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When **Committees** Object After Class Accepts Plan

Courts have found duty to raise concerns if statutory violations exist.

BY ROSANNE THOMAS MATZAT

INCIDENT to the plan negotiation process, typically taking place over a period of evolving circumstances, is a growing tendency for a committee to withhold affirmative support of the plan until final concessions can be extracted. Experience has shown many creditor and bondholder committees that changing dynamics can serve as the source of additional consideration, sometimes garnered right up to or at the confirmation hearing.

Reserving the ammunition to obtain these additional concessions often requires that a committee object to confirmation of a proposed Chapter 11 plan. A dichotomy is raised when this objection is interposed in the face of an accepting class constituency. When a balloting report showing that the class of claimants represented by a committee has voted for the acceptance of the plan, should a committee still be free to raise an objection to confirmation of the plan?

Section 1103 of the Bankruptcy Code sets forth the powers and duties of an official creditors' committee in a Chapter 11 case. The section provides:

A committee appointed under §1102 of this title 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 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 §1104 of this title; and

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

11 U.S.C. §1103(c).

"Although section 1103(c) states that a committee 'may' exercise these powers, the members of a committee have a fiduciary duty to their constituents and are obligated to exercise those powers as necessary to protect the interests of those constituents." 7 L. King et al., Collier on Bankruptcy ¶1103.05[1], at 1103-21 (15th Ed. Rev. 1998); see also *In re Pierce*, 237 B.R. 748, 758 (Bankr. E.D. Ca. 1999); *In re Granite Partners, L.P.*, 210 B.R. 508, 516 (Bankr. S.D.N.Y. 1997); *In re ABC Automotive Prods. Corp.*, 210 B.R. 437, 441 (Bankr. E.D. Pa. 1997); *In re Caldor, Inc.*, 193 B.R. 165, 169 (Bankr. S.D.N.Y. 1996); *In re L.F. Rothschild Holdings, Inc.*, 163 B.R. 45, 49 (Bankr. S.D.N.Y. 1994); *In re REA Holding Corp.*, 8 B.R. 75, 81 (Bankr. S.D.N.Y. 1980).

The committee's "duty extends to the class as a whole, not to its individual members." *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 717, 722 (Bankr. S.D.N.Y. 1992); see also *In re SPM Mfg. Corp.*, 984 F.2d 1305, 1315 (1st Cir. 1993); *Granite Partners*, 210 B.R. at 516. In addition, the Bankruptcy Code limits the scope of the committee's duty to the class it represents, owing no duty to the debtor or the estate generally. See *Granite Partners*, 210 B.R. at 516; *Pan Am Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438, 514 (Bankr. S.D.N.Y. 1994).

Function and Authority

The committee's "primary function 'is to advise the creditors of their rights and the proper course of action in the bankruptcy proceedings.' " *Caldor*, 193 B.R. at 169 (quoting *Matter of Bohack Corp.*, 607 F.2d 258, 262 n.4 (2d Cir. 1979)); see also *ABC Automotive*, 210 B.R. at 441. This responsibility is most evident in the committee's participation in the formulation of a plan pursuant to §1103(c)(3). The legislative history to §1103 makes it clear that Congress envisioned that the official committees "will be the primary negotiating bodies for the formulation of the plan of reorganization. They will represent the various classes of creditors and equity security holders from which they are selected." H.R. REP. NO. 595, 95th Cong. 401 (1st Sess. 1978), 1978 U.S.C.C.A.N. 6357.

Although a committee is vested with considerable power and authority and is charged with negotiating the plan on behalf of its constituencies, a committee is not authorized or empowered to bind its constituency to the acceptance of a plan. See *In re Donlevy's Inc.*, 111 B.R. 1, 2 (Bankr. D. Mass. 1990). Notwithstanding a committee's inability to bind its constituency, there are cases that hold a committee may object to the confirmation of a proposed Chapter 11 plan even though the ultimate balloting reports indicate that its constituency voted for the acceptance of such plan. See *In re EBP, Inc.*, 171 B.R. 601, 602 (Bankr. N.D. Ohio 1994); *In re Central Medical Center, Inc.*, 122 B.R. 568, 571 (Bankr. E.D. Mo. 1990); *In re Tenn-Fla Partners*, 1993 Bankr. Lexis 789 *4 (Bankr. W.D. Tenn. April 29, 1993).

In *EBP*, the debtor argued that the committee's counsel acted outside the scope of its

Rosanne Thomas Matzat *is a partner in the bankruptcy and reorganization group at Hahn & Hessen.*

authority in filing an objection to the debtor's plan because the class of claimants that it represented voted for the plan's acceptance. The court stated that "the only statutory constraints are addressed under §1103(a) and (b)" and "[n]one of those statutory constraints are violated or at issue." *EBP*, 171 B.R. at 602. The court found:

> [T]he Debtor has failed to adduce any evidence to show the scope of any authority which the Committee, itself, may have imposed upon its counsel. Without such, the Debtor's assertion that the Committee's counsel acted beyond the scope of his authority is not only conclusory but, is otherwise unsubstantiated. Counsel to a creditors' committee undertakes the obligation to represent the interests of the entire class fairly, not just the members of the Committee.

Id. (citing *Matter of Arlan's Dept. Stores*, 615 F.2d 925, 932 (2d Cir. 1979); *Berner v. Equitable Office Bldg. Corp.*, 175 F.2d 218 (2d Cir. 1949). The court concluded that "[t]he fact that the [class of] unsecured claimants voted in favor of the Debtor's Plan, while the Committee filed an objection to the Plan is not necessarily incongruous." *EBP*, 171 B.R. at 602.

Standing to Object

In *Central Medical Center*, the court concluded that, notwithstanding the bondholders' vote for the acceptance of the proposed plan, the bondholders' committee had standing to object to such plan for three reasons. The court first stated that "the specific language of Section 1109(b) supports the Committee standing." *Central Medical Center*, 122 B.R. at 571. Second, the court did "not ascribe to the view that because a committee's constituents have voted for pecuniary treatment under a plan, therefore they have waived their right (and thus the committee's right) to raise objections relating to Section 1129(a)." Id. Accordingly, the court determined:

> In voting to accept the Plan, individual bondholders merely voted to accept the pecuniary treatment accorded them under the Plan. This does not mean that the Committee waived its rights to object to the means of implementing that treatment. Thus, in voting to accept a plan, the only provisions of Section 1129(a) under which a committee has waived its objection is subsection (a)(8), which governs plan modification and class acceptance.

Id. Finally, the court found "that as part of upholding its fiduciary responsibility to its constituents, a committee has both a duty and an obligation to raise objections to any provision of a plan it deems violative of Section 1129(a)." Id.

The *Central Medical Center* court appears to be suggesting a distinction which may have merit in addressing the issue. Imagine a situation, for example, where a committee negotiates a plan of reorganization with a debtor and the debtor's secured creditor whereby the secured creditor agrees — in exchange for a release of claims from the debtor's estate and the debtor's creditors — to a certain fixed payment and a 100 percent interest in certain of the debtor's avoidance actions, and unsecured creditors are proposed to receive a 50 percent cash distribution at confirmation.

A dichotomy is raised when an objection to confirmation of a proposed Chapter 11 plan is interposed in the face of an accepting class constituency.

The committee, while perhaps not displeased with the proposed 50 percent cash distribution, may wish to maintain leverage to obtain some percentage interest in the avoidance actions being otherwise retained in the plan by the secured creditor. The debtor ballots the plan without the recommendation of the committee in favor or against the plan treatment, and the class of unsecured creditors votes in favor of the plan.

To the extent a committee constituency has voted affirmatively to accept specific pecuniary treatment under a plan, there seems to be a fundamental unfairness to the plan proponent in allowing the committee to continue to raise objection to things which relate specifically to that pecuniary treatment in the sole interest of obtaining enhanced treatment, for example, the liquidation analysis under §1129(a)(7).

Arguably, the balloted constituency, by having agreed to the pecuniary treatment, has made its assessment of its preference for reorganization over liquidation. Further, arguably, by pressing objections contrary to this class decision, a committee is impeding confirmation and working contrary to its fiduciary duty to represent the interest of that class as a group. *Accord In re Cara Corp.*, 1992 Bankr. LEXIS 672 *5 (Bankr. E.D. Pa. April 27, 1992) (considering it "improper, inequitable, and violative of 11 U.S.C. §§1129 (a)(3), (b)(1), for the Committee to press" for a cram down of its class in the face of a rejecting vote from its constituency).

Accordingly, the posited committee should be precluded from raising an objection that the liquidation of the debtor's assets presents greater value to unsecured creditors than the 50 percent cash distribution afforded in the plan. This position, even if supportable based on independent appraisals, seems fundamentally contrary to the stated position of the majority of the class as evidenced by the balloting. Stated otherwise, this position, taken to a successful conclusion, would result in defeat of the reorganization and presumably, the liquidation of the debtor — a result contrary to the expressed desire of the class represented by the committee.

On the other hand, to the extent there are other plan provisions which may be violative of other provisions of §1129(a) or make the plan otherwise non-confirmable (e.g. impermissibly broad releases, non-conformance with regulatory provisions under §1129(a)(6)), a committee should and must continue to exercise an independent duty to the court and to the plan process to raise these concerns. See *In re Union Meeting Partners*, 165 B.R. 553, 569 (Bankr. E.D. Pa. 1994) (and cases cited therein referring to a court's independent duty to review plan terms for confirmability).

So, for example, if the posited committee believes that a good faith issue is raised in the relevant jurisdiction as to the viability of the third party release running to the secured creditor, then the committee may have both a right and an obligation to object to the plan on this basis. If imposition of this objection then results in the secured creditor agreeing to allocate some percentage of the avoidance claims to the unsecured creditors as additional consideration for the releases in a final hour, non-material modification of the plan, then the objection and the result seem to be in accord with the statutory intent and the rationale in *Central Medical*.

HAHN&HESSEN LLP
488 Madison Avenue • New York, NY 10022
212-478-7200
Rosanne Thomas Matzat • 212-478-7410
www.hahnhessen.com