 1102.02[2] (17th ed. rev. 2015).

⁶ Sample formation materials used by the U.S. Trustee are included in the Appendix to the Trustee's Manual and are attached as an Appendix to this article.

⁷ While a member may be removed due to a change in status (i.e., a creditor changes from unsecured to secured or otherwise sells its claim) or apparent breach of fiduciary duty, removal generally should not be based on a mere conflict within the committee over the strategy or objections. *See* Roberta A. DeAngelis & Nan Robert Eitel, *Committee Formation and Reformation: Considerations and Best Practices* (2011); *see also In re Barney's, Inc.*,

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