Global Restructuring Review

The Art of the Ad Hoc

Editors
Howard Morris, James M Peck and Sonya Van de Graaff

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A Comparison of an Ad Hoc Committee and Official Committee Under Insolvency and Other Laws in England and the United States

Nick Angel, Peter Newman and Edward Rasp[1]

Introduction

Corporate restructurings inherently involve agreements between debtors and their creditors with respect to amendments of the terms of debt obligations that the debtors will not be able to honour. In most restructurings, these agreements will require the consent of multiple creditors and it is therefore efficient for the debtors to negotiate with groups or committees of their creditors. In many circumstances, groups or committees of creditors will join together on an ad hoc basis to represent the interests of their constituencies in negotiations with the debtors and, in some cases, other creditor groups, shareholders or other stakeholders. In formal restructuring or insolvency proceedings, similar considerations have led to the creation of formal 'official' committees to represent certain constituencies in the relevant formal process. The activities and powers of each creditors' committee vary between jurisdictions and types of proceedings.

In this chapter, we compare the activities and powers of formal and informal committees with regard to three primary themes: (1) role and powers, (2) formation and governance, and (3) obligations, duties and liabilities. We have limited the discussion to the laws generally applicable to corporate restructurings or insolvency under English law and US law (i.e., in an English administration and in a Chapter 11 case in the US). Notably, one of the most commonly used English law tools for implementing a restructuring, a scheme of arrangement, makes no provision for official creditors' committees (although ad hoc committees are often instrumental in the formulation and implementation of restructuring schemes) and is therefore not discussed in this chapter. Official and ad hoc committees also have roles in restructurings in many other jurisdictions, as well as in specialised restructuring procedures tailored

1 Nick Angel and Peter Newman are partners and Edward Rasp is an associate at Milbank, Tweed, Hadley & McCloy LLP.

to a particular entity or industry, for example, bank, broker/dealer insolvencies, although these go beyond the scope of this chapter.

Role and powers

The role of a creditors' committee and the powers it has vary greatly across jurisdictions and different types of proceedings, and depend on the different types of creditors comprising the committee and various other factors. The role and powers afforded to a committee are generally reflective of the overall purpose of the statutory scheme of the relevant proceeding.

English law

Official committee

The creditors of a company in English administration, administrative receivership or liquidation proceedings have the option to form an official committee under the Insolvency Act 1986 and the Insolvency (England and Wales) Rules 2016 (SI 2016/1024) (the English Rules),[2] but there is no requirement to do so.[3] The role of the official committee in an English administration is significantly less material than the role an official committee might have in restructurings in other jurisdictions or even the role an ad hoc committee might play in an administration. The limited role of official committees in English administrations is consistent with the general design of administration, which displaces company management from the day-to-day operation of the business and entrusts the administrators with significant discretion to take actions to administer the estate in furtherance of the purposes of the administration.

The English Rules describe the role of an official committee as assisting the administrator in discharging its functions through consultation and consensus, reviewing the administrator's proposed remuneration, and such other matters as may be agreed with the administrator.[4] The official committee is not specifically entitled to retain professional advisers and no provision is made for payment of advisory costs of an official committee from the administration estate. Consequently, creditors electing to serve on the committee must be willing to bear the costs of doing so. The English Rules provide an official committee with limited rights, or tools, to accomplish their function: they may request information from the administrator, which, except under limited circumstances, must be provided; they may seek a meeting with the administrator at any reasonable time following seven days' notice; and they have the right to reject the administrator's proposed remuneration (which typically does not include costs and expenses).[5] The official committee does not have any investigative powers or the right to

2 Insolvency Act 1986, Schedule B1, para. 57(1); Statement of Insolvency Practice 15 (England & Wales), Annexe A, para. 1.1.

3 The English Rules provide creditors the right to form a creditors' committee in administrative receiverships, and a liquidation committee in the case of a liquidation. Broadly speaking, the committees in those proceedings serve the same purpose and their members are generally provided the same sort of powers and duties as the creditors' committee in an administration. We will focus on English administration for purposes of this chapter.

4 Insolvency (England and Wales) Rules 2016, r17.2; Statement of Insolvency Practice 15 (England & Wales), Annexe A, paras. 1.2 & 5.

5 Insolvency Act 1986, Schedule B1, para. 57(3); Statement of Insolvency Practice 15 (England & Wales), Annexe A, para. 4.5.

negotiate matters with the administrator, but the committee is authorised to challenge any of the administrator's conduct that unfairly harms creditors' interests.[6] The actions of the official committee are not binding on creditors generally, but a court may regard the committee's views as influential when considering the views of creditors as a whole.[7]

The English Rules and the Statement of Insolvency Practice provide little in the way of guidance for an official committee in discharging its role and powers, apart from:

- requiring the administrator to call the first committee meeting within six weeks of the committee's formation;
- requiring at least two members of the committee and the administrator to be present for quorum purposes;
- identifying the administrator or its designate as chair of the official committee;
- establishing that each member of the official committee has only one vote;
- setting minimum notice requirements for committee meetings; and
- specifying that consideration of the administrator's proposed remuneration ought to include multiple factors, such as:
    - complexity of the case;
    - exceptional responsibilities required of the administrator;
    - the effectiveness of the administrator's actions; and
    - the value and nature of the company's property subject to the administration.[8]

On top of such limited powers, the committee's right to approve the administrator's proposed remuneration is further curtailed by the administrator's right to make an application at court for approval of its remuneration without committee approval.

Informal committees

Informal committees are typically formed to coordinate with a singular creditor voice the negotiation of, and help to influence the implementation of, a company's restructuring outside of, and sometimes within, an administration. Some trace the role and powers of informal committees in English restructurings back to what is known as the London Approach – a voluntary, collective approach for dealing with distressed companies adopted by banks in the late 1970s and endorsed by the Bank of England. The role of informal committees was historically considered to be administrative in nature rather than an advisory role in which the members influence creditors' commercial decisions.[9] As more non-bank creditors, such as hedge funds and other investment vehicles, have become involved in English restructurings, and additional tools, such as debt-for-equity exchanges and new money or 'DIP' loans, have become a part of the restructuring toolkit, the roles of informal committees have become increasingly more substantive by seeking to structure restructuring transactions and then garner creditor consensus for the transaction they have negotiated.

6 Statement of Insolvency Practice 15 (England & Wales), Annexe A, para. 7.

7 *RE WSBL Realisations 1992 LTD* [1995] 2 BCLC 576, [1995] BCC 1118; Re C E King Ltd [2000] 2 BCLC 297.

8 Statement of Insolvency Practice 9 (England & Wales).

9 Insol's *Statement of Principles for a Global Approach to Multi-creditor Workouts II*, Fourth Principle.

There is no prescriptive regime applicable to the rights or powers of an informal committee established in relation to a company restructuring under English law. As a practical matter, therefore, the functions and powers of informal committees are highly dependent on the facts of a particular case, including whether the holdings of the committee's members are sufficient to pass any required votes without outside creditor support, the level of engagement and working relationship the committee develops with the company and other stakeholders, and the alternatives available to the company.

US law

Official committees

The US Bankruptcy Code[10] requires the US Trustee, a component of the US Department of Justice tasked with oversight of the administration of bankruptcy cases, to form at least one committee of unsecured creditors in Chapter 11 cases to represent the interests of its constituents.[11] Unlike in an English administration, the official committee in a Chapter 11 case has a significant role, with extraordinary rights and obligations (discussed below) designed to protect the interests of unsecured creditors and give a voice to those creditors who might otherwise not be able to participate in the restructuring. Official committees are fiduciaries for the creditor group that they represent and their duties extend beyond the members of the committee themselves. The role of the official committee is an integral part of a Chapter 11 case, which leaves the debtors' management in control of a business (at least initially), under the oversight of the official committee. As a well-advised and empowered representative of the debtors' unsecured creditors, the official committee is entitled (and often expected by US bankruptcy court judges) to be heard on any matter in the case, and typically takes a lead role in negotiating the terms of a plan of reorganisation.

A restructuring under Chapter 11 will typically involve only one official committee of unsecured creditors, but the US Bankruptcy Code permits the US Trustee to form additional committees of unsecured creditors or equity security holders, where it deems appropriate, to represent the relevant constituencies adequately.[12] In addition, the US Bankruptcy Code grants the US bankruptcy courts the authority to require the formation of additional committees where a stakeholder has demonstrated that an additional committee is necessary to represent the applicable constituencies adequately.

Evaluating the need for additional committees should include consideration of the increased costs and the added complexity associated with that additional committee, whether all creditors will be treated the same in the restructuring, and, in the case of a consolidated Chapter 11 restructuring, whether the consolidation was for administrative purposes only. Evaluating the need for a committee of equity security holders should include the likelihood of any value remaining for distribution to shareholders after making distributions in full to

10 11 U.S.C. Sections 101 et seq. (as amended from time to time) (the 'US Bankruptcy Code').

11 Note that Chapter 7 of the US Bankruptcy Code, which governs liquidations, also permits the formation of an official committee of creditors, but does not require that one be formed. Chapter 7 official committees generally have more limited roles than an official committee in a restructuring implemented under Chapter 11.

12 11 U.S.C. Section 1102.

each other class of creditors and whether the company's board is likely to protect the shareholders' interests adequately.[13]

The US Bankruptcy Code provides the potential for dispensing with the requirement to form an official committee if it would not be necessary to protect creditor rights.[14] In addition, there may be practical steps a US Bankruptcy Court or US Trustee might take that would have the effect of dispensing with the requirement to form an official committee, such as delaying the deadline to schedule a meeting of creditors and formation of a committee for a specified length of time to allow the US Bankruptcy Court to approve the plan of reorganisation and for the company to exit Chapter 11.[15]

The US Bankruptcy Code prescribes the following functions and powers for an official committee of creditors to discharge its duties (discussed below) in a Chapter 11 case:

- the requirement to provide the committee's constituents with access to information except where it would violate certain confidentiality provisions or risk breaking legal privilege;
- the right to consult with management on the administration of the restructuring and the business generally;
- the ability to investigate the acts, conduct, assets, liabilities, financial condition of the company, the company's operations and the desirability for it to remain in business, as well as any other matter relevant to the Chapter 11 case or implementation of the Chapter 11 plan of reorganisation;
- the right to participate in the formulation of the Chapter 11 plan of reorganisation;
- the requirement to advise its constituents of determinations made in formulating the Chapter 11 plan of reorganisation;
- the requirement to collect and file acceptances or rejections of the Chapter 11 plan of reorganisation with the US bankruptcy court;
- the ability to request the appointment of a trustee to take over management of the company or an examiner to investigate certain matters; and
- other services as necessary.[16]

In addition to the prescribed functions and powers, an official committee is permitted to appear and be heard on any issue in a Chapter 11 case,[17] and a US bankruptcy court, as a court of equity, may also grant an official committee derivative standing to pursue avoidance actions on behalf of the company if the company is not adequately pursuing those actions.[18]

The official committee's supervision of the company, its pursuit of avoidance actions and the general exercise of its functions are supported by the ability to seek broad, comprehensive discovery and its right to employ its own, independent advisers at the company's expense.[19] With each of these powers, the official committee is able to exert significant leverage in the

13 *In re Pilgrim's Pride Corp.*, 407 B.R. 211 (Bankr. N.D. Tex. 2009).

14 11 U.S.C. Section 1102(2).

15 See, e.g., *In re American Color Graphics, Inc.*, Case No. WL 2764539 (Bankr. D. Del. 2008).

16 11 U.S.C. Sections 1102(b), 1103(c).

17 11 U.S.C. Section 1109(b).

18 *Commodore Int'l Ltd. v. Gould (In re Commodore Int'l Ltd.)*, 262 F.3d 96 (2d Cir. 2001).

19 11 U.S.C. Section 1103(a).

case to protect creditors, which might not otherwise be available to an individual creditor or an informal committee.

Informal committees

The US Bankruptcy Code, similar to the English Rules, neither expressly provides for nor prohibits the formation of an informal committee. As with committees formed in English restructurings, there is significant variance in the role of an informal committee depending on the circumstances, including where the claims represented by the committee sit in the debtors' capital structure and likely recovery prospects, and the size of holdings of the committee's membership. Similarly, informal committees are not entitled to any specific rights or powers other than those available to creditors generally and that have been delegated to the committee by its constituents. Notwithstanding the lack of prescribed functions and powers, an informal committee may still be able to exert significant leverage in a Chapter 11 restructuring, and ad hoc committees are sometimes able to recover their advisory costs if they can establish that they made a 'substantial contribution' to the restructuring.[20]

Formation and governance

English law

Official committees

The official committee in an English administration is elected by a simple majority of the relevant creditors during a creditors' meeting, whether held in person or electronically.[21] The English Rules require an official committee to have at least three, but no more than five, members.[22] Only creditors who have proved for a debt that is not fully secured and whose proof has not been wholly disallowed for voting purposes or wholly rejected for distribution or dividend purposes may serve on an official committee.[23] Members of the official committee are not permitted to serve as creditors in their own right at the same time as acting for another creditor.[24] The formation of the committee requires the issuance of a certificate of due constitution by the administrator, to which each committee member has consented but is not subject to being sanctioned by the court.[25]

Informal committees

There is no prescriptive regime applicable to the formation and governance of an informal committee. The formation of an informal committee and its governance can range from involving limited formality to exhaustive documentation. In fact, in some cases it is the distressed company itself that will initiate the formation with particular creditors in the context of looming covenant obligations or potential refinancing options. Whether initiated by the company or the creditors themselves, an informal committee often comprises lenders or

20 11 U.S.C. Section 503(b)(3)(D).

21 Insolvency Act 1986, Schedule B1, para. 57(1).

22 Insolvency (England and Wales) Rules 2016, r.17.3.

23 Insolvency (England and Wales) Rules 2016, r.17.4.

24 Insolvency (England and Wales) Rules 2016, r.17.17.

25 Insolvency (England and Wales) Rules 2016, r.17.4–17.6.

bondholders with the largest claims against the company, but sometimes includes institutions with smaller claims where they have more experience in work-out and restructuring matters.

Once formed, a committee's governance structure will depend on the nature and size of the committee and the similarities and differences of each member's underlying claims, among other things. In the UK, informal committees of banks in restructurings implemented under English law tend to involve more formalities than one would find in, say, informal committees of hedge funds in restructurings under US law. Indeed, the Loan Markets Association publishes extensive documentation and guidance on the formation and governance of informal committees of lenders setting out the exhaustive details of the committee's formation, powers, obligations, duties and liabilities, among other things. In contrast, informal committees comprising alternative credit providers typically involve less formal governance. Notwithstanding the level of formality involved in an informal committee's formation and governance, there are a number of matters that members may want to consider:

- voting thresholds for committee actions (or instructions to advisers) and whether there are situations where the committee may act with a lower threshold;
- the potential resignation of existing members and appointment of new members and any limits on trading their claims;
- the functions and powers delegated to the committee;
- the duties and obligations expected from, and assumed by, the committee;
- expense reimbursement and work fees; and
- liability disclaimers and indemnities with regard to the company and its constituents.

Those matters can be documented in any manner of ways, including in a committee appointment letter from the company or the applicable creditors, or in the engagement terms of the committee's advisers.

US law

Official committees

The US Bankruptcy Code provides that the official committee will 'ordinarily consist of the persons, willing to serve, that hold the seven largest claims against' the company and that reflect the mix of claims held by its constituents.[26] In certain cases, it may be appropriate to appoint more than seven members to the committee to ensure that the committee's members are representative of the constituency that it represents. Once the committee has been formed, the US Bankruptcy Court has limited discretion to order any changes in the committee's composition and generally only where it is necessary to ensure the committee's constituents are adequately represented.[27]

In circumstances where an informal committee has already formed and commenced work prior to the commencement of the Chapter 11 case, the US Trustee may appoint members of that committee to serve as the official committee. In determining whether to appoint members of a pre-Chapter 11 committee to the official committee, the US Trustee must consider whether the members were selected fairly and whether they are representative of the different

26 11 U.S.C. Section 1102(b).

27 11 U.S.C. Section 1102(a)(4).

types of claims represented by the official committee.[28] The US Trustee and the particular creditors will also need to consider whether, as members of pre-Chapter 11 committees or otherwise, the creditors are subject to standstill, waiver or forbearance provisions that might conflict with or otherwise impair their ability to discharge their fiduciary duties (discussed below) as members of the official committee.

The basic features of an official committee's governance are often reflected in bylaws or terms of reference, in part, as evidence of compliance with their fiduciary duties.

Informal committees

The formation and governance of an informal committee under US law is similar to the formation and governance of an informal committee under English law (discussed above).

Obligations, duties and liabilities

English law

As discussed above, the official committee in an English administration has relatively few obligations other than those that may be agreed between the committee and the administrator, reviewing the administrator's proposed remuneration and reviewing the adequacy of the security provided by the administrator. The official committee is generally not obligated to provide information to creditors as that is part of the administrator's functions. The official committee, however, is considered to act as a fiduciary to the unsecured creditors in discharging its functions.[29] As a fiduciary, members of the official committee may only deal with the estate in their personal capacity if in doing so they act in good faith and for value.[30] Finally, members of an official committee in an English administration are not paid for their service, but they may seek reimbursement for reasonable travel expenses associated with attending meetings called by the administrator.[31]

Informal committees

As informal committees are not constituted pursuant to or under any particular set of laws or rules, their obligations, duties and liabilities will generally depend on the scope of their appointment just as much as their powers and functions, and should be set out clearly in any appointment letters or bylaws, etc., and expressly provide the committee members with appropriate indemnities, exculpations and disclaimers in connection with actions undertaken in the discharge of their duties to protect the committee members from any unintended liabilities.

Participation on an informal committee may involve the receipt of inside information from the company, including the status of restructuring negotiations, so committee members may be subject to securities law limitations on their ability to trade bonds or other securities issued by the company. Given that limitation, committee members may want the

28 11 U.S.C. Section 1102(b).

29 *In re Bulmer* [1937] Ch. 499.

30 Insolvency (England and Wales) Rules 2016, r17.25.

31 Insolvency (England and Wales) Rules 2016, r17.24; Statement of Insolvency Practice 15 (England & Wales), Annexe A, para. 11.

company to agree on suitable disclosure provisions with respect to any material non-public or price-sensitive information provided to them, which will need to be considered against the company's desire or need to maintain confidentiality surrounding the potential restructuring.

The members of an informal committee and the committee itself are generally not entitled as a matter of law to reimbursement of costs and expenses incurred in connection with the restructuring, although costs may be provided for in the underlying credit documentation, and market practice generally prescribes that distressed borrowers should fund the costs of creditor advisers to negotiate a restructuring, although arrangements can vary materially from case to case. Costs and expenses are typically covered in the context of a consensual deal and provision for this should be included in the relevant appointment letters and restructuring documentation.

Finally, members of informal committees generally do not incur liability as a result of serving on the committee, but where the committee receives a delegation of particular powers or duties from its constituents, it may incur liability subject to the terms of their appointment and the relevant delegation.[32]

US law

Official committees

As noted above, an official committee owes fiduciary duties of care and loyalty to its constituents, which means that members of the committee must act in the best interest of the entire constituency rather than in their own individual interests. The committee's advisers should be able to assist the committee's members in discharging their fiduciary duties. The costs and expenses of the official committee are generally paid by the distressed company following approval from the US bankruptcy court. Individual members generally have no liability for the committee's costs and expenses. The official committee is also subject to certain public disclosure rules in a Chapter 11 case that include disclosure of each member's name, address and disclosable economic interest as of the date the committee was formed, and an ongoing duty to update that disclosure as necessary.[33]

Informal committees

The obligations, duties and liabilities of an informal committee in the US are broadly similar to those discussed above in relation to an informal committee under English law. As discussed above in respect of English law, members of informal committees generally do not owe fiduciary duties to anyone by virtue of serving on the committee, including the company, other committee members, its constituents, or other similarly situated creditors. In certain situations, however, a committee may be deemed to have assumed fiduciary duties where its members are deemed temporary insiders, either through the receipt of confidential information in the course of their employment or where they have accumulated a blocking position in a particular class and they purport to act on behalf of that class.[34] Committee members and

32 *National Westminster Bank plc v. Rabobank Nederland*, [2007] EWHC 1056 (Comm).

33 Bankruptcy Rule 2019.

34 See *In re Was. Mut., Inc.*, 461 B.R. 200 (Bankr. D. Del 2001).

their advisers should be careful to ensure that duties are not inadvertently assumed and not to give the appearance that informal committees speak for non-members.

While informal committees are generally not entitled to reimbursement of their costs and expenses, where the committee demonstrates that it has made a 'substantial contribution' to the negotiation and implementation of a plan of reorganisation, the US bankruptcy court may approve the reimbursement of reasonable costs and expenses.[35]

Finally, informal committees may also be subject to certain public disclosure rules in a Chapter 11 case regarding the claims and interests held by its members beyond the disclosures required of an official committee. These rules impose a requirement for 'every group or committee that consists of or represents . . . multiple creditors or equity security holders that are (A) acting in concert to advance their common interests, and (B) not composed entirely of affiliates or insiders of one another' to disclose certain facts including the name of each entity causing the committee to be formed or for whom the committee will act, and with regard to each member, its name, address and disclosable economic interest as of the date the committee was formed and imposes an ongoing duty to update such disclosures.[36] Where the committee represents the interests of a person not part of the committee, the committee must also disclose the acquisition date of each such economic interest that was acquired in the year preceding the commencement of the Chapter 11 case.[37] Failure to comply can result in serious repercussions, including preclusion from being heard in the case, invalidation of acts or authority obtained by the committee, and other appropriate sanctions.

Conclusion

The activities and power of most creditors' committees – whether official or informal – are premised on the basic underlying principle of representing the interests of the committee's constituency in determining and implementing a restructuring. The main differences, however, relate to how this basic principle is put into action, and that will vary significantly based on the circumstances and jurisdiction.

35 11 U.S.C. Section 503(b)(3)(D).

36 Bankruptcy Rule 2019.

37 Bankruptcy Rule 2019.

Appendix 1

About the Authors

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Nick Angel leads Milbank's European financial restructuring practice from London. Nick has been advising on restructuring matters for over 25 years with a focus on complex situations, often with a significant international element, that have a high value or particular importance to his clients. Over the course of his career, Nick has developed exceptionally broad experience, having advised just about every type of stakeholder with a role to play in a restructuring, on a very broad range of restructuring types, on transactions in countries in six of the world's seven continents and in a wide range of industries.

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As a partner in Milbank's financial restructuring group in London, Peter Newman advises companies, creditors and other stakeholders on large and complex restructurings, bankruptcies and insolvencies in Europe, the US and around the world. His experience crosses many borders and industries. He specialises in structuring creative solutions to help his clients achieve value-maximising outcomes in distressed situations.

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The Art of the Ad Hoc – published by Global Restructuring Review – is a guide on how to work successfully with ad hoc committees. To borrow from Hon. James M Peck in his introduction, 'art' is the right word for a discipline driven as much by 'creativity, improvisation, intuition and occasional inspiration' as by 'dry logic'. *The Art of the Ad Hoc* draws on the collective wisdom and real life experiences of 20 distinguished practitioners from 10 different firms to illuminate this art.

Part I explains an ad hoc committee's formation and organisation; Part II, its activities and powers; and Part III, what trading committee members may undertake. There is an emphasis on the practical throughout.

Published digitally at GlobalRestructuringReview.com and updated annually, the editor and publisher hope that, over time, the guide will codify best practice in this area. *The Art of the Ad Hoc* is the first title in the GRR Guides series.

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