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Conflicts of Interest Issues Involving Committee Members

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CONFLICTS OF INTEREST ISSUES INVOLVING COMMITTEE MEMBERS

I. Introduction

Section 1102(a)(1) of the Bankruptcy Code provides for the U.S. trustee to appoint an unsecured creditors' committee and, in appropriate cases, additional creditors' committees or equity committees. Once appointed, a committee member owes a fiduciary duty to the entire body of creditors or interest holders represented by that committee. *See, e.g., Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 256 (3d Cir. 2001) ("*Westmoreland*"). It has been said that committee members must have undivided loyalty to those whom they represent without any conflicts of interest. *See Woods v. City National Bank*, 312 U.S. 262, 269 (U.S. 1941). In addition, a committee member's fiduciary duty requires the member to maintain confidentiality and to avoid conflicts of interest that would affect the member's ability to serve on the committee and to fulfill the member's duty to the group. 7 Collier on Bankruptcy ¶ 1103.05[2][a]-[b] (15th Ed. Rev. 2006).

A member of a creditors' or equity committee may have a conflict of interest with the class of creditors or equity holders represented by the committee, perhaps due to a claim or suit against the debtor, or a particular interest the creditor may have separate and apart from the general interest of maximizing recoveries from the estate. In addition, in a world where bankruptcy claims are freely traded, committee members may end up holding different types of claims, some of which may conflict with the interest of creditors of the class represented by the committee. *See, e.g., In re Seaescape Cruises, Ltd.*, 131 B.R. 241, 243-244 (Bankr. S.D. Fla. 1991). In some cases, a committee member's conflict of interest may be considered serious enough to warrant attempting to remove the committee member under new Section 1102(a)(4), which authorizes courts to change the membership of a committee to assure adequate representation.

The foregoing circumstances present a number of issues for consideration, including:

(1) What can and should committee members do upon learning that another committee member has such conflicts?

(2) What duty does a committee member have concerning disclosure of conflicts? Does counsel for a committee have a duty to require disclosure even if committee members do not wish to reveal the interests they may hold?

(3) Where should the line be drawn between permissible and impermissible conflicts, and when is it appropriate to seek removal of a committee member due to a conflict of interest?

(4) May a bankruptcy court use new Section 1102(a)(4) to change the membership of a committee by removing a member for conflict reasons?

(5) What can and should committee counsel do when faced with these issues, to fulfill counsel's duty to the committee and the creditors it represents, without improperly

substituting counsel's judgment for the judgment of the committee members concerning such matters?

The existing case law does not provide clear answers to these questions, but does provide some basic principles which serve as a reference point for considering when it may be appropriate to seek removal of a committee member due to an impermissible conflict.

II. Authority of the Bankruptcy Court to Remove Committee Members

A. Pre-BAPCPA Law

Prior to 1986, Section 1102(c) of the Bankruptcy Code allowed the bankruptcy court to alter the composition of a committee. Section 1102(c) was repealed in 1986, and its deletion led to disparate views among the courts regarding the judiciary's authority to remove a committee member due to conflicts. After the repeal of Section 1102(c), some courts held that the decision to remove a committee member rested solely with the U.S. trustee, and that a bankruptcy court had no authority to review that decision. *See In re Dow Corning Corp.*, 212 B.R. 258, 264 (E.D. Mich. 1997); *Smith Wheeler Tech., Inc.* (*In re Smith Wheeler Tech., Inc.*), 139 B.R. 235, 239 (9th Cir. BAP 1992); *In re Drexel Burnham Lambert Group, Inc.*, 118 B.R. 209, 210 (Bankr. S.D.N.Y. 1990).

Despite the deletion of Section 1102(c), the majority of courts still held that the bankruptcy court had the authority to review a U.S. trustee's decision regarding the removal of a committee member. Courts adopting the majority view differed on the applicable standard of review. Some courts reviewed the U.S. trustee's decision on a *de novo* basis, while other courts examined whether the U.S. trustee abused his or her discretion by acting "arbitrarily and capriciously." *Compare In re Sharon Steel Corp.*, 100 B.R. 767, 776 (Bankr. W.D. Pa 1989) (holding that "the reconstitution of an existing official committee is subject to *de novo* review by the Bankruptcy Court in order to determine the adequacy of the representation"), *and In re Texaco Inc.*, 79 B.R. 560, 566 (Bankr. S.D.N.Y. 1987) (stating that the issue of adequate representation is entrusted to the courts and determined on a *de novo* basis), *with In re America West Airlines*, 142 B.R. 901 (Bankr. D.Ariz. 1992) (stating that the trustee's decision to remove a committee member will only be overturned if the trustee acted arbitrarily and capriciously), *and In re Columbia Gas System, Inc.*, 133 B.R. 174 (Bankr. D. Del. 1991) (reviewing the trustee's refusal to appoint a creditor to the committee under an abuse of discretion standard).

B. Effect of New Section 1102(a)(4) on a Bankruptcy Court's Ability to Remove a Committee Member

With the adoption of BAPCPA, particularly new Section 1102(a)(4), Congress has specifically given bankruptcy courts the authority to alter the composition of a committee and review a trustee's appointment of committee members. New Section 1102(a)(4) provides, in relevant part:

> On request of a party in interest and after notice and a hearing, the
> court may order the United States trustee to change the
> membership of a committee appointed under this subsection, if the

court determines that the change is necessary to ensure adequate representation of creditors or equity security holders.

11 U.S.C. § 1102(a)(4). It remains to be seen whether courts will use Section 1102(a)(4) to remedy a situation where a committee member has a conflict of interest that impairs the member's ability to fulfill its fiduciary duties, and if so, what standard courts will apply. Although there were no reported opinions addressing Section 1102(a)(4) at the time that this writing was submitted for publication, and no helpful legislative history accompanying the section, the standard for ordering the U.S. trustee to change the membership of a committee may be the same as the standard for appointing additional committees under Section 1102(a)(2). To succeed on a motion under Sections 1102(a)(2), the movant must show that the appointment of an additional committee, or a change in an existing committee's membership, "is necessary to ensure adequate representation of creditors or equity security holders." 11 U.S.C. § 1102(a)(2). As discussed in Section III.A below, questions regarding the scope of new Section 1102(a)(4) have recently been raised in the *Refco* bankruptcy cases pending in the Southern District of New York Bankruptcy Court. As of the date these materials were submitted for publication, the Refco court had yet to rule on these issues.

III. Selected Cases Dealing with Conflicts of Committee Members

A. Cases in which a Conflict Constituted a Breach of Fiduciary Duty and/or Warranted Removal

Following are summaries of selected cases in which courts have held that the actions of a committee member constituted a breach of fiduciary duties arising from their membership on the committee and/or warranted the removal of the member from the committee.

1. Using Committee Membership to Serve Own Interests to Detriment of Creditors Generally

In *In re Fibermark, Inc.*, No. 04-10463 (Bankr. D. Vt. 2004), internal disputes between members of the unsecured creditors' committee led to the appointment of an examiner to investigate the actions of the committee members and counsel to the committee. After investigating those actions, the examiner submitted a report concluding, in relevant part, that two members of the committee breached their fiduciary duties to the unsecured creditor class. The examiner estimated that the projected value of distributions that would be made to general unsecured creditors decreased by almost $60 million as a result of the committee members' actions.

The examiner's report discussed several instances that he believed gave rise to breaches of the committee members' fiduciary duties to the unsecured creditor class. One such instance involved the committee's opposition to the debtor's proposed key employee retention program ("KERP"), which resulted in a three day evidentiary hearing. The examiner found that a major facet of the KERP battle was the animosity of one committee member for the debtors' professionals, and not the terms of the KERP itself. The professional fees charged in connection with the KERP litigation totaled approximately $1.65 million. Another breach alleged by the examiner occurred when certain members of the committee opposed the debtors'

proposal that a class of small unsecured creditors be allowed to opt for a cash payment under the proposed plan of reorganization. During this lengthy and contentious debate, the examiner concluded that the committee members who opposed the proposal were attempting to monopolize the funding opportunity for their own gain as larger unsecured creditors at the expense of unsecured creditors holding smaller claims.

The examiner also concluded that certain committee members breached their fiduciary duties by proposing plan terms favoring their own potential equity interests in the reorganized debtor. When the debtor filed for bankruptcy, two committee members collectively held approximately 35% of the debtors' notes, which would be converted to equity in the reorganized debtor under the debtor's proposed plan. Through claims trading during the case, another company, which also became a committee member, obtained more than 35% of the debtors' notes. The other two committee members realized that they might not be able to control the reorganized debtor, and began insisting on enhanced minority shareholder protections.

After the issuance of the examiner's report, the two committee members who allegedly breached their fiduciary duties reached a settlement. Although they did not admit to any wrongdoing, the two committee members agreed to provide up to $4.2 million in cash to the holders of allowed noteholder claims and general unsecured claims, except for the three noteholder committee members involved in the dispute. In addition, the committee members who were the subject of the report shared the costs of the examiner's investigation, which totaled $1.75 million.

Query: The primary motivation for devoting the significant time required to serve on an official committee is the member's belief that it will enable the member to better protect its own financial interests. How does a court decide when the member's own financial interests conflict with the interests of the class represented by the committee such that the member can no longer satisfy its fiduciary duties?

2. Breach of Fiduciary Duty Found Even in Transaction Involving Non-Estate Assets

In *Westmoreland Human Opportunities, Inc. v. Walsh*, 327 B.R. 561 (W.D. Pa. 2005), the Chapter 11 trustee commenced an adversary proceeding against a member of the creditors' committee, alleging that the committee member breached its fiduciary duty by replacing the debtor as grantee of a HUD grant without consideration or bankruptcy court approval. The bankruptcy court entered a judgment against the committee member. On appeal, the Third Circuit held that the debtor's interest in the grant was not estate property and remanded the case for a determination of whether a duty to fellow committee members exists when a member is involved in a transaction dealing with non-estate property.

Considering an issue of first impression, on remand the bankruptcy court held that a committee member also owes a fiduciary duty to committee members in connection with a transaction involving non-estate property. More specifically, the court found:

> [T]he existence of a fiduciary duty that exists on a "vertical" level between the many unsecured creditors and the members of the

> unsecured creditors committee cannot be effectuated and preserved if such a fiduciary duty does not also exist on a "horizontal" level among the members of that committee.

327 B.R. at 573.

The court found that the creditor breached its duties to the committee members and the unsecured creditors generally, because it failed to provide the committee members with notice and opportunity to object to the proposed transaction, which conceivably could have impacted the recovery of creditors in the case, despite the fact that the transaction involved non-estate property. The court further noted that if the committee were to approve such a transaction, the member would then be required to seek bankruptcy court approval, if the transaction could conceivably affect distributions to creditors. In addition, the court held that even if the transaction could have no conceivable effect on creditor recoveries, the member would still have a duty to give fellow committee members notice and an opportunity to object, although bankruptcy court approval would not be necessary.

Query: If a proposed transaction could have no conceivable effect on creditor recoveries, is there a legitimate basis for imposing requirements on a committee member to disclose the details of a proposed transaction to the committee?

3. Prepetition Entanglement with the Debtor's Affairs

a. In re Venturelink Holdings, Inc.

In *In re Venturelink Holdings, Inc.*, 299 B.R. 420 (Bankr. N.D. Texas 2003), the debtors filed a motion to remove a committee member who had been the chairman of the board of one of the debtors, and who had also served as a director or officer of several affiliated debtors. Prior to the petition date, the committee member sued one of the debtors, and that debtor filed a counterclaim for breach of fiduciary duty. It was anticipated that recoveries received on the counterclaim would partially fund the debtor's Chapter 11 plan.

At the time the debtor filed its motion to remove the committee member, the breach of fiduciary duty claim was unresolved. As a result, the court found that the member could not serve on the committee. Specifically, the court held that a creditor on a committee who is the subject of a breach of fiduciary duty claim undermines the basic bankruptcy tenet that the bankruptcy process must both be fair and appear fair. The court also stated that the appearance of a breach of a fiduciary duty should mandate removal. The court observed that the nature of the claim itself created the disqualifying conflict.

The court also noted that, as a matter of public policy, a former officer or director of a debtor should not serve on a creditors' committee, because creditors' committees will necessarily analyze the performance of former officers and directors, and a former officer or director will have a natural tendency to steer the focus of the committee away from his or her performance. Consequently, the court held that the trustee acted arbitrarily and capriciously in refusing to remove the member from the committee.

b. <u>In re Penn-Dixie Indus., Inc.</u>

In *In re Penn-Dixie Indus., Inc.*, 9 B.R. 941 (Bankr. S.D.N.Y. 1981), the U.S. trustee appointed an official committee of equity security holders. Two members of the equity committee filed motions to remove each other from the committee. One member, the debtor's largest shareholder, allegedly had a conflict because it planned to seize control of the debtor and decrease the value of the debtor's shares in furtherance of the acquisition. Another member allegedly had a conflict because it was so entangled with the debtor's day-to-day operations prior to the bankruptcy filing that it could not exercise its duties under Section 1103(c) of the Bankruptcy Code. The SEC then filed a motion to remove both shareholders from the equity committee because the "bitter internecine warfare between [the committee members] made the committee impotent."

The court denied the motion to disqualify the largest shareholder from the equity committee because the allegation that the shareholder would use confidential information in attempting to seize control of the debtor was speculative. The court granted the motion to remove the shareholder that was involved in the debtor's prepetition day-to-day operations, including recommending the bankruptcy filing, selecting bankruptcy counsel, dealing with the debtor's daily affairs and negotiating with creditors. The court held that the shareholder's "entanglement with the debtor renders it unfit to monitor, scrutinize, investigate, and negotiate with the debtor, key components of Section 1103. No clearer impermissible conflict could be imagined." The court denied the SEC's motion to remove both shareholders from the committee, determining that "[w]ithout two to tango (tangle), the Committee should now be 'manageable.'"

4. Involvement in Significant Litigation against the Debtor

In *In re Fas Mart Convenience Stores, Inc.*, 265 B.R. 427 (Bankr. E.D. Va. 2001), the trustee appointed an entity to the unsecured creditors' committee that was involved in what the court described as a contentious adversary proceeding against the debtors, demanding, among other things, approximately $4 million that it asserted to be "trust funds" that did not belong to the debtors' estate, the outcome of which would significantly impact distributions to unsecured creditors. The committee intervened in the trust fund litigation, and was participating as a party defendant. In addition, the committee member aggressively asserted its position in the underlying bankruptcy case and was directly adverse to the committee with respect to several motions. The committee, by unanimous vote of the other members, filed a motion to strike the member's appointment.

The court reviewed the trustee's decision under an abuse of discretion standard. The court found that the appointee's aggressive efforts to establish its secured status could seriously undermine the committee's efforts on behalf of the other unsecured creditors. Thus, the court found that the appointee had a conflict of interest that was pervasive, and that it could not honor its fiduciary duty to all unsecured creditors so long as it was prosecuting the litigation against the debtors and the committee. As a result, the court ordered the appointee suspended from the committee until such time as the trust fund litigation was resolved.

B. Cases Involving Conflict That Did Not Warrant Removal of Member

Below are summaries of selected cases in which courts held that certain conflicts did not warrant the removal of a committee member from the committee. These courts held that creditors holding disputed claims and creditors that favor liquidation over reorganization may still serve on a committee.

1. Committee Member as the Holder of Disputed Claims against the Debtor Subject to Pending Litigation

In *In re Microboard Processing*, 95 B.R. 283 (Bankr. D. Ct. 1989), the debtor filed a motion to remove two of its largest unsecured creditors from the unsecured creditors' committee. The debtor argued that the two creditors should be removed from the committee because their claims arose out of alleged breaches of contracts and were the subject of pending litigation, in contrast to the claims of all the other creditors whose claims were undisputed. The debtor also argued that the two creditors should be removed because their claims were disproportionate to all other unsecured debt.

The court denied the debtor's motion, and noted that it is axiomatic that all unsecured creditors have an inherent conflict with each other because, absent a 100% distribution, the elimination or reduction of any such claim will benefit all others. *See also In re Rickel & Assocs., Inc.,* 272 B.R. 74, 99-100 (Bankr. S.D.N.Y. 2002). According to the court, that situation is not an impermissible conflict of interest which would bar appointment to, or justify removal from, a creditors' committee, nor does an impermissible conflict arise merely because one of the members of the committee has an interest adverse to that of the others. The court rejected the debtor's argument that a conflict of interest existed based upon the pendency of adversary proceedings resulting from claim objections, which, if successful, would increase distributions to other unsecured creditors. In the court's view, if that were a convincing argument, a debtor could easily control the composition of creditors' committee by objecting to the claims of those creditors the debtor wants to remove. The court also rejected the debtor's argument that holding a disproportionately large claim constituted an impermissible conflict of interest, in part because Section 1102 contains precatory language directing the court "ordinarily" to appoint the persons with the seven largest claims.

In *In re Richmond Tank Car Company*, 93 B.R. 504 (Bankr. S.D. Tex. 1988) a creditor sought appointment to fill a vacancy on the unsecured creditors' committee. The creditor was the largest trade creditor, although the amount of its proof of claim was disputed and the subject of state court litigation which began two years prior to the filing of the debtors' petition. The creditor sought appointment because it was the largest trade creditor and would represent a class of disputed claims. The debtor opposed appointment because there was already a trade creditor on the committee, and it believed the creditor seeking appointment was attempting to gain leverage in the state court litigation by gaining access to undisclosed information in the debtors' possession. The court held that the disputed nature of the creditor's claim and the fact that the parties were involved in pending state court litigation did not create a conflict of interest sufficient to exclude the creditor from membership on the unsecured creditors' committee. The court considered it the better view that, until actions are taken which indicate

some breach or conflict, the court should not deny a creditor a position on a creditors' committee based on "speculation."

2. Committee Member Favoring Liquidation over Reorganization

In *In re Laclede Cab Company*, 145 B.R. 308 (Bankr. E.D. Mo. 1992), the debtor in possession objected to the composition of the creditors' committee. Specifically, one of the three members of the committee had a claim against the debtor based on a state civil suit, in which the committee member had obtained a prepetition default judgment against the debtor. The judgment had been appealed by the debtor prior to the commencement of the case. In the reorganization, the committee member's claim was scheduled as disputed, contingent and unliquidated.

The grounds for the debtor's objection were that the claim was disputed, that the member was hostile to a reorganization, and that therefore the member had a conflict of interest. With respect to the alleged conflict of interest, the court found that there was no evidence to establish that the committee member had breached or would breach its fiduciary duty. There was also no showing that the committee member had an interest adverse to the creditors' committee. Accordingly, the court overruled the debtor's objection to the appointment of the member. In addition, on the debtor's other two grounds, the court recognized that (1) a holder of a disputed claim can sit on a creditors' committee and (2) that the debtor's belief that the committee member does not want to see the debtor reorganized is not sufficient to remove the member from the committee. *See also In re Seaescapes Cruises, Ltd.*, 131 B.R. 241, 243-244 (Bankr. S.D. Fla. 1991)("Although Section 1102 of the Bankruptcy Code states no standards regarding who may serve on the creditors' committee, there is nothing in the statute which would prevent service on the creditors' committee of a creditor unsympathetic to the efforts of a debtor to reorganize.").

C. In re Refco, Inc., *et al.*, Case No. 05-60006 (Bankr. S.D.N.Y. 2005)

1. Background

On October 17, 2005, Refco Inc. and certain affiliated entities, including Refco Capital Markets, Ltd. ("Refco CM"), a commodities broker, filed voluntary Chapter 11 petitions in the U.S. Bankruptcy Court for the Southern District of New York. On October 28, 2005, the U.S. Trustee appointed seven members to serve on the unsecured creditors' committee; subsequently, two additional members were appointed. Shortly after the bankruptcy filing, several account holders of Refco CM instituted adversary proceedings (collectively, the "Estate Property Actions") seeking a determination that certain cash and securities held in the debtor's accounts should be returned to the account holders because they were not property of the bankruptcy estate. In addition, several Refco CM account holders filed a motion to convert Refco CM's case to a Chapter 7 stockbroker liquidation case.

Shortly after the conversion motion was filed, the U.S. Trustee asked three members of the unsecured creditors' committee to resign. The three members were customers of Refco CM and were each seeking a determination that the property held in their accounts was not property of the Refco CM bankruptcy estate. The U.S. Trustee asserted that the positions taken

by these committee members were inconsistent with their fiduciary duties to the general unsecured creditor class of the Refco, Inc. bankruptcy estate. The committee members declined the U.S. Trustee's request to resign, and committee counsel supported the committee members' position. In their responses to the U.S. Trustee, all three committee members relied heavily on *In re Microboard Processing*, 95 B.R. 283 (Bankr. D. Ct. 1989). As noted below, in *Microboard* the court declined to remove two committee members who were parties to adversary proceedings that could potentially decrease distributions to the unsecured creditor class.

The *Refco* bankruptcy court temporarily stayed the Estate Property Actions and held a trial on the conversion motion. At the conclusion of the trial, the bankruptcy court agreed with the account holders that Refco CM is a "stockbroker" and that the account holders are "customers" of Refco CM. However, rather than immediately converting the case to a stockbroker liquidation case under Chapter 7, the bankruptcy court deferred its ruling so that the parties could explore an amicable settlement under Chapter 11. The court also appointed a Chapter 11 trustee for the Refco CM bankruptcy estate.

Subsequently, the Chapter 11 trustee and many of the largest creditors of Refco CM did in fact reach a settlement. Under the terms of the proposed settlement agreement, the parties agreed to a mechanism for the allocation of Refco CM's assets which would resolve the Estate Property Actions by treating Refco CM's account holders as securities claimants with the same priority as "customers" under the stockbroker liquidation provisions of Chapter 7. The settlement agreement also deferred further attempts to convert the case to a case under Chapter 7 while the parties attempted to finalize a Chapter 11 plan consistent with the terms of the settlement agreement.

2. Removal of Committee Members and Motion to Change the Composition of the Committee under New Section 1102(a)(4)

While the settlement motion was pending, the U.S. Trustee, by issuing a notice, reconstituted the creditors' committee and removed six of the nine members, all of which were customers of Refco CM involved in the Estate Property Actions, due to alleged conflicts of interest. In response, on August 2, 2006, certain removed committee members (the "Movants") filed an emergency motion for the entry of an order reversing the U.S. Trustee's decision, or alternatively, reappointing the members to the committee "to assure adequate representation" under Section 1102(a)(4).

The Movants first argued that Section 1102(a)(4) requires the U.S. Trustee to seek bankruptcy court approval prior to removing committee members due to a conflict, and that even if the U.S. Trustee has implied authority to remove committee members, the court should review the U.S. Trustee's decision on a *de novo* basis, as opposed to the "abuse of discretion" standard applied by some courts prior to BAPCPA. The Movants also argued that even under the "abuse of discretion" standard, the U.S. Trustee's removal from the committee of the Movants should be reversed. According to the Movants, a committee member should not be removed absent a showing that the committee member: "(i) has breached or is likely to breach a fiduciary obligation owed to general unsecured creditors, or (ii) has an actual conflict of interest with the class of creditors represented by the committee member." Relying on *Microboard* and *In re Fas Mart Convenience Stores, Inc.*, 265 B.R. 427 (Bankr. E.D. Va. 2001), the Movants

claimed that a committee member can seek to protect its rights as a creditor without breaching its fiduciary duty to the unsecured creditor class generally. Specifically, the Movants asserted their right to seek a determination that the accounts held with Refco CM are not property of the bankruptcy estate without breaching their fiduciary duties to the unsecured creditor class, and that courts consistently have recognized that intercreditor conflicts in bankruptcy cases are permissible and inevitable, absent a 100% distribution.

The Movants further argued that even if the U.S. Trustee did not abuse her discretion in removing them, the court should order the U.S. Trustee to change the reconstituted committee "to assure adequate representation" under Section 1102(a)(4). In support of this position, the Movants noted that the remaining three members of the committee are all bondholder claimants, which represent only 10% of the unsecured creditor claims in the case. Weighing the factors typically considered in determining whether representation of a committee is "adequate" under Section 1102(a)(2) dealing with the addition of committee members, the Movants claimed that (1) the former nine member committee functioned effectively, notwithstanding intercreditor differences; (2) the nature of the *Refco* cases required a single, diverse committee to foster consensus on key intercreditor and intercompany issues; and (3) the U.S. Trustee's removal action was not supported by key creditor constituencies.

The U.S. Trustee followed with another notice modifying the composition of the unsecured creditors' committee, "clarifying" that she was bifurcating the committee. The three bondholder claimants remained on the unsecured creditors' committee, and the U.S. Trustee appointed an additional creditors' committee, consisting of five of the six former members, to represent the claims of Refco CM account holders.

The U.S. Trustee responded to the Movants' emergency motion with a memorandum stating that the notice of reconstitution was the first step in transforming a bitterly divided committee into two effective committees. The U.S. Trustee argued that the former nine member committee represented two groups of creditors with irreconcilable goals, with one group favoring distributions at the parent level and the other group favoring distributions at the Refco CM level. The U.S. Trustee made clear that she viewed the Movant's emergency motion as a request for access to the original committee's professionals and information, which she did not oppose. With respect to the legal arguments in the emergency motion, the U.S. Trustee claimed that new Section 1102(a)(4) does not alter her ability to remove committee members, and that Section 1102(a)(4) can only be used to change the composition of the committee to assure adequate representation, and not for any other reason.

Subsequently, the bankruptcy court entered a bridge order adjourning the hearing on the emergency motion. The bridge order authorized the members of the newly appointed additional committee to have access to the same professionals and information as the original creditors' committee. The court also ordered the official committee and the additional committee to negotiate in good faith with respect to establishing a global subcommittee of creditors. Those negotiations were fruitful and resulted in a "Joint Creditor Committee Protocol Stipulation and Order" filed by the U.S. Trustee, the Refco CM trustee, the members of the reconstituted official committee, and the members of the additional committee, that appears to have resolved the emergency motion. The proposed stipulation and order provides that the official committee would create a joint subcommittee consisting of the members of the official

committee and additional committee. In addition, the joint subcommittee would represent the interests of general unsecured creditors in the *Refco* bankruptcy cases, with the exception of issues relating to asset allocation and Chapter 11 plan issues between Refco CM and the other debtors. The proposed stipulation and order also would require the joint subcommittee to be subject to the bylaws of the original nine member committee, and would grant each committee continued access to the original committee's professionals. As of the date these materials were submitted for publication, the stipulation and order was awaiting court approval.

Query: Are the removed committee members correct that a committee member should not be removed absent a showing that the committee member (i) has breached or is likely to breach a fiduciary obligation owed to general unsecured creditors, or (ii) has an actual conflict of interest with the class of creditors represented by the committee member? Are these the only grounds courts should consider when deciding whether a committee member should be removed? If asserting an interest in property of the estate is an impermissible conflict, how is this distinguishable from a PACA, reclamation, or administrative priority claim? Is the result in *Refco* justified due to the magnitude and impact of the Estate Property Actions on the unsecured creditors' recoveries?

IV. Hypotheticals

A. Potential Purchase of a Debtor's Assets

Shortly after the debtor files for Chapter 11 bankruptcy protection, it becomes clear that the debtor will not attempt to reorganize, but instead would sell substantially all of its assets through a bankruptcy auction. A member of the creditors' committee becomes interested in buying the company and submits a qualifying bid to purchase the assets pursuant to the debtor's court approved bidding procedures.

Another unsecured creditor, who is not on the committee, files a motion pursuant to new Section 1102(a)(4) to *change* the composition of the committee by replacing the potential purchaser with another creditor due to the potential purchaser's alleged conflict of interest. In its motion, the unsecured creditor argues that because the potential purchaser is interested in getting the lowest sale price for the debtor's assets, the court must remove the member "to assure adequate representation."

Under what circumstances should the court use new Section 1102(a)(4) to remove a committee member due to such a conflict? What if the committee member influences the committee to support its bid and to object to a sale to a competing bidder? What if the committee member's bid is clearly the highest and best offer?

B. Direct Business Competitor of a Debtor

The Chapter 11 debtor and a member of the creditors' committee are direct business competitors in a niche field in which the debtor and the committee member are the only competitors in certain regions of the country. Therefore, if the committee member receives business in those regions, it reduces the amount of business the debtor will receive. Does this

create a conflict that warrants removal? What duties does the committee member owe to its fellow committee members and the unsecured creditor class? Is the committee member required to seek committee and/or bankruptcy court approval before competing against the debtor?

C. Equity Committee Member Involved in a Debtor's Prepetition Operations

On the belief that equity holders could receive a distribution, the U.S. trustee appoints an official committee of equity holders to represent the interests of the debtor's equity class. One member of the equity committee was the debtor's president and a member of its board who holds a substantial percentage of the outstanding shares. The committee member has not been involved in the debtor's management for more than three years. Would a motion to remove the debtor's former president from the equity committee be well founded?