

BANKRUPTCY

WHEN IS A CREDITOR ELIGIBLE TO SERVE ON AN UNSECURED CREDITORS COMMITTEE: ONE OF THE NATION'S LEADING BANKRUPTCY COURTS PROVIDES SOME CLARITY

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In *In re Park West Circle Realty, LLC*, ___ B.R. ___ (Bankr. S.D.N.Y. 2010), the Bankruptcy Court for the Southern District of New York was faced with what seemed like a relatively simple issue: who may serve on a committee of unsecured creditors in a Chapter 11 proceeding? For the *Park West* court, answering this question proved to be more difficult than one might expect.

The United States Trustee—an agent of the Department of Justice that serves as an advocate for all creditors in bankruptcies—is required to appoint a committee of unsecured creditors in all Chapter 11 cases. Essentially, this committee serves a “watchdog” function: it has the power to retain lawyers and accountants (subject to court approval and to be paid by the estate), consult with the U.S. Trustee or the debtor concerning the administration of the estate, investigate the debtor’s business, finances, and the desirability of continued operations, and participate in the formulation of a plan of reorganization. Thus, the Committee protects the rights of all unsecured creditors during a bankruptcy proceeding, including those unsecured creditors whose claims may not be large enough to warrant their own active involvement in the Chapter 11 case.

The Bankruptcy Code states that a committee “shall ordinarily consist” of members that hold one of the seven largest unsecured claims against the debtor. Beyond this guidance from the Code, eligibility to serve on a committee is more imprecise. When the U.S. Trustee selects committee members, he or she must select members who represent the different categories of the debtor’s creditors, such as bank lenders, trade creditors, union/employee creditors, and rejected lease/executory contract claimholders. Consequently, there is no set formula for selecting committee members, as this must be done on a case by case basis by evaluating the best way to make the committee representative.

The issue in *Park West* arose when the U.S. Trustee rejected the Debtors’ largest creditor, Constantine Cannon LLP as a member of the unsecured creditors’ committee. Constantine Cannon had served as the Debtors’ prepetition legal counsel, incurring an unpaid claim of approximately \$2.18 million. The U.S. Trustee feared that if she allowed Constantine Cannon to serve on the committee, there would be a potential disclosure of attorney-client privileged information obtained by Constantine Cannon through its representation of the Debtors. Constantine Cannon disagreed and requested that the court allow Constantine Cannon to be a member.

In holding that Constantine Cannon should be a member of the committee, the court outlined a list of factors that a U.S. Trustee

should consider when selecting members of the unsecured creditors committee. The list included:

1. [T]he ability of the committee to function;
2. the nature of the case;
3. the standing and desires of the various constituencies;
4. the ability for creditors to participate in the case even without an official committee and the potential to recover expenses pursuant to § 503(b);
5. whether different classes may be treated differently under a plan and need representation;
6. the motivation of the movants;
7. the delay and additional cost of granting the motion;
8. the point in the proceeding when the motion is made;
9. the tasks the committee is to perform; and
10. any other relevant factors.

Park West, ___ B.R. at ___.

After analyzing these factors, the *Park West* court found that the U.S. Trustee’s committee selections did not adequately represent creditors like Constantine Cannon. With the second highest claim being only \$140,000, no other creditor had a claim as substantial as Constantine Cannon’s claim. Additionally, Constantine Cannon was the only creditor with a personal guarantee claim against the debtors. The court also took into consideration the fact that Constantine Cannon’s outstanding claim was one of the primary factors leading to the Debtors’ bankruptcy petition. Finally, with no objection from either of the debtors, the Bankruptcy Court held that in order to have a committee that represented all claimants, Constantine Cannon would have to be a part of it.

Park West demonstrates that a creditor is not automatically entitled to participate in an unsecured creditors committee simply because it has one of the largest unsecured claims. There is much more to consider, such as the effect the member’s participation will have on the entire proceeding. As seen in *Park West*, however, having a unique claim against the debtor is one way to make the cut.

Ultimately, a U.S. Trustee’s objective in selecting committee members is to consider the totality of the circumstances and to make certain that the committee is composed of creditors that can adequately represent *all* creditors. In so doing, the U.S. Trustee—like the committee he or she appoints—helps to maintain the integrity of the bankruptcy process as a whole.

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