

ISSUES OF COMMITTEE RELEVANCY IN CURRENT CHAPTER 11 CASES

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Due to a number of forces, most importantly the global recession and the resulting global macroeconomic conditions, creditor committees are now having difficulty in finding their role in many chapter 11 cases. Many factors, including rapid declines in asset values, mean that many secured lenders find themselves holding loans that are vastly under-collateralized. At the same time, the credit markets have all but dried up and companies in distress are being left with virtually no opportunities to refinance their debt, even if they haven't experienced a significant decline in the value of their assets. When this is coupled with the loss of cash flow that many businesses are experiencing as a result of the global recession, a great number of companies that would have previously survived difficult times are left with little choice other than to seek protection under chapter 11. Exacerbating these circumstances is that many banks and other lenders have found that now is the most opportune time to shed underperforming loans, regardless of the loss they may incur, in order to clean up their balance sheets. This means that often, lenders are more inclined to just get out, regardless of the losses realized.

Poignant examples of this are real estate developers and home builders. The rapid decline in property values and the sharp decrease in new home sales have led many developers to drastically reduce the prices of the homes they are building and, hopefully, selling. However, builders must still pay mortgage releases to their lenders under construction loans that were

entered into when property values were much higher. Thus, their margins disappear rapidly and they end up with negative cash flows in a very short period of time.

Once a Chapter 11 petition is filed by a distressed business, unsecured creditors and the committees that represent their interests are thrust into a case with a secured lender that is completely underwater. This is very different from many pre-recession situations where collateral values were arguably close enough for unsecured creditors to have a convincing argument that, but for the egregious conduct of the lender and Debtor who were self-interested and were pushing for a quick resolution to the case, unsecured creditors might realize some recovery. Now, however, it is commonplace in chapter 11 cases that secured lenders are so undersecured that they dominate the cases and the timeline and have taken over the role that committees have traditionally played in keeping debtor excesses in check (and keeping other lenders in check, for that matter).

Committees and their advisors, therefore, now find themselves struggling to find a relevant voice in an ever increasing number of chapter 11 cases. Accordingly, the question must be asked: what can committees and their professionals do to find that voice and secure for themselves a seat at the table with debtors and their lenders? The traditional avenues still exist:

1. Committees can choose to push lenders and play the stay relief/foreclose card to see if the lenders really want to exit the loan out of bankruptcy.
2. Committees can push both the debtor and the lender by conducting what has been referred to as “a scorched earth” investigation of everything even more thoroughly than in the past because the committee has nothing to lose. The potential hazard of this approach is that if an investigation does not uncover anything, the professionals could end up footing most of the bill.

3. Committees can cooperate with the lender to force a fast liquidation and get a small dividend for assisting with gaining approval of and completing a quick liquidation.

4. Committees can cooperate with debtor in forcing a lender to “stay in” where there may be value but over a longer period of time through a boot-strap chapter 11 plan. However, this is dependent on a going concern valuation of the enterprise that shows the lender receiving what they are entitled to under their loan, just over a period of time.

Given the current climate, when evaluating its options, creditor committees should be pragmatic about what is achievable.