American Bankruptcy Institute Law Review

Volume 5 Number 1 Spring 1997

THE PROBLEM WITH CREDITORS' COMMITTEES IN CHAPTER 11: HOW TO MANAGE THE INHERENT CONFLICTS WITHOUT LOSS OF FUNCTION

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Theorists posit that the current Bankruptcy Code [*FN:* See 11 U.S.C. §§101−1330 (1994 & Supp. I 1995).] (1) supplants an inter−creditor loss allocation agreement that would have been negotiated among creditors but for the cost [*FN:* See Barry E. Adler, Bankruptcy & Risk Allocation , 77 Cornell L. Rev. 439, 440 (1992) (describing "risk sharing" and "creditors' bargain" models of bankruptcy theory).] and (2) is deemed preferable to creditors than state collection law because it preserves a more valuable debtor than would piecemeal collection actions by creditors. [*FN:* See id. at 444−45 (describing how collective bankruptcy proceeding is preferable to individual creditor actions).] However, most creditors who are "out of the money" are not theorists. Noble concepts such as collectivism, [*FN:* See Shelby D. Green, " Reasonable Expectations" Define Broad Power to Liquidate a Solvent Close Corporation in Bankruptcy , 41 Drake L. Rev. 421, 450−451 (1992) (describing "collectivism" theory in terms of goal of bankruptcy which is achieving maximum asset values to satisfy common pool of claimants) (citing Laurence Ponoroff & F. Stephen Knippenberg, The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy , 85 Nw. U. L. Rev. 919, 948−51 (1991) .] loss allocation and sharing [*FN:* See Green, s upra note 4, at 451 (describing "the traditional theory" of bankruptcy process as vehicle for apportionment of loss among creditors).] probably do not inspire their service on chapter 11 creditors' committees. Instead, these creditors' foremost thoughts are probably fueled by self−interest. Their acceptance of an active participatory role in a bankruptcy proceeding through service on a committee is most likely motivated by each committee member's interest in obtaining the maximum possible return on its claim. [*FN:* See*In re* Microboard Processing Inc., 95 B.R. 283, 285 (Bankr. D. Conn. 1989) (describing inherent conflict of interest of unsecured creditors as axiomatic);*In re* Grant Broad. of Phila. Inc., 71 B.R. 655, 664 (Bankr. E.D. Pa. 1987) (noting that if having adverse interest to other creditors was enough by itself to bar creditors' committee membership than many otherwise eligible candidates would be disqualified).]

Yet, underlying the increased powers granted to committees under the Bankruptcy Reform Act of 1978 [*FN:* Bankruptcy Reform Act of 1978, Pub. L. 95−598, 92 Stat. 2549 [hereinafter Bankruptcy Reform Act] (codified in part as amended at 11 U.S.C. §§101−1330 (1994 & Supp. I 1995)).] are the principles of fiduciary duty and the obligation of the committee to act solely to promote the interests of all creditors holding the types of claims represented by the committee. [*FN:* See Grant Board, 71 B.R. at 664 (stating committee members are fiduciaries and owe "undivided loyalty and impartial service" to all creditors); s ee also Official, Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1315 (1st Cir. 1993) (noting that creditors' committee owes fiduciary duty to those it represents and not debtor or estate);*In re* Barney's Inc., 197 B.R. 431, 442 (Bankr. S.D.N.Y. 1996) (discussing fiduciary duty owed by committee members to all creditors represented and stating no duty is owed to debtor or its estate). See generally Collier on Bankruptcy ¶ 11−3.05 [2] (Lawrence P. King *et al.* eds., 15th ed. rev. 1996) (discussing fiduciary duties owed by committee members).] In light of the fact that the creditors' committee is "the only entity with the statutory authority [under the Bankruptcy Code] to closely scrutinize the conduct of the debtor in possession during the course of corporate reorganization," [*FN:* See Marta Andrews, The chapter 11 Creditors' Committee: Statutory Watchdog? , 2 Bankr. Dev. J. 247, 247 (1985) (discussing powers, role and function of creditors' committee).] its proper functioning can be vital to the reorganization process. [*FN:* See*In re* Drexel Burnham Lambert Group Inc., 138 B.R. 717, 722 (Bankr. S.D.N.Y.) (referring to committee's "significant and central role" in reorganization) (quoting*In re* Penn−Dixie Indus. Inc., 9 B.R. 941, 944 (Bankr. S.D.N.Y. 1981)), aff'd sub nom. , Lambert Brussels Assocs. Ltd. Partnership v. Drexel Burnham Lambert Group Inc. (*In re* Drexel Burnham Lambert Group Inc.), 140 B.R. 347 (S.D.N.Y. 1992).]

The problem is that although all creditors can understand and share the same basic goal of maximizing the estate and the return for their creditor class, there exists inherent conflicts between creditors. [*FN:* See cases cited supra note 6

(discussing inherent conflicts of interest). In many ways, the inherent tension that plagues the creditors' committee proves the hypotheses of both Professors Warren and Baird. See Elizabeth Warren, Bankruptcy Policy , 54 U. Chi. L. Rev . 775, 785−89 (1987) (arguing that Bankruptcy Code which is only collection scheme with distribution among creditors as its central goal puts creditors in competition); Douglas G. Baird & Thomas H. Jackson, Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy , 51 U. Chi. L. Rev . 97, 103 (1984) (arguing that goal of Code is not to pit creditor against creditor in battle to distribute limited assets, but to utilize principles of collectivism to enhance each creditor's return). While the creation of official committees clearly promotes collectivism, in reality, the ever−present distribution issues are a backdrop for all committee action. See Warren, supra , at 808−10. Thus, there is a dichotomy between a committee's function under the Code and the practical reality of each of the committee member's individual situation. The committee scheme only works, however, if creditors serving as committee members can recognize or learn that collective action will ultimately be beneficial to their individual situations.] Creditors who serve on official committees, whose goal is to divvy an insufficient pie, are susceptible to the pressure of conflicts in their individual capacities. [*FN:* See *In re* Microboard Processing Inc., 95 B.R. 283, 285 (Bankr. D. Conn. 1989) (explaining that inherent conflict among committee members absent 100% distribution is tolerable and does not justify the removal of members from creditors' committee or bar appointment). Indeed, this conflict is central to the bankruptcy scheme. See Warren, s upra note 11, at 785 ("[W]ith an inadequate pie to distribute and the looming discharge of unpaid debts, the dispute [in bankruptcy] center[s] on who is entitled to shares of the debtor's assets and how these shares are to be divided.").] These conflicts often surface when various catalytic, and inevitable, distribution issues arise in a bankruptcy case. [*FN:* See Nancy B. Rapoport, Turning and Turning in the Widening Gyre: The Problem of Potential Conflicts of Interest in Bankruptcy , 26 Conn. L. Rev . 913, 916 (1994). In her article, which analyzes an attorney's ability to represent more than one creditor, Professor Rapoport identifies a type of conflict, in addition to potential and actual conflicts, that is typical in a bankruptcy case. See id. This is the issue−specific conflict, which is defined as a "dormant, temporary, actual conflict" or "DTAC." See id. Professor Rapoport argues that bankruptcy law needs a new approach for identifying DTACs and determining, before the DTAC arises, when representation of more than one client is proper. See id. at 985−90. In this Article, we suggest that similar conflict problems involving committee members should be anticipated and that committees must define solutions to such conflicts.] When the task of plan analysis and drafting begins and distribution issues are considered, the distinctions between unsecured claimants, which may have seemed innocuous when the case began, can become battlegrounds within the committee. [*FN:* See *In re* National Liquidators Inc., 182 B.R. 186, 192 (S.D. Ohio 1995). In National Liquidators , service by a creditor on an official committee was recognized by the court to give rise to an "inherent tension" resulting from the committee's duty to investigate claims and initiate avoidance actions. See id. Under the scheme established by the Bankruptcy Code, this "inherent tension" is a necessary and acceptable evil and remains so until an actual conflict arises. See id .] Therefore, guidance is needed on how to balance committee members' unavoidable self−interest with the committee's fiduciary duty.

When such conflicts arise within the committee or when the potential for conflict exists at the formation of the committee, neither the Bankruptcy Code, the Bankruptcy Rules, [*FN:* Fed. R. Bankr. P. 1001−9032 (1994).] nor the case law provides much guidance on how to balance committee members' unavoidable self−interest with the committee's fiduciary obligations. [*FN:* This is due largely to the fact that most conflicts are extremely fact sensitive and may ultimately be addressed administratively by the United States Trustee, but must initially be addressed by the committee and its counsel. See *In re* Dow Corning Corp., 194 B.R. 121, 130 (Bankr. E.D. Mich. 1996) (noting that both Congress and appellate courts offer little guidance regarding standards for removing or adding committee members) (quoting Kenneth N. Klee & K. John Shaffer, Creditors' Committees Under chapter 11 of the Bankruptcy Code , 44 S.C.L. Rev. 995, 1032 (1993)).] Often, committee members' inability to achieve such balance can result in conflicts that impair the functioning of the committee. [*FN:* See *In re* Penn−Dixie Indus. Inc., 9 B.R. 941, 945 (Bankr. S.D.N.Y. 1981) (finding committees require freedom from influence so they may properly scrutinize and enforce claims) (quoting Woods v. City Nat'l Bank & Trust Co., 312 U.S. 262, 268−69, reh'g denied , 312 U.S. 715 (1941)).]

In reviewing case law, the question of how to resolve a conflict that has impaired the committee's ability to function effectively is generally framed as how to remove the offending committee member. [*FN:* See infra note 20 and accompanying text (providing cases which discuss bankruptcy court's ability to remove members from committee).] The most often litigated issue is whether the bankruptcy court has the authority to alter the committee. Since the deletion in 1986 of Bankruptcy Code section 1102(c), [*FN:* 11 U.S.C. §1102(c) (repealed 1986).] the case law on this issue is divided. [*FN:* See Dow Corning , 194 B.R. at 130. One commentator has said that "[n]o issue involving creditors' committees has been the subject of as much concern as the ability to alter the composition of a committee . . . . [T]he case law does not represent a seamless web, but rather more of a disjointed patchwork of decisions that cannot be reconciled easily." See Klee & Shaffer, supra note 16, at 1032. It appears, however, that three basic theories have developed: (1) in the absence of statutory authority, certain courts have held that they lack the authority to alter a committee, see *In re* Hills Stores Co., 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992); (2) other courts have held that they have de novo authority to alter a committee's composition, see *In re* Sharon Steel Corp., 100 B.R. 767, 776 (Bankr. W.D. Pa. 1989); and finally, (3) courts have held that, if the U.S. Trustee's original appointment was arbitrary, capricious or an abuse of discretion, the court can alter the committee, see Masters, Mates & Pilot Plans v. Lykes Bros. SS. Co. (*In re* Lykes Bros. SS. Co.) 200 B.R. 933, 939 (M.D. Fla. 1996); *In re* Columbia Gas Sys. Inc., 133 B.R. 174, 175−76 (Bankr. D. Del. 1991); *In re* First RepublicBank Corp., 95 B.R. 58, 60 (Bankr. N.D. Tex. 1988).] The lack of consensus among the courts makes this type of litigation protracted and costly. [*FN:* As illustrated by the recent decisions in

the Dow Corning case, if conflicts are not recognized and resolved early on, the resulting litigation may destroy the functioning of the committee, add to expenses and delay the conclusion of the bankruptcy proceedings. See *In re* Dow Corning Corp., 194 B.R. 121, 147 (Bankr. E.D. Mich. 1996) (Dow Corning I) (ordering tort claimants committee disbanded because members were attorneys, not creditors, and thus membership did not comply with section 1102(b); physicians' committee ordered to be appointed because current unsecured creditors' committee did not adequately represent physicians' contingent claims; trade claims found to be adequately represented);*In re* Dow Corning Corp., 194 B.R. 147, 147 (Bankr. E.D. Mich. 1996) (Dow Corning II) (denying motion for stay while appeal decided whether tort claimants' committee needed to be reconstituted). After Dow Corning II , the district court stayed the bankruptcy court's decision to order the reconstitution of the tort claimants' committee, pending an appeal to the 6th Circuit, on the grounds that the U.S. Trustee is likely to prevail in the arguments that the court lacked the power under the Bankruptcy Code to modify a creditors' committee, once such committee is appointed, and that a person need not be an actual creditor to serve on a committee. See Breast Implants: Order Disbanding Dow Corning Creditors' Committee is Stayed , Bankr. L. Rep. (BNA) 317, 325 (Apr. 17, 1996). Whether the 6th Circuit pronounces the bankruptcy court's decision correct or incorrect, the decisions present an array of issues relevant to committee conflicts, including who is eligible to serve on a committee, how to resolve the problem of inadequate representation by a committee of different types of claimants, how to enfranchise contingent claimants, and whether the bankruptcy court has authority to disband and order modification of a committee. The current posture of this case demonstrates the uncertainties surrounding the division of authority between the U.S. Trustee and the bankruptcy court regarding committee conflicts and, therefore, why it is imperative that creditors' committees resolve their own conflicts.] All parties should be sensitive to the economic risks involved in litigating committee conflict issues. They include both actual costs and the time and opportunities lost when creditors' recoveries on their claims are delayed, [*FN:* See*In re* MCorp Fin. Inc., 160 B.R. 941, 957 (S.D. Tex. 1993) (discussing direct costs and opportunity costs of pursuing bankruptcy litigation).] and should use non−litigation alternatives whenever realistically calculated to resolve the issues. [*FN:* See Daniel J. Bassel, Coalition Building Through Bankruptcy Creditors' Committees , 43 U.C.L.A. L. Rev. 1622−23 (1996) (noting bankruptcy courts' increasing favorable view toward alternative dispute resolution).]

Given the "inherent tension" created by the committee process, [*FN:* See National Liquidators Inc. , 182 B.R. 186, 192 (S.D. Ohio 1995) (discussing cause of inherent tension of committee process).] it is appropriate and necessary for committees to institute their own self−policing measures. [*FN:* See Klee & Shaffer, supra note 16, at 1058 (stating that adoption of bylaws one of committee's first concerns); see also First RepublicBank , 95 B.R. at 61 (stating creditor disagreement over strategy or objectives does not justify removal of any member and concluding that those disagreements must be resolved through committees decision making process).] If the committee does not provide an appropriate procedure for individual committee members to assert their individual positions and distinguish such actions from actions undertaken by the committee, then the fiduciary duties of all of the members can be compromised. [*FN:* See infra Part II. (discussing committee members' fiduciary duty).] Therefore, the committee, with strong guidance from counsel, must insist upon early and complete disclosure of the nature and components of each member's claims. [*FN:* See Bernard Shapiro, ALI−ABA Course of Study: chapter 11 Business Reorganizations: Creditors' Committees , C444 ALI−ABA 111, 128−32 (1989) (suggesting as advisable that committees adopt bylaw requiring all committee members to submit conflict statements).] After such disclosure has occurred, the committee must establish procedures allowing members, at the appropriate time, to assert their individual positions but at all times requiring that each member distinguish its individual creditor role from its fiduciary duty to the committee and the creditor group it represents. [*FN:* See id. (suggesting authorizing committee members to act in own interests if interest is properly disclosed).] In a best case scenario, proper management of conflicts within the committee will permit the committee to continue functioning with regard to the catalytic issues, despite the existence of conflicts, without the need for intervention by the U.S. Trustee or the court. [*FN:* See Klee & Shaffer, supra note 16, at 1058 (emphasizing importance of setting guidelines early to avoid later conflicts).]

This article attempts to aid committee counsel in identifying types of conflicts that can arise among members of creditors' committees and describe mechanisms that may prevent conflicts from hampering or halting the functioning of the committee. It is the authors' belief that, by educating the committee members and including appropriate conflict resolution procedures in the committee by−laws, committee counsel should be able to anticipate and act to resolve many conflicts before being forced to react to the factionalization of the committee and before the committee ceases effectively to function. [*FN:* Much has been written on the problems of conflicts in bankruptcy, see, e.g., Regina Stango Kelbon et al., Conflicts, The Appointment of "Professionals," and Fiduciary Duties of Major Parties in chapter 11 , 8 Bankr. Dev. J . 349 (1991) (discussing importance of disclosure to proper functioning committee), and the functions of the creditors' committees in a chapter 11 case, see, e.g., Klee & Shaffer, supra note 16, at 1043−53; Andrews, supra note 9, at 249−62 (reviewing functions of committees) but most of the analysis of conflicts in connection with creditors and their committees has focused on lawyers' conflicts of interest in representing committees and/or individual creditors, see, e.g., Rapoport, supra note 13, at 985−90 (suggesting rules to assist lawyers in deciding whether potential conflict prevents representation of committee); Dennis S. Meir & Theodore Brown Jr., Representing Creditors' Committees under chapter 11 of the Bankruptcy Code , 56 Am. Bankr. L.J. 217, 226−30 (1982) (reviewing restrictions in section 1103(b) pertaining to committees ability to appoint attorneys, accountants and other professionals). However, in Kenneth Klee & John Shaffer's article Creditors' Committees Under chapter 11 of the Bankruptcy Code , the authors do discuss possible solutions to the problems of multiple committees for related debtors and the need for a mechanism to alter the composition of committees and to remove committee members in the face of actual conflict of interest

or breach of duty. See Klee & Shaffer, supra note 16, at 1032−33, 1037−39. This Article may recap some of what has already been written, but we hope to go one step further by sharing our experience in anticipating and resolving conflicts within committees.]

I. Background

With the enactment of the Bankruptcy Code in 1978, [*FN:* Bankruptcy Reform Act, supra note 7.] Congress took the administrative task of monitoring the estate out of the hands of the courts and gave that role to creditors. [*FN:* See H.R. Rep. No. 95−595, at 401 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6194 (stating that section 1102 allows committee to supervise debtor in possession and trustee);*In re* Diversified Capital Corp., 89 B.R. 826, 828−29 (Bankr. C.D. Cal. 1988) (noting that Code contemplates creditor's committees as having "principal monitoring responsibility" of debtor).] Bankruptcy Code section 1102 [*FN:* 11 U.S.C. §1102 (1994). Section 1102 provides that: (a)(1) Except as provided in paragraph (3), as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate. (2) On request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders. The United States trustee shall appoint any such committee. (3) On request of a party in interest in a case in which the debtor is a small business and for cause, the court may order that a committee of creditors not be appointed. (b)(1) A committee of creditors appointed under subsection (a) of this section shall ordinarily consist of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee, or of the members of a committee organized by creditors before the commencement of the case under this chapter, if such committee was fairly chosen and is representative of the different kinds of claims to be represented. (2) A committee of equity security holders appointed under subsection (a)(2) of this section shall ordinarily consist of the persons, willing to serve, that hold the seven largest amounts of equity securities of the debtor of the kinds represented on such committee. 11 U.S.C. §1102.] now makes the appointment of a creditors' committee by the United States Trustee mandatory in all chapter 11 cases, except for small business cases. [*FN:* See id. ;*In re* McLean Indus. Inc., 70 B.R. 852, 856 (Bankr. S.D.N.Y. 1987) (describing U.S. Trustee pilot program as means of achieving congressional goal of "separating `the administrative duties in bankruptcy from the judicial tasks,' leaving bankruptcy judges free to resolve disputes untainted by knowledge of administrative matters unnecessary and perhaps prejudicial to an impartial judicial determination.") (quoting H.R. Rep. No . 99−764, at 18 (1986), reprinted in 1986 U.S.C.C.A.N. 5227, 5230).]

A creditors' committee "may be appointed at any time before consummation of a plan of reorganization, even after the confirmation of a plan," [*FN:* See Kelbon et al., supra note 30, at 426 (discussing possibility of postconfirmation responsibilities requiring committee involvement).] if warranted by the attendant circumstances. [*FN:* See , *e.g.* ,*In re* Diversified Capital Corp., 89 B.R. 826, 831 (Bankr. C.D. Cal. 1988) (explaining that postconfirmation appointment of committee was justified by debtor's disposal of property in violation of plan).] In addition, a committee appointed before confirmation of a plan may continue to act after confirmation where the best interests of the creditor class are served. [*FN:* See id. at 830 (noting no requirement that duties of committee cease upon confirmation).] The general rule that "the committee is dissolved at confirmation, when property of the estate is revested in the debtor, except as provided in a plan" does not mean that the committee must dissolve before consummation, especially where investigation of the debtor's activities after confirmation are in the interest of creditors. [*FN:* See Creditors' Comm. v. Parks Jaggers Aerospace Co. (*In re* Parks Jaggers Aerospace Co.), 129 B.R. 265, 267 (M.D. Fla. 1991) (finding where debtor failed to perform plan obligations, duties, and responsibilities of committees under section 1103(c)(2), (5) may be necessary and appropriate after confirmation); see also *In re* Doctors' Hosp. of Tampa, Ltd., 183 B.R. 312, 314 (Bankr. M.D. Fla. 1995) (stating that there is rebuttable presumption that committee continues after confirmation). But see Unsecured Creditors' Comm. of Butler Group Inc. v. Butler (*In re* Butler), 94 B.R. 433 (Bankr. N.D. Tex. 1989) (stating that once chapter 11 case terminates through dismissal or conversion to chapter 7, creditors' committee dissolved because statute which authorized its existence is no longer applicable).]

In general, the official committees, supervised by the U.S. Trustee, should represent "an appropriate constituent body of parties in interest for the benefit of the reorganization process as a case proceeds through the bankruptcy court." [*FN:* See*In re* Eastern Maine Elec. Coop. Inc., 121 B.R. 917, 933 (Bankr. D. Me. 1990).] To facilitate the committee's function, section 1103(c) of the Code enumerates a non−exclusive list of the powers and duties of the committee vis−à−vis the estate. [*FN:* Section 1103(c) states that: A committee appointed under section 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'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 section 1104 of this title; and (5) perform such other services as are in the interest of those represented. 11 U.S.C. §1103(c) (1994).] Section 1103(c) is clear that a committee has the authority to and "may" exercise any of the enumerated functions. [*FN:* See Collier on Bankruptcy ¶ 1103.05 (Lawrence P. King *et al.* eds., 15th ed. rev. 1996).] The section does not explicitly provide in its text, but its title, "Powers and Duties of Committee," implies that the committee also has a duty to perform these acts. [*FN:* See id. at ¶ 1103.05[2] (discussing nature of fiduciary duty owed by committee members to those they represent).] Although

there is some debate as to whether a committee *must* perform the functions described in section 1103(c), [*FN:* Compare *In re* Western Management Inc., 6 B.R. 438, 443 (Bankr. W.D. Ky. 1980) (stating that without recommendation and findings from committee court cannot confirm reorganization plan), with Andrews, supra note 9, at 272−73 (concluding that committee's fiduciary duty to constituent creditors is confined to duty of loyalty and that no duty of care is owed and thus committee is able but not obligated to perform the functions described in section 1103(c)).] there is no debate that when the committee does act, it must act on behalf of all creditors of the class that the committee represents. [*FN:* See 11 U.S.C. §1102(b); s ee also Official Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1315 (1st Cir. 1993) (rejecting contention that committee is fiduciary for debtor's estate and finding that committee must pursue course which is in best interest of class it represents) (citing*In re* Seaescape Cruises, Ltd., 131 B.R. 241, 243 (Bankr. S.D. Fla. 1991)).]

Committee members need to remain aware that despite the variety of roles the committee may undertake, [*FN:* In a more recent decision in the Dow Corning case, the court had occasion to consider what types of activities were appropriate for an official committee. See*In re* Dow Corning Corp., 199 B.R 896 (Bankr. E.D. Mich 1996). Thus, the court found that the tort claimants' committee was not allowed authorized to lobby the Federal Drug Administration because while section 1103 "does not grant the committee blanket authority to represent its constituency in matters outside and independent of the bankruptcy case." *Id.* at 900 (quoting*In re* Johns−Manville Corp., 52 B.R. 879, 884 (Bankr. S.D.N.Y. 1985), aff'd , 60 B.R. 842 (S.D.N.Y.), rev'd on other grounds , 801 F.2d 60 (2d Cir. 1986). Thus, although the tort claimants' committee was authorized under section 1103 to monitor the debtor's lobbying activity, and any lobbying efforts by the committee members was held by the court to be "private and not part of the bankruptcy process." See id. at 903.] their fiduciary duty remains constant. The committee often acts as a conduit of information to and from the creditor class, [*FN:* See, *e.g.* , Eastern Maine Elec. Coop. Inc., 121 B.R. 917, 933 (Bankr. D. Me. 1990) (committee should gather information from its constituency and channel information through committee and its professionals so that concerns can be articulated by representative entity).]but has increased powers and expanded obligations, as well as an adversarial role, under the Code. [*FN:* See SPM Mfg. , 984 F.2d at 1316. In SPM Mfg . the court stated that: [The] committee must sometimes be adversarial . . . The creditors' committee is not merely a conduit through whom the debtor speaks and negotiates with creditors generally. On the contrary, it is purposely intended to represent the necessarily different interests of the creditors it represents. It must necessarily be adversarial in a sense, though its relation with the debtor may be supportive and friendly. *Id.* (quoting*In re* Daig Corp., 17 B.R. 41, 43 (Bankr. D. Minn. 1981)).] The underlying purpose of the committee, regardless of the particular action undertaken by the committee at any given time, is to "aid, assist and monitor the debtor to ensure that the unsecured creditors' views are heard and their interests promoted and protected." [*FN:* See Pan Am Corp. v. Delta Air Lines Inc., 175 B.R. 438, 514 (S.D.N.Y. 1994) (citing SPM Mfg. , 984 F.2d at 1315−16).]

II. Committee Members as Fiduciaries of Creditor Class

Since the adoption of Bankruptcy Code section 1102, courts have stated on several occasions that a creditors' committee owes a fiduciary duty only to the creditors' class that the committee represents. [*FN:* See SPM Mfg. , 984 F.2d at 1315 (finding that committee had no fiduciary duty to estate); Johns−Manville Sales Corp. v. Doan (*In re* Johns−Manville Corp.), 26 B.R. 919, 924 (Bankr. S.D.N.Y. 1983) (noting that it is well established that creditors who serve on committees owes its duty to class it represents).] Thus, the rule that existed under the prior Bankruptcy Act has not changed under the Code. Members of the creditors' committee assume a fiduciary obligation to the creditors whom they were elected to represent. [*FN:* See Andrews, supra note 9, at 272 nn.189−91 (citing cases).]

A. Committee Members as Fiduciaries: The Legal Principles

When a creditor agrees to serve on an official creditors' committee, it undertakes to act in a fiduciary capacity on behalf of the members of the class it represents. [*FN:* See Johns−Manville , 26 B.R. at 924 ("where a committee representative or agent seeks to represent or advance the interest of an individual member of a competing class of creditors or various interests or groups whose purposes and desires are dissimilar, this fiduciary is in breach of his duty or loyal and disinterested service.") (citations omitted); see also *In re* Enduro Stainless Inc., 59 B.R. 603, 605 (Bankr. N.D. Ohio 1986) (stating that member of creditors' committee undertakes to act in fiduciary capacity and may not act as to promote only that creditors' interest).] In this capacity, the committee members owe the other members of the represented class their undivided loyalty and allegiance. [*FN:* See Pension Benefit Guar. Corp. v. Pincus, Verlin, Reich & Goldstein Prof'l Corp., 42 B.R. 960, 963 (E.D. Pa. 1984) (stating committee owes loyalty to group it represents) (citation omitted);*In re* Haskell−Dawes Inc., 188 B.R. 515, 522 (Bankr. E.D. Pa. 1995).] The Supreme Court has cautioned that the "whole body of law" imposes "the most rigorous responsibilities for fair dealing" on fiduciaries who represent the rights of others. [*FN:* See Johns−Manville , 26 B.R. at 925 (quoting Young v. Higbee Co., 324 U.S. 204, 213 (1945)).]

As a consequence of a committee member's role as a fiduciary, it "may not act through the committee in such a manner as to promote only that creditor's interest." [*FN:* See Enduro Stainless , 59 B.R. at 605.] If a committee member does use the appointed position to further its own self−interest, the fiduciary duty owed by that committee member to the

creditor class is violated. [*FN:* See United Steelworkers of Am. v. Lampl (*In re* Mesta Mach. Co.), 67 B.R. 151 (Bankr. W.D. Pa. 1986) (finding that committee member violates fiduciary duty by using position to further self−interest).]

A corollary to the committee's fiduciary duty has developed in the case law. A grant of immunity is available to committee members for actions that are within the scope of the committee's authority as conferred by statute or court order. [*FN:* See Philip v. L.F. Rothschild Holdings Inc. (*In re* L.F. Rothschild Holdings Inc.), 163 B.R. 45, 49 (S.D.N.Y. 1994) (stating that section 1103(c)(3) implies right of limited immunity to committee members) (citing Central Transp. Inc. v. Roberto (*In re* Tucker Freight Lines Inc.), 62 B.R. 213, 218 (Bankr. W.D. Mich. 1986));*In re* Drexel Burnham Lambert Group Inc., 138 B.R. 717, 722 (Bankr. S.D.N.Y.) (providing that members of committee could not be sued absent willful misconduct), aff'd sub nom. Lambert Brussels Assocs. Ltd. Partnership v. Drexel Burnham Lambert Group Inc. (*In re* Drexel Burnham Lambert Group Inc.), 140 B.R. 347 (S.D.N.Y. 1992).] Such immunity is limited, however, "to actions taken within the scope of the committee's authority as conferred by statute or the court and may not extend to 'willful misconduct' of the committee or its members." [*FN:* See L.F. Rothschild , 163 B.R. at 49 (quoting Leudke v. Delta Airlines, 159 B.R. 385, 392−93 (S.D.N.Y. 1993)).] Furthermore, the grant of immunity does not extend to *ultra vires* activity by the committee. [*FN:* Pan Am Corp. v. Delta Air Lines Inc., 175 B.R. 438, 514−15 (S.D.N.Y. 1994) (stating willful misconduct or ultra vires activity must be shown to overcome immunity); see also Official Unsecured Creditors' Comm. of General Homes Corp. v. American Savs. & Loan Ass'n of Fla. (*In re* General Homes Corp.), 181 B.R. 870, 882 (Bankr. S.D. Tex. 1994) (noting that committee has no immunity in connection with filing of unauthorized adversary proceeding asserting cause of action belonging to estate).]

The fiduciary duty of the committee, concurrent with a grant of limited immunity and increased powers, creates its own potential for abuse. "It is necessary to the reorganization process that a committee exercise its role carefully and judiciously, and not to bring to the attempted reorganization tactics invoked for the improper purposes of harassment or delay." [*FN:In re* General Homes Corp. , 181 B.R. 898, 902 (Bankr. S.D. Tex. 1995). In General Homes , the committee abused its authority by commencing an adversary proceeding against the debtor and others, on the day before a confirmation hearing, alleging preference, fraudulent conveyance, equitable subordination and other nonbankruptcy derived claims. See id. at 899. The court found that "committee members and their counsel may be liable for the actions they take in attempting to gain leverage," and refused to vacate the sanctions if imposed by or to approve a compromise of the improper litigation. See id.] Committee members must take care that the powers conferred by section 1103(c) of the Code are exercised within the confines of the committee's fiduciary role.

B. Committee Members as Fiduciaries: Application of the Legal Principles

It is axiomatic that all potential committee members come to the initial meeting of creditors with one major concern: how to enhance their individual claim. Each creditor eligible for service on a committee [*FN:* See discussion infra Part III.A. (providing types of creditors eligible for service on unsecured creditors' committee).] will have both individualized knowledge of the debtor and individualized issues with the debtor. However, the existence of a fiduciary duty is neither obvious at the outset nor instinctive to these potential members of a committee. Given the divergent interests that can be represented on a committee, collective action may be impossible if such a duty is not embraced by each member. [*FN:* See General Homes , 181 B.R. at 902 (noting that committees play active and vital role in development of viable plan of reorganization and so their duties must be executed carefully and judiciously).]

Therefore, after the committee is initially convened and as difficult issues arise, counsel's primary purpose must be to educate and instruct the members of the committee regarding their fiduciary duties. [*FN:* See discussion infra Part IV. (discussing committee counsel's role).] Often, this requires a formal presentation in oral and/or written form, emphasizing the members' representative function, the duty of loyalty owed to the creditor class, [*FN:* See discussion infra note 106.] the proper use of information and the need for disclosure among the committee members regarding the nature of their claims, their dealings with the debtor and any dealings they may have had with any non−debtor, but debtor−related, third parties.

III. Organization and Structure of Creditors' Committees

As stated in section 1102(b), the committee is intended to be representative of the different kinds of claims held by the committee's constituents. [*FN:* See 11 U.S.C. §1102(b) (1994).] Ideally, by virtue of the representative nature of the committee, each of the members of the class is assured that its interests are adequately represented without having to participate in the proceedings personally. [*FN:* "These committees are designed to deal with the debtor in a more manageable way than the entire body of creditors could. They are representative bodies that must speak for groups of creditors with similar interests." H. R. Rep. No . 95−595, at 235 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6194.] "[T]he ultimate aim is to strike a proper balance

between the parties such that an effective and viable reorganization of the debtor may be accomplished." [*FN:In re* Hills Stores, 137 B.R. 4, 7 (Bankr. S.D.N.Y. 1992); see also Andrew DeNatale, The Creditors' Committee Under the Bankruptcy Code−−A Primer , 55 Am. Bankr. L.J. 43, 45 (1981) (stating that committee selection process is intended assure fair representation).]

When the committee process envisioned by the Bankruptcy Code works, allowing entities with differing reorganizational goals to serve together often benefits the debtor. [*FN:* See*In re* Northeast Dairy Coop. Fed'n Inc., 59 B.R. 531, 534 (Bankr. N.D.N.Y. 1986) (stating inclusion of entities with different reorganization goals benefits debtor) (citing*In re* Altair Airlines Inc., 727 F.2d 88, 90−91 (3d Cir. 1984)).] "No two creditors have identical interests, . . . and the Code implicitly recognizes that fact by providing a procedural framework for handling the various divergent interests of the parties to a bankruptcy." [*FN:* Official Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1317 (1st Cir. 1993) (citation omitted).] However, given the variety of unsecured creditors that have been allowed to serve on creditors' committees, adequate representation and cooperative action by the members of a committee often remain more of an elusive goal than a certainty. [*FN:* See id. at 1318.]

Courts have recognized that a committee member faces a difficult choice when his or her best interests are in direct conflict with those of the other unsecured creditors. [*FN:* See *In re* America West Airlines Inc., 142 B.R. 901, 903 (Bankr. D. Ariz. 1992) (explaining that creditor has completely different perspective than other committee members because its ability to exercise control over debtor in possession as result of newly secured status), aff'd in part and vacated on other grounds , 40 F.3d 1058 (9th Cir. 1994).] Thus, where a committee member is so conflicted that it is absolutely unable to represent the committee's constituency, removal of the member from the committee is the U.S. Trustee's likely solution. For example, in *In re America West Airlines Inc.*, [*FN: Id.*] a major trade creditor provided post petition financing to the debtor in exchange for secured status for 85% of its claim. [*FN:* See id. at 903.] This created a substantial conflict requiring removal of this creditor from the committee. [*FN:* See id.] However, given the variety of creditor interests able to serve on a committee, the conflicts are usually not so apparent. [*FN:* See*In re* Seaescape Cruises, Ltd., 131 B.R. 241, 243 (Bankr. S.D. Fla. 1991) (providing that Code does not preclude both secured and unsecured creditors from serving on committee).] Because some tension is inherent and therefore acceptable, [*FN:* See *In re* National Liquidators Inc., 182 B.R. 186, 192 (S.D. Ohio 1995) (stating that committee's role as investigator of creditor claims and avoidance actions found to create inherent tension).] counsel must evaluate all of the relevant circumstances and endeavor to find an effective and appropriate middle ground. [*FN:* Counsel and the committee should remember that "[t]he duty of the unsecured creditors' committee to pursue the best interests of the unsecured creditors requires different outcomes in different situations. . . ." Official Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1318 (1st Cir. 1993).]

A. Who May Serve on the Committee

The plain language of the Code mandates that the United States Trustee *shall* appoint a committee of *creditors* holding unsecured claims. [*FN:* See 11 U.S.C. §1102(a) (1994).] Although the Code's definition of "creditor" [*FN:* See id. §101(10).] and "claim" [*FN:* See id. §101(5).] mandates that only actual creditors may sit on a creditors' committee, [*FN:* See *In re* Celotex Corp., 123 B.R. 917, 920 (Bankr. M.D. Fla. 1991) (stating that trustee is required to select actual claimants to participate in committee).] in fact, U.S. Trustees exercise wide latitude in appointing creditors to a committee where the creditor is representative of the class of claims. [*FN:* See*In re* Walat Farms Inc., 64 B.R. 65, 68 (Bankr. E.D. Mich. 1986) (describing process of appointing committee members).] The decision regarding whether or not a creditors' committee is sufficiently representative of the class is determined on an *ad hoc* basis considering the facts presented in each individual case. [*FN:* See Klee & Shaffer, supra note 16, at 1012−13. However, it is clear that an actual conflict of interest, (versus a potential conflict of interest) can result in disqualification. See id. Generally, actual conflicts are conflicts of interest arising from the creditor's relationship to the debtor either as a result of insider or competitor status. See id. The existence of an actual conflict of interest can be measured, of course, by both the creditor's status vis−à−vis the debtor and its conduct with regard to other claimants. See id.]

Generally, courts have allowed representatives of creditors to be committee members. [*FN:* See*In re* First RepublicBank Corp., 95 B.R. 58, 60 (Bankr. N.D. Tex. 1988) ("The committee can include the individual creditor or its representative."); *In re* Charter Co., 42 B.R. 251, 254 (Bankr. M.D. Fla. 1984) (allowing indenture trustee to serve on committee); *In re* M.H. Corp., 30 B.R. 266, 267 (Bankr. S.D. Ohio 1983) (allowing attorney to serve on committee).] Recently, however, the bankruptcy court in *In re Dow Corning Corp.*, [*FN:* 194 B.R. 121 (Bankr. E.D. Mich. 1996).] (*Dow Corning I*) challenged the ability of lawyers to sit on a creditors' committee as representatives of their clients' claims. [*FN:* See id. at 137−38. In Dow Corning I , the Bankruptcy Court for the Eastern District of Michigan recently disbanded the tort claimants' committee on the grounds that none of the eight attorney members originally appointed were "creditors holding unsecured claims." See id. at 138. Although the District Court stayed this decision pending an appeal to the 6th Circuit court of appeals on the grounds that the bankruptcy court does not have the authority to remove committee members,

the bankruptcy court's opinion outlines a variety of conflicts faced by lawyers who act as representatives on a committee. See id. at 136−38.] Notwithstanding, the *Dow Corning I* decision, when a representative accepts appointment to an official committee, it does so with the understanding that it has a fiduciary duty of undivided loyalty and impartial service to all constituency creditors. [*FN:* See supra note 52 and accompanying text. Cf. *In re* County of Orange, 179 B.R. 195, 202−03 (Bankr. C.D. Cal. 1995) (citations omitted) (stating that, like other members, indenture trustee serving on creditor's committee must act in best interest of all creditors).]

Several courts have allowed unions representing employees to serve their members on a committee. [*FN:* See *In re* Enduro Stainless Inc., 59 B.R. 603, 605 (Bankr. N.D. Ohio 1986) (appointing United Steel Workers of America to unsecured creditors' committee); *In re* Altair Airlines Inc., 727 F.2d 88, 90 (3d Cir. 1984) (allowing debtor's employee labor union to serve on creditors' committee); *In re* Schatz Fed. Bearings Co., 5 B.R. 543, 548 (Bankr. S.D.N.Y. 1980) (same). But see *In re* Allied Delivery Sys. Co., 52 B.R. 85, 86 (Bankr. N.D. Ohio 1985) (finding open hostilities between debtor and union justified denial of union's application for committee appointment).] Courts have also permitted indenture trustees to serve on committees on behalf of debenture holders despite the fact that indenture trustees typically have their own claims against the debtor for fees and charges against the indenture. [*FN:* See *In re* McLean Indus. Inc., 70 B.R. 852, 855 (Bankr. S.D.N.Y. 1987) (finding that indenture trustees often serve on such committees); *In re* Charter Co., 42 B.R. 251, 254 (Bankr. M.D. Fla. 1984) (finding nothing in private agreement formed basis to exclude indenture trustees from serving on creditors' committee).] Courts are divided as to whether insiders of the debtor and competitors of the debtor should be permitted to serve on committees. [*FN:* For cases involving insiders: see *In re* Vermont Real Estate Inv. Trust, 20 B.R. 33, 36 (Bankr. D. Vt. 1982) (insider holding third largest unsecured claim allowed to serve on committee). But see *In re* Swolsky, 55 B.R. 144, 145 (Bankr. N.D. Ohio 1985) (finding presence of insider on committee destroyed confidentiality of committee communications); *In re* Glendale Woods Apartments, Ltd., 25 B.R. 414, 415 (Bankr. D. Md. 1982) (requiring insider be removed from committee); *In re* Daig Corp., 17 B.R. 41, 42 (Bankr. D. Minn. 1981) (deciding father−son relationship between principle officer of creditor and debtor's chairman prevented service by potential committee member). For cases involving competitors: see *In re* Plant Specialties Inc., 59 B.R. 1, 2 (Bankr. W.D. La. 1986) (citing competitor's familiarity with industry and insight into debtor's affairs as reasons why appointments would be beneficial to reorganization process); but see *In re* Wilson Foods Corp., 31 B.R. 272, 272 (Bankr. W.D. Okla. 1983) (finding competitor of debtor not permitted to serve on committee due to conflict of interest and divided loyalties).] Clearly, however, competitors who might receive and improperly use confidential information as a result of service on a committee may be denied membership. [*FN:* See *In re* Wilson Foods Corp., 31 B.R. 272, 272 (Bankr. W.D. Okla. 1983) (declining to appoint competitor to creditor's committee because of confidentiality concerns).] Other courts have held that merely being a competitor of the debtor is not grounds alone for exclusion from an official committee. [*FN:* See, *e.g.* , Plant Specialties , 59 B.R. at 1.] However, if a competitor is appointed to a committee, potential conflict issues can be addressed by the adoption of protective measures concerning trade secrets and other competitive information.

B. Issues Relating to the Adequacy of the Committee's Representation of its Constituents

Imagine the conflicts that might result from the following hypothetical situations: a debtor anticipates paying unsecured creditors 25 cents on the dollar if it proves that the value of its encumbered property is lower than the value [*FN:* At a valuation under 11 U.S.C. §506(a) (1994).] asserted by the partially secured creditor on the committee; or a debtor proposes to settle certain preference and fraudulent conveyance actions against certain of the committee members, which will help the debtor gain the continued support of these creditors (insider and trade creditors) for the reorganized debtor, even though it appears that a slightly higher dividend would be paid to all creditors if the debtor proceeded to trial.

Although every creditor hopes that the committee will react to the debtor's proposals in a manner that promotes its own interests, the reality is that the committee is likely to be divided along several lines. Some of these competing interests may cancel each other out, but it is more likely that two or more of one type of creditor (e.g. institutional lenders) on the committee will continually vote their own interests, dominating the committee and overpowering another type of creditor (e.g. trade creditors) with fewer representatives on the committee. [*FN:* When two competing plans of reorganization treat an undersecured creditor's secured and unsecured claims differently (by one plan providing a greater distribution to unsecured creditors and the other plan providing better treatment for the secured portion of the creditor's claim) it is foreseeable that a partially secured creditor serving on the unsecured creditors' committee may have difficulty determining which plan the committee should recommend to the creditor body. See, *e.g.* ,*In re* Walat Farms Inc., 64 B.R. 65, 69−70 (Bankr. E.D. Mich. 1986) (providing that conflicts presented by unsecured creditors service on committee were too remote to prohibit appointment of such creditor); *In re* Seaescape Cruises Ltd., 131 B.R. 241, 243 (Bankr. S.D. Fla. 1991) (allowing partially secured creditor to serve despite recognition of potential conflict). A similar problem would be faced by an unsecured creditor who also has an equity interest or administrative claim. See, *e.g.* ,*In re* America West Airlines Inc., 142 B.R. 901, 903 (Bankr. D. Ariz. 1992) (providing that administrative claim gave committee member different perspective vis−à−vis debtor and disqualified creditor from service on committee). The indenture trustee serving on the committee may be

pursuing an administrative claim for fees and expenses which would reduce the distribution available to unsecured creditors. Insiders, while holding unsecured claims, may have other loyalties to the debtor and may have some other interest in the debtor continuing in business, regardless of the fact that liquidation may provide higher distributions to unsecured creditors. In addition, the institutional lenders, which look for a maximum present recovery, may not have the same interests as trade creditors who look forward to continuing to do business with a debtor that would be healthier if cash on hand is maintained instead of paid to institutional lenders. See, *e.g.* ,*In re* Altair Airlines Inc., 727 F.2d 88, 90 (3d Cir. 1984) (explaining that trade creditors often "prefer to forego full payment . . . and [preserve] a customer, while lenders may prefer liquidation and prompt payment.")] In such case, the group of creditors represented by the "squelched" committee members are not "adequately represented" by the committee [*FN:* See *In re* Dow Corning Corp., 194 B.R. 121, 141 (Bankr. E.D. Mich. 1996) ("adequate representation exists if [a creditor group has] a meaningful voice on the committee in relation to their posture in the case.");*In re* Sharon Steel Corp., 100 B.R. 767, 777−78 (Bankr. W.D. Pa. 1989) (explaining that adequate representation requires that diverse interests be represented on and participate in committee).] if they consistently are denied a meaningful voice on the committee.

Courts have recognized that committee members need not have parallel interests in order to be representative, [*FN:* See, *e.g.* ,*In re* Plabell Rubber Prods. Inc., 140 B.R. 179, 181 (Bankr. N.D. Ohio 1992) (stating that all committee members need not have parallel interests);*In re* Texaco Inc., 79 B.R. 560, 567 (Bankr. S.D.N.Y. 1987) (same).] and that service on a committee with the authority to investigate claims and avoidance actions against creditors often casts committee members into conflict. [*FN:* See *In re* National Liquidators Inc., 182 B.R. 186, 192 (S.D. Ohio 1995) (holding that inherent tension exists between committee, its members and its constituents given committee's authority to investigate legitimacy of creditor's claims).] Unless the committee is unable to serve the best interests of the creditor constituency, the divergence of interests and inherent conflicts are accepted by the committee process and reorganization scheme and the overpowered creditor is not considered to be disenfranchised. [*FN:* See Official Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1316−17 (1st Cir. 1993) (stating that committee process is enhanced when adversarial) (citing*In re* Seaescape Cruises, Ltd., 131 B.R. 241, 243 (Bankr. S.D. Fla. 1991)); see also *In re* Plant Specialties, 59 B.R. 1, 1 (Bankr. W.D. La. 1986) (explaining that party seeking removal of conflicted creditor bears burden of proving detriment to estate).]

The dilemma for committee counsel arises when a creditor has a potential conflict or is consistently outvoted on the committee by other members. [*FN:* See *In re* Hills Stores Co., 137 B.R. 4, 7−8 (Bankr. S.D.N.Y. 1992) (discussing creditors who are consistently outvoted).] In such cases, counsel must take steps to ensure that the committee member has a meaningful voice and can adequately represent similar claimants, despite being in the minority and needing to protect its own interests, and that the committee continues to act in the best interests of the diverse creditor class. Circumstances may require counsel to advise each faction within the committee regarding the legal ramifications to the creditor class of the action it desires. Each faction may also need its own access to the committees' professionals in order to develop its position within the committee.

A "meaningful voice" can thus be defined as the full opportunity of a committee member, prior to a committee vote, to present to the committee the position of the creditor constituency holding claims most similar to the claim of that member. [*FN:* See*In re* Dow Corning , 194 B.R. at 141 (stating that adequate representation exists if creditors have meaningful voice).] When adequate representation becomes a problem and a committee member is unable to present the position of its constituents, counsel is cast in the role of mediator and facilitator. [*FN:* Cf. Official Comm. of Unsecured Creditors v. Eagle−Picher Indus. Inc. (*In re* Eagle−Picher Indus. Inc.), 169 B.R. 130, 136 (Bankr. S.D. Ohio 1994) (appointing mediator to assist constituency to find acceptable plan).] Committee counsel's goal, ultimately, is not to facilitate absolutely every committee action that each committee member desires, but to ensure that the entire group of diverse claimants has the means and opportunity to consider the interests of the whole creditor body and, if possible, can take cooperative action that is in the best interests of the entire constituent class. [*FN:* See*In re* EBP Inc., 171 B.R. 601, 602 (Bankr. N.D. Ohio 1994) (stating that counsel undertakes representation of entire class fairly, not just committee members);*In re* Drexel Burnham Lambert Group Inc., 138 B.R. 717, 722 (Bankr. S.D.N.Y.) (stating that committee counsel's goal is not to maximize any one creditor's interest), aff'd sub nom. Lambert Brussels Assocs. Ltd. Partnership v. Drexel Burnham Lambert Group Inc. (*In re* Drexel Burnham Lambert Group Inc.), 140 B.R. 347 (S.D.N.Y. 1992).]

IV. The Role of Counsel in Representing the Committee

As discussed earlier, committee counsel must approach its engagement as a committee−retained professional by bearing in mind that he or she will need to be more than just a legal advisor and advocate. [*FN:* See Texas Extrusion Corp. v. Lockheed Corp. (*In re* Texas Extrusion Corp.), 844 F.2d 1142, 1163 (5th Cir. 1988) (authorizing attorney for creditors' committee to consult with creditors);*In re* Wire Cloth Prod., 130 B.R. 798, 812 (Bankr. N.D. Ill. 1991) (stating that attorneys for creditors' committee must further economic interests of unsecured creditors);*In re* Pettibone Corp., 74 B.R. 293, 309 (Bankr. N.D. Ill. 1987) (delineating counsel's functions necessary to creditors' committee performance).] In the committee context, counsel must act in a number of capacities

including: an educator and advisor regarding fiduciary duties and the reorganization process in general, [*FN:* See Berner v. Equitable Office Bldg. Corp., 175 F.2d 218, 220 (2d Cir. 1949) (finding fiduciary duty owed to entire class of creditors even if hired by one member of class).] a mediator of intra−committee and inter−creditor disputes, [*FN:* See Manville Corp. v. Equity Sec. Holders Comm. (*In re* Johns−Manville Corp.), 66 B.R. 517, 528−29 (Bankr. S.D.N.Y. 1986) (noting efforts of legal representatives in resolving disputes between creditor classes and separate committees).] a consensus builder when no clear majority exists, [*FN:* See id. at 530.] a facilitator for those members lacking in representation and resources when the best interest of creditors are at issue, [*FN:* See United Steel Workers of Am. v. Lampl (*In re* Mesta Machine Co.), 67 B.R. 151, 157 (Bankr. W.D. Pa. 1986) (finding counsel not only had duty to committee but each individual creditor that committee represents).] and a representative and advocate in court for the entire creditor class. [*FN:* See Pan Am Corp. v. Delta Airlines Inc., 175 B.R. 438, 514 (S.D.N.Y. 1994) (stating creditors' committees and those who serve it have fiduciary duty to entire class of creditors); Pension Benefit Guar. Corp. v. Pincus, Verlin et al., 42 B.R. 960, 963 (E.D. Pa. 1984) (stating that counsel's obligation is to represent entire class fairly).] To succeed in these tasks, counsel must effectively gather information and anticipate potential conflicts.

A. Anticipating Conflicts

The most difficult aspect of committee counsel's job may be anticipating conflicts. As noted above, each committee member comes to the initial meeting with its own economic interests at heart. [*FN:* See supra notes 63−65 and accompanying text.] Committee counsel, on the other hand, is responsible for ensuring that the committee advances the collective interests of the entire creditor class. [*FN:* See supra notes 63−65 and accompanying text.] Committee counsel who lacks sufficient information from the committee members (*e.g.*, regarding the nature of their claims, their knowledge of the debtor and the debtor's and its affiliates' activities) may, as a case progresses, feel like the proverbial rat in a maze−−rushing blindly towards a goal, only to find that a conflict issue exists where he or she thought was a clear path. Inevitably, if counsel consistently cannot clear the path, the committee's credibility with the court, the debtor and other major parties will be impaired and the committee will cease to function effectively. [*FN:* See Corrine Ball , An Overview of chapter 11 , 556 Pli/Comm 71, 89 (1990) (noting importance of credibility to creditors' committee performance).]

1. Disclosure

Courts seem to expect extraordinary foresight in determining whether the committee is representative of the class of claims. In *In re Drexel Burnham Lambert Group Inc.*, [*FN:* 118 B.R. 209 (Bankr. S.D.N.Y. 1990).] the court found that it should not consider the uniqueness of the claims of the individual committee members, but rather how these claims will be treated under a plan. [*FN:* See id. at 212.] Although it is not always possible to make such predictions, similar insight is needed by committee counsel in order to effectively manage conflicts. [*FN:* See generally Nancy B. Rapoport, Seeing the Forest Through and the Trees: The Proper Role of the Bankruptcy Attorney , 70 Ind. L. J. 783 (1995) (discussing how bankruptcy attorneys must zealously advocate full disclosure).]

In the context of discussing attorneys' conflicts of interest, another court stated that "[i]nadequate disclosures disable courts from properly determining the propriety of legal employment." [*FN:In re* National Liquidators Inc., 182 B.R. 186, 197 (S.D. Ohio 1995).] Likewise, inadequate disclosure by committee members hinders committee counsels' efforts to predict conflicts and prevents the committee from fulfilling its duty to the class, as the proper functioning of the committee often depends on the pooling of information. [*FN:* See *In re* Eastern Maine Elec. Coop. Inc., 121 B.R. 917, 933 (Bankr. D. Me. 1990) (discussing committee's role as conduit of information).]

Often, information regarding a creditor's claim or dealings with the debtor may not be evident to anyone but that particular creditor. Committee members often have preconceived notions regarding the direction the case may take based on the nature of their own dealings with the debtor, [*FN:* See Kelbon et al., supra note 30. "'[C]reditors' committees often contain creditors having a variety of viewpoints. Some members may favor liquidation; others may favor continuation of the business . . . Some debt may be contractually subordinated to other debt. Debentures, for example, are often subordinated to senior institutional indebtedness but not to trade debt. Maximization of return to debenture holders may lead to different views from those of senior indebtedness. . . . In most cases [such conflicts] can be expected among creditors acting to protect their separate business interests.'" See id. at 429 (quoting*In re* McLean Indus. Inc., 70 B.R. 852, 861 (Bankr. S.D.N.Y. 1987)). Certain of these conflicts are unavoidable and, thus, must be classified as "acceptable," but are undoubtedly conflicts that will influence the direction chosen by the committee in dealing with the debtor. See id.] which are unknown to other members and counsel. Furthermore, committee members may have knowledge of the facts relating to the operation of the debtor's business, but may lack the legal sophistication to anticipate avoidance, consolidation, subordination or distribution issues that will ultimately affect the entire creditor class. Therefore, at an early point in the case, all committee members should disclose to the committee the nature of their

claims against the debtor, and against debtor−related third parties.

The ability of counsel to obtain full disclosure from committee members will often determine counsel's effectiveness in anticipating conflicts that may occur in a case when plan analysis or drafting and distribution issues arise. While coaxing such information from committee members may not always be an easy endeavor, full disclosure will assist counsel in its later representation of the committee by allowing counsel to craft, and allowing the committee to adopt, appropriate conflict resolution mechanisms.

Appreciation by the committee of the need for full disclosure becomes extremely important when the committee selects a chairperson. The job of chair involves more work and resources than many committee members are willing or able to commit. [*FN:* Institutional lenders who have the resources or prior experience with the bankruptcy process may be savvy regarding the reorganization process and often are the most likely volunteers for the position of committee chair.] However, the committee chair often becomes powerful because it controls the committee's agenda, the professionals' budget and often has substantially greater contact than do other committee members with the debtor and its key employees. [*FN:* See Peter Blain & Diane Harrison, Creditors' Committees Under chapter 11 of the United State Bankruptcy Code: Creation, Composition, Powers, and Duties , 73 Marq. L. Rev. 581, 619 (1990) (describing role of chairperson of committee); Harvey A. Stricken, Commencement of a chapter 11 Case , 647 PLI/Comm. 49, 99 (1993) (describing role of chairperson as presiding over meeting, working closely with professions and acting as spokesperson for committee).] In many cases, the committee chairperson develops a working relationship with many of the debtors' key employees and is privy to a greater amount of information regarding the debtor [*FN:* In addition to being privy to information regarding the debtor, the committee chair, as the committee's designee, also has greater access than do the remaining committee members to the debtors' professionals, potential purchasers of assets and other significant creditors who chose not to be on the committee.] than are other committee members.

Therefore, before the committee selects a chairperson, all candidates for the position must fully disclose the nature of their claims and the basic nature of their business dealings with the debtor or other debtor−related third parties. In order to promote the further sharing of information among the committee, the committee chair, like all committee members, must be impressed with the notion of full and continuous disclosure, and should be encouraged to share the substance of all extra−committee conversations.

2. Confidentiality

The information provided to the committee either from non−public sources or from analyses by the committee professionals, as well as the deliberations of the committee, must be kept in strict confidence. [*FN:* See*In re* Rusty Jones Inc., 107 B.R. 161, 164 (Bankr. N.D. Ill. 1989) (discussing negative impact of leak of confidential information);*In re* Featherworks Corp., 25 B.R. 634, 644 (Bankr. E.D.N.Y 1982) (noting that violations of confidences held by attorney may hinder functions of committee).] Only by the committee conducting itself in this manner will it encourage production of information from the debtor to the committee and facilitate full, open and complete deliberations by the committee.

In most cases, it is the debtor that requires a confidentiality agreement with the committee regarding non−public information it discloses to the committee. [*FN:* When the debtor and the creditors' committee are taking the same position concerning an important issue, they can enter into a joint defense agreement with respect to that specific matter.] A confidentiality agreement among committee members may enhance the committee members' awareness of the appropriate uses of information and the need for appropriate limited disclosure to properly conduct the tasks of the committee. Such an agreement will restrict the member's use of confidential information learned as a result of committee membership [hereinafter "committee information"] for legitimate committee business.

Dissemination of committee information should be limited to individuals within the member's organization who have responsibility for the debtor's reorganization case. [*FN:* See cases cited supra note 120 (discussing negative consequences of violation of confidences).] For example, a committee member's receivables manager might need access to "committee information," but certainly should not discuss this information with the member's pricing manager. In addition, non−signers on the committee should be excluded from discussions involving confidential committee information. Although it is impossible to totally anticipate or prevent a breach of confidentiality, the agreement should be court approved and contain remedies for violation of the agreement including contempt for willful violation of a court order.

B. Separate Action by "Conflicted" Committee Members

In managing committees in which conflicts are likely to arise, it is important also to remember that in a bankruptcy case there are avenues for creditor participation other than through the committee process. [*FN:* See *In re* Dow Corning Corp., 194 B.R. 121, 143 (Bankr. E.D. Mich. 1996) ("The need for adequate representation . . . must be balanced against the availability of other avenues for creditor participation.").] Pursuant to Bankruptcy Code section 1109, [*FN:* 11 U.S.C. §1109 (1994).] any party in interest, including a creditor who is a member of a committee, may raise and be heard on any issue in the case. [*FN:* See id. ; see also*In re* Addison Community Hosp. Auth., 175 B.R. 646, 650 (Bankr. E.D. Mich. 1994) (discussing creditors' right to be heard); Fuel Oil Supply and Terminaling v. Gulf Oil Corp., 762 F.2d 1283 (5th Cir. 1985) (noting broad rights to intervene as consistent with expansive right to be heard under section 1109).] Therefore, a creditor may elect to take a position in court concerning certain issues that is different from the position taken by the committee. [*FN:* See Sapolin Paints Inc., 6 B.R. 582 (Bankr. E.D.N.Y. 1980) (allowing creditor to intervene and regretting argument that only committee should be heard).] For example, creditors subject to avoidance claims will need the flexibility to defend their claims from attack by the debtor, or where the committee has intervened, from attack by the committee. In addition, certain creditors may wish to support an action by the debtor against one or more other committee members.

Upon formation of the committee, provisions that permit members to deal with conflicts by taking individual action may be included in the committee's by−laws. By−law provisions should (1) require members to disclose to the committee actual conflicts and any prior connections with the debtor and other foreseeable parties in interest, (2) outline procedures for selection of a chairperson and specific disclosures required of the chairperson, and (3) provide for exclusion from committee action of a member on any matter on which it is determined to have a conflict of interest, provided such member can pursue independent action that does not result in a breach of any obligation owed as a committee member. The by−laws relating to voting should provide for the possibility of exclusion of the conflicted member on issues where a conflict arises. In addition, in order to prevent use of committee information to improperly further a member's individual interest at the expense of the creditor class, committee members should agree to keep confidential any committee information exchanged by the committee and its professionals.

C. Separate Committees and Subcommittees

Different treatment under a plan or an anticipated plan of the various types of claims represented by an unsecured creditors' committee may have a divisive impact upon the committee. In such case, the solution may lie in the appointment of separate committees or subcommittees. [*FN:* See 11 U.S.C. §1102(a)(2) (giving court discretion to appoint additional committee of creditors).] Currently, the trend in cases involving large, publicly traded companies seems to be the appointment of separate equity committees and, therefore, fewer courts are also willing to appoint separate creditors committees especially when doing so will result in a increased professional expenses. [*FN:* See Ad Hoc Bondholders Group v. Interco Inc. (*In re* Interco Inc.), 141 B.R. 422, 425 (Bankr. E.D. Mo. 1992) (rejecting creation of additional committee due to disruption in reorganization process);*In re* Public Serv. Co. of N.H., 116 B.R. 344, 346 (Bankr. D.N.H. 1990) (holding additional committee warranted without showing inadequate representation of existing equity committee);*In re* Eastern Maine Elec. Coop. Inc., 121 B.R. 917, 927 (Bankr. D. Me. 1990) (measuring potential conflicts with cost of additional committee lends cause to reject appointment).] However, if a separate committee is otherwise appropriate, the potential for added cost has been held insufficient to deprive creditors of the formation of a separate committee. [*FN:* See Interco , 141 B.R. at 424 (citing*In re* McLean Indus. Inc., 70 B.R. 852, 860 (Bankr. S.D.N.Y.).]

The standard for appointment of a separate committee of creditors or equity holders is stated by the Bankruptcy Code in relatively simple language: "whether such additional committee is necessary to assure their adequate representation." [*FN:* 11 U.S.C. §1102(a)(2).] However, a review of the case law reveals that attainment of this standard is often difficult to prove. [*FN:* See*In re* McLean Indus. Inc., 70 B.R. at 861 (discussing vagueness of "adequate representation");*In re* Salant Corp., 53 B.R. 158, 161 (Bankr. S.D.N.Y. 1988) (determining need for additional committee based on whether adequate representation exists); see also *In re* Hill Stores Co., 137 B.R. 4, 5 (Bankr. S.D.N.Y. 1992) (stating that there is no "bright line" test for adequate representation).] "In the usual case, [creditors acting to promote their separate business interests] might not require a separate committee unless they impair the ability of the unsecured creditors' committee to reach a consensus." [*FN:* See McLean Indus. , 70 B.R. at 861.]

For example, in *In re Orfa Corp.*, [*FN:* 121 B.R. 294 (Bankr. E.D. Pa. 1990).] the court balanced the need for a separate committee against the movants' selfish motive for appointment of a separate committee, the broad opposition to the application, the possibility of delay at a crucial juncture in the case and the added cost entailed by the proposed appointment. [*FN:* See id. at 295.] In *In re Wang Laboratories Inc.*, [*FN:* 149 B.R. 1 (Bankr. D. Mass. 1992).] the court

evaluated the adequacy of the existing committee's representation of the moving equity holders by examining the number of shareholders, the complexity of the case and whether the cost of an equity committee was outweighed by the concern for adequate representation. [*FN:* See id. at 2 (citing*In re* Johns−Manville Corp., 68 B.R. 155, 159 (S.D.N.Y. 1986)).] In addition, other courts have considered the current committee's ability to function, the nature of case, the standing and desires of the various constituencies [*FN:* See*In re* Hills Stores Co., 137 B.R. 4, 5−6 (Bankr. S.D.N.Y. 1992) (citing McLean Indus. , 70 B.R. at 860); Ad Hoc Bondholders Group v. Interco Inc. (*In re* Interco Inc.), 141 B.R. 422, 424 (Bankr. E.D. Mo. 1992) (discussing factors to consider in creation of additional committees); see also *In re* Cumberland Farms Inc., 142 B.R. 593, 595 (Bankr. D. Mass. 1992) (refusing to appoint secured lenders committee if, inter alia , lenders "individualistic interests" would not be enhanced by collective representation).] and whether appointment of a separate committee would vindicate a prime function of a committee. [*FN:* See *In re* Sharon Steel Corp., 100 B.R. 767, 779 (Bankr. W.D. Pa. 1989) (holding appointment of additional committee would not assist in formulation of plan of reorganization).]

If factionalization of the committee is foreseeable, a request for the appointment of separate committees is more likely to be successful if made at the beginning of the case instead of waiting until the consensus process is impaired. [*FN:* See *In re* Public Serv. Co. of N.H., 116 B.R. 344, 346 (Bankr. D.N.H. 1990) (refusing to appoint additional committee late in reorganization process); s ee also*In re* Dow Corning Corp., 194 B.R. 121, 143 (Bankr. E.D. Mich. 1996) (placing heavy weight on timeliness of motion as discretionary factor in its decision).] In *Orfa Corp.*, the possibility of distribution conflicts was held not to justify a separate committee when the movants were clearly aware of the possible conflict at a much earlier stage of the case. [*FN:* See*In re* Orfa Corp. , 121 B.R. 294, 298 (Bankr. E.D. Pa. 1990).] Because "the potential effectiveness of an official committee is, to a large degree, determined by the stage a reorganization proceeding has reached," the movant must act promptly to request an additional committee. [*FN:* Albero v. Johns−Manville Corp. (*In re* Johns−Manville Corp.), 68 B.R. 155, 161 (S.D.N.Y. 1986).] "The delay in submission of the request for a separate committee following the original filing of these proceedings [is] itself a factor to be considered in any decision." [*FN:* See Ad Hoc Bondholders Group v. Intero Inc. (*In re* Intero Inc.), 141 B.R. 422, 424−25 (Bankr. E.D. Mo. 1992) (quoting*In re* Public Serv. Co. of N.H., 89 B.R. 1014, 1018 (Bankr. D.N.H. 1988)).]

In two or more related cases, separate committees may be required. [*FN:* See*In re* White Motor Credit Corp., 18 B.R. 720, 721 (Bankr. N.D. Ohio 1980) (requiring separate creditors' committee for each of five related cases).] There is a presumption of impropriety when a single trustee, counsel or committee is appointed in related cases where substantive consolidation, inter−debtor claims or piercing the corporate veil are at issue. [*FN:* See Gill v. Sierra Pac. Constr. Inc. (*In re* Parkway Calabasas, Ltd.), 89 B.R. 832, 835 n.3 (Bankr. C.D. Cal. 1988), aff'd , 949 F.2d 1058 (9th Cir. 1991).] Such a presumption is only rebuttable in the case of "a potential conflict of interest, [where] no other competent fiduciary or professional is available, or the possibility that the conflict will become actual is remote and circumstances make use of a common fiduciary and professionals particularly compelling." [*FN:In re* B H & P Inc., 949 F.2d 1300, 1305 (3d Cir. 1991) (quoting and affirming*In re* B H & P Inc., 103 B.R. 556, 568 (Bankr. D.N.J. 1989), aff'd in part & rev'd in part , 119 B.R. 35 (D.N.J. 1990)).] In addition, the court in *In re White Motor Credit Corp.*, [*FN:* 18 B.R. 720 (Bankr. N.D. Ohio 1980).] held that Bankruptcy Code section 1102, by its express language, requires the appointment of separate committees in related cases, but noted that the composition of the separate committees may be identical. [*FN:* See id. at 722; see also *In re* Beker Indus. Corp., 55 B.R. 945 (Bankr. S.D.N.Y. 1985) (finding debenture holders entitled to their own committee to ensure adequate representation).] Despite *White Motor Credit*, the present overwhelming trend, even in complicated, related cases, is to appoint one consolidated committee. [*FN:* See*In re* McLean Indus. Inc., 70 B.R. 852, 862 (Bankr. S.D.N.Y. 1987) (noting lack of indication of congressional intent and extreme cost of separate committees).]

As an alternative to separate committees, subcommittees within the unsecured creditors' committee can often be an effective method of dealing with representation issues. As previously discussed, [*FN:* See supra notes 93−101 and accompanying text.] trade creditors or vendors may consistently be outvoted by other committee members. Thus, they may need to form a subcommittee to address a specific issue or to investigate legitimate concerns regarding the debtor's affairs. Such a subcommittee of trade creditors, created for limited purposes, may employ separate legal counsel [*FN:* If the professional fees of the subcommittee are to be paid by the estate, the retention must be authorized by the court. See 11 U.S.C. §§327, 328 (1994). However, courts have relied on the 1994 amendments to section 503(b)(c) in holding that "compensation of [counsel employed by individual committee members] may be appropriate if . . . the services conferred 'a significant and demonstrable benefit upon the reorganization process which ha[s] not been rendered solely on behalf of a creditor's own interest.'" *In re* County of Orange, 179 B.R. 195, 203 (Bankr. C.D. Cal. 1995) (quoting*In re* United States Lines Inc., 103 B.R. 427, 430 (Bankr. S.D.N.Y. 1989)). Previously, courts had rejected this "substantial contribution" theory. See , *e.g.* ,*In re* UNR Indus. Inc., 736 F.2d 1136, 1139 (7th Cir. 1984) (no authorization in Code for compensation of members of statutory committee);*In re* Automotive Nat'l Brands Inc., 65 B.R. 412, 413 (Bankr. W.D. Pa. 1986) (denying reimbursement for committee members relying on UNR Indus Inc.);*In re* Windsor Comm. Group Inc. 54 B.R. 504, 509 (Bankr.

E.D. Pa. 1985) (serving on committee is matter of choice accepted by creditors with understanding that they must bear their own expenses).] while utilizing the committees' accountants or financial advisors. This approach may be more cost effective than appointing a separate committee and may allow trade creditors to participate and adequately represent their constituents.

In a large case, in which more than seven committee members are often appointed, provisions for subcommittees can be written into the committee's by−laws. Some issues for the committee to consider in drafting such provisions include: the circumstance under which subcommittees may be appropriate, the purposes for which subcommittees may be appointed, how appointment of a subcommittee will affect voting by the committee and whether and on what terms and conditions subcommittees should be authorized to employ professionals or share the committee's professionals, more particularly, to share the committee's accountants.

D. Voting

By−laws of the committee should specifically address voting procedures at the inception of the case. In many instances, a large committee appointed in the reorganization of a large public company will have a number of members who become inactive as the case winds on for an extended period of time. The potential for abuse of the committee process that can occur is that these inactive members can be asked to vote late in the case on a critical issue regarding plan formulation or on issues on which they have not been active. As a consequence, the dynamics of the committee can quickly shift. In an attempt to limit this potential abuse, most creditors' committees do not allow voting by proxy and may require a certain level of attendance and participation at meetings before voting.

E. The Bankruptcy Court as a Last Resort

As highlighted by the *Dow Corning* decisions, there is no settled authority regarding the role of the bankruptcy court in altering the composition of committees. [*FN:* See supra notes 21, 85 and accompanying text.] The case law does establish, however, that the lack of consensus among the courts may result in protracted litigation over the membership and structure of official committees. [*FN:* See , *e.g.* ,*In re* Sharon Steel Corp., 100 B.R. 767 (Bankr. W.D. Pa. 1989).] In *In re Sharon Steel Corp.*, [*FN:* See id.] for example, the court held that it had *de novo* authority to reconstitute an official committee to include debenture holders, trade creditors and a union. [*FN:* See id. at 774.] At issue was the U.S. Trustee's decision, *two years after* the court's action, to appoint a separate committee of debenture holders. [*FN:* See id.] After a lengthy court battle, the court found that the U.S. Trustee had exceeded his administrative role and had, effectively, rescinded the court's order in a manner that was impermissible and unconstitutional. [*FN:* See id.]

Consistent with the decision in *Sharon Steel*, courts have maintained that bankruptcy courts do have the power to adjudicate disputes by altering the composition of committees, [*FN:* See note 159 infra and accompanying text.] notwithstanding the deletion in 1986 of section 1102(c), which provided that the court could change the size and membership of committees. [*FN:* Section 1102(c) has been deleted, and the Code is now silent on the issue whether the court is able to change the size and membership of the committee. Despite the fact that the U.S. Trustee has been given more power since 1986, the bankruptcy courts have continued to interpret section 1102 as expressly retaining the bankruptcy courts' ability to decide de novo the questions of whether to expand an existing committee or whether additional committees are necessary to ensure adequate representation.] The court in *Dow Corning I* summarized the existing case law as follows:

The case law on this point breaks down into three camps. One of the camps argues that a court is generally powerless to affect the makeup of a committee appointed by the United States Trustee. *See, e.g.*, *In re Hills Stores Co.*, 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992); *In re Drexel Burnham Lambert Group Inc.*, 118 B.R. 209, 210−11 (Bankr. S.D.N.Y. 1990). The second camp states that the authority to alter a committee's composition vests entirely with the court, which is to make its determination on a *de novo* basis. *Sharon Steel*, 100 B.R. at 785−86; *In re Public Service Co. of New Hampshire*, 89 B.R. 1014, 1021 (Bankr. D. N.H. 1988); *Texaco*, 79 B.R. at 566. The third camp takes the middle ground, by maintaining that the court can order the United States trustee to alter committee membership, but that it can only do so upon a finding that the United States trustee's original appointment was either arbitrary and capricious or an abuse of discretion. *In re*

Columbia Gas Sys. Inc., 133 B.R. 174, 176 (Bankr. D. Del. 1991); *First RepublicBank*, 95 B.R. at 60. [*FN:In re* Dow Corning Corp., 194 B.R. 121, 130 (Bankr. E.D. Mich. 1996). The Dow Corning I court joined the second camp, and held that the U.S.

Trustee's construction of section 1102, which it found to be controlling as to the U.S. Trustee's actions, was a matter of law on which "[t]he final word . . . belongs to the courts. . . ." See id. at 133. The district court's decision to stay the recomposition of the tort claimants' committee, which resulted from the decisions in Dow Corning I and II , strongly suggests that the Dow Corning case will ultimately land in the first camp, which holds that courts have no authority to affect the makeup of the committee. See supra notes 21, 85 and accompanying text.]

Although litigation always involves risk for the parties involved, in a bankruptcy proceeding the time delays caused by litigation can equal the time value of a creditors' claims and add an extra layer of risk and expense. [*FN:* Cf. *In re* Central Ice Cream Co., 59 B.R. 476, 487 (Bankr. N.D. Ill. 1985) (discussing large cost and great risk involved in protracted litigation in bankruptcy).] Accordingly, parties considering litigation as a means of resolving conflict issues should be sensitive to the full economic impact of such litigation.

However, a party's preparedness for litigation can often be a factor in negotiations that forces compromise and, ironically, avoids costly litigation. Committees should, thus, be prepared to litigate if any member's inability to uphold its fiduciary duties becomes a stumbling block, but should always aim for negotiation and compromise in the first instance.

V. Fiduciary Responsibility of Counsel to a Creditors' Committee

Counsel to a committee owes the committee and its constituent class its undivided loyalty and allegiance. [*FN:* See *In re* National Liquidators Inc., 182 B.R., 186, 192 (S.D. Ohio 1995) (stating 1103(b) prohibits concurrent representation if such representation would . . . jeopardize counsel's undivided loyalty); Fisher, Hecht & Fisher v. D.H. Overmyer Telecasting Co. (*In re* D.H. Overmyer Telecasting Co.), 47 B.R. 823, 824 (Bankr. N.D. Ohio 1985).] The integrity of the bankruptcy system demands that professionals serving a committee not place themselves in a situation where their independence, loyalty and integrity can be questioned by the creditor body which they represent. [*FN:In re* Oliver's Stores Inc., 79 B.R. 588, 597 (Bankr. D.N.J. 1987).] Thus, the fiduciary duty of the committee to its constituency and of committee counsel to the committee "cannot be misdirected by the relationship of the committee's counsel with other entities that have other considerations than the committee or its constituency." [*FN:In re* Celotex Corp., 123 B.R. 917, 920 (Bankr. M.D. Fla. 1991) (citations omitted) (denying application for retention of committee counsel that had been retained and paid substantial fees by "Asbestos Litigation Group" that dominated committee).]

A fiduciary duty issue that arose in *In re EBP Inc.*, [*FN:* 171 B.R. 601 (Bankr. N.D. Ohio 1994).] illustrates the conflicts that committee counsel can face. In *EBP*, counsel for the committee filed, on behalf of the committee, an objection to the debtor's plan which the unsecured creditor class had voted to accept. [*FN:* See id. at 601.] On the debtor's motion to strike the objection as beyond counsel's authority, the court considered whether counsel for the committee can file an objection to confirm when the class represented by counsel votes to accept. [*FN:* See id.] Based on the unique fact that a large majority in both number and amount of unsecured claims (including the committee chair which held 70% of the unsecured claims) had not voted, the court held the debtor's allegations to be unsubstantiated and that counsel had not breached its fiduciary duty. [*FN:* See id. at 602.]

The facts of *EBP* depict a situation in which counsel appeared to be acting at the behest of one large creditor (who happened to be the committee chair) on behalf of the committee, and thereby avoided a breach of his fiduciary duty only because the committee chair had not bothered to vote. [*FN:* See id.] Had more creditors holding a larger amount of claims voted their claims for the plan, and had the chair voted against the plan, *EBP* would have presented a closer question and the filing of the objection may have been deemed a violation of the duty owed the class. [*FN:* See EBP, 171 B.R. at 602.] Although *EBP* may have been correctly decided on its unique facts, the case presents a situation that should make committee counsel extremely wary that actions proposed by the committee are actually representative of the interests of the creditor class and not of one or two dominant creditors on the committee.

EBP should also be contrasted to the cases holding that committee counsel owes a duty of loyalty to the committee and may not represent individual creditors in situations where this duty may be compromised. [*FN:* See , *e.g.* ,*In re* Levy, 54 B.R. 805, 807−08 (Bankr. S.D.N.Y. 1985).] Counsel should be aware that it has an "obligation [owed to each, individual class member] to utilize due care in the performance of the duty they expressly assumed." [*FN:* Pension Benefit Guar. Corp. v. Pincus, Verlin, Hahn, Reich & Goldstein Prof'l Corp., 42 B.R. 960, 964 (E.D. Pa. 1984) (denying law firm's motion for summary judgment dismissing creditor's complaint alleging attorney−client relationship between firm and individual class member).] Furthermore,

the case law indicates that every class member has standing to enforce the fiduciary duty owed by committee counsel to the committee and the creditor class. [*FN:* See Kelbon et al., supra note 30, at 431−35.]

A. Recognition of an Adverse Interest

Despite the fiduciary constraints on committee counsel's actions, the Code permits committee counsel to simultaneously represent individual creditors. [*FN:* See 11 U.S.C. §1103(b) (1994).] Bankruptcy Code section 1103(b) provides that:

An attorney . . . employed to represent a committee . . . may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case. Representation of one or more creditors of the same class as represented by the committee shall not *per se* constitute the representation of an adverse interest. [*FN:* See id.]

The second sentence of section 1103(b) is a liberalization of the bar against dual representation which existed when the Code was initially enacted. [*FN:* See *In re* National Liquidators Inc., 182 B.R. 186, 192 (S.D. Ohio 1995).] In eliminating this *per se* bar, "Congress implicitly determined that the inherent tension between a committee and one of its creditors, standing alone, was immaterial and any conflict too theoretical to warrant being classified as an adverse interest. [*FN:* See id.]

The liberalization of the prohibition against concurrent representations does not preempt the requirements that professionals possess no adverse interest and remain disinterested. [*FN:* See Interwest Bus. Equip. Inc. v. United States Trustee (*In re* Interwest Bus. Equip. Inc.), 23 F.3d 311, 316 (10th Cir. 1994) (interpreting subsection 327(c) of Bankruptcy Code which is analogous to standard established under section 1102(b)).] The provision stating that concurrent representation is not a *per se* representation of an adverse interest "allow[s] joint representation . . . if there is no apparent conflict of interest." [*FN:* See id.] Thus, a court can disqualify solely because of joint representation, if an actual conflict exists between the committee−client and the creditor−client. [*FN:* See id.]

Despite the Code's silence on the meaning of "adverse interest," courts have fashioned their own definition: "to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant." [*FN:* See TWI Int'l Inc. v. Vanguard Oil & Serv. Co., 162 B.R. 672, 675 (S.D.N.Y. 1994) (citation omitted).] Application of this definition in an actual case, in which all the facts relating to the debtor's transactions with creditors may not be readily apparent at the outset, requires foresight on the part of counsel. [*FN:* The current proposal by the Section of Business Law of the American Bar Association for changes to Bankruptcy Rule 2014, dealing with "Employment of Persons Pursuant to section 327, section 1103, or section 1104," would require specific disclosures of "all connections . . . whether or not such connections would constitute a basis for disqualifications. . . ." The proposal identifies types of connections that should be disclosed and would require a supplemental verified statement to be filed and served within 15 days after later discovery of any matter required to be disclosed under the rule. Furthermore, the proposed revisions to Rule 2016 permit a determination of the propriety of a disqualified lawyer's action in connection with actual conflicts of interest, which would be determined based only on facts and circumstances the lawyer disclosed in good faith after an appropriate inquiry at the time of undertaking or continuing a representation. These proposed changes have the effect of focusing a court's attention with respect to compensation decisions on what counsel should have known, with less emphasis on foresight.] As discussed at greater length later, [*FN:* See discussion infra Part V.B.] the disclosure requirements that the Code and Rules impose upon counsel act as a further safeguard against conflicts by providing the court and other parties in interest the opportunity to examine counsel's connections, evaluate possible conflicts, and if necessary, object to any improper employment application. [*FN:* See , *e.g.* ,*In re* Lee, 94 B.R. 172, 176 (Bankr. C.D. Cal. 1988) (stating that disclosure requirement gives decision making power regarding employment to court and parties in interest and not counsel "whose judgment may be clouded by the benefits of the potential employment").]

In undertaking a dual representation, counsel must make a determination regarding the potential for conflict. Is the possibility of a dispute regarding the creditor's claim "remote, speculative or hypothetical" or would "concurrent representation . . . interfere with counsel's vigorous advocacy for either client, jeopardize counsel's undivided loyalty to either client, or endanger the confidences and secrets of either client?" [*FN:* See *In re* National Liquidators Inc., 182 B.R., 186, 191−93 (S.D. Ohio 1995) (citing*In re* Oliver's Stores, Inc . , 79 B.R. 588, 593−94 (Bankr. D.N.J. 1987));*In re* Poage, 92 B.R. 659, 666 (Bankr. N.D. Tex. 1988);*In re* Peck, 112 B.R. 485, 492 (Bankr. D. Conn. 1990).] It is evidence of a "likelihood" of some actual dispute, not "[s]peculation and hypothesizing" that results in a disqualifying adverse interest. [*FN:* See National Liquidators , 182 B.R. at 193.]

A disqualifying adverse interest may result, however, where concurrent representation gives rise to a perception of impropriety. "Perceptions are important; how the matter likely appears to creditors and to other parties in legitimate interest should be taken into account." [*FN:In re* Martin, 817 F.2d 175, 182 (1st Cir. 1987).] Questionable fee arrangements, in particular, can create a disqualifying appearance of impropriety, if not an actual adverse interest. [*FN:* See , *e.g.* ,*In re* Electro−Optix, U.S.A. Inc., 130 B.R. 621, 622−63 (Bankr. S.D. Fla. 1991) (simultaneous representation of committee and largest creditor, who had agreed to advance counsel's fees incurred as committee counsel, created an appearance of impropriety sufficient to disqualify counsel and was held clearly improper).]

Additionally, courts have indicated that, when reviewing alleged conflicts, they will use an objective standard. In *Rome v. Braunstein*, [*FN:* 19 F.3d 54 (1st Cir. 1994).] the court held that an objective determination was needed regarding "whether any competing interest of a court−appointed professional `created either a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors−−an incentive sufficient to place those parties at *more than an acceptable risk*−−or the *reasonable perception* of one.'" [*FN:* See id. at 58 (citing Martin, 817 F.2d at 180 (emphasis added)). In Rome , the 1st Circuit seems to have backed away from the Martin rationale which embraced a more subjective application of the "meaningful incentive" test in order to determine the professional's state of mind rather than the extent to which an appearance of propriety or impropriety exists . See id. ; Martin , 817 F.2d at 182.]

B. Disclosure by Committee Counsel

The disclosure requirements of the Bankruptcy Code and Rules [*FN:* See 11 U.S.C. §327 (1994); Fed. R. Bankr. P. 2014 and 2016.] are intended to preserve the integrity of the bankruptcy process and ensure impartiality of all estate retained professionals. [*FN:* See*In re* Tinely Plaza Assocs., L.P., 142 B.R. 272, 280 (Bankr. N.D. Ill. 1992) (requiring strict enforcement of section 327(a) and Rule 2014(a) to preserve integrity of bankruptcy system); see also *In re* Michigan Gen. Corp., 78 B.R. 479, 482 (Bankr. N.D. Tex. 1987) (rejecting negligence and ignorance as excuse for failure to satisfy section 327 requirements).] Proper disclosure permits the bankruptcy court to fulfill its duty to ensure "that attorneys [who represent parties to bankruptcy proceedings] do not have interests adverse to those of the estate [or in the case of committees, the creditor class] . . . that the attorneys only charge for [beneficial] services . . . and that they charge only 'reasonable fees' . . . ." [*FN:* Neben & Starrett Inc. v. Chartwell Fin. Corp. (*In re* Park Helena Corp.), 63 F.3d 877, 880 (9th Cir. 1995), *cert. denied* , 116 S. Ct. 712 (1996) (citations omitted).]

With full disclosure by counsel, "the Court and parties in interest [can] determine whether connection[s] disqualif[y] the applicant from the employment sought." [*FN:In re* Lee, 94 B.R. 172, 176 (Bankr. C.D. Cal. 1988).] The court and other parties to the proceeding may have information that is not available or which presently seems innocuous to the applicant, but in actuality, has some bearing on whether connections disclosed by the applicant present a potential or actual conflict. [*FN:* See id. at 176 (stating that purpose of disclosure is to permit court and interested parties to determine if connection disqualifies applicant).]

The standards for disclosure are, therefore, necessarily strict. [*FN:* Park Helena , 63 F.3d at 881 (finding that disclosure requirements are applied literally and harshly); Tinley Plaza , 142 B.R. at 278.] The disclosure rules imposed by Federal Rules of Bankruptcy Procedure 2014 [*FN:* Fed. R. Bankr. P. 2014.] and 2016 [*FN: Id.* at 2016.] impose upon attorneys an independent responsibility for which failure to comply is sanctionable. Failure to disclose is sanctionable even if proper disclosure would have shown that the attorney had not actually violated any Bankruptcy Code provision or any Bankruptcy Rule. [*FN:* See Park Helena , 63 F.3d at 882.] Negligent or inadvertent omissions "do not vitiate the failure to disclose." [*FN:* See id. at 882 (stating that failure to disclose will result in sanctions).] Where a failure to disclose is deemed willful or knowing, courts have uniformly held that all compensation should be denied, regardless of the value of services rendered. [*FN:* See , *e.g.* , Electro−Wire Prods. Inc. v. Sirote & Permutt, P.C. (*In re* Prince), 40 F.3d 356, 361 (11th Cir. 1994) (concluding all compensation should be denied because of "intolerable conflicts of interest which unduly prejudiced the debtor"); Gray v. English, 30 F.3d 1319, 1323 (10th Cir. 1994).]

These disclosure rules apply to large, multi−departmental law firms as equally as they apply to sole practitioners. [*FN:* See Prince , 40 F.3d at 361.] "Law firms, no matter their size, must ensure that their representations do not result in irreconcilable, intolerable conflicts that can only result in harm to their clients . . ." [*FN: Id.*] While all involved in the bankruptcy process hope that few of the "connections" of firms that are realistically considering applications to become estate−retained professionals rise to the level of the conflicts recently presented in *Electro−Wire Prods. Inc. v. Sirote & Permutt, P.C. (In re Prince)*, [*FN:* 40 F.3d 356 (11th Cir. 1994). In Prince , the head of a firm's bankruptcy department failed to disclose work performed by the firm's estate planning department which may have given rise to a fraudulent conveyance by the

debtor to his wife. See id. at 358−59. In addition he failed to disclose the debtor's payment for these services which made the firm a potential preference defendant. See id.] all professionals contemplating retention must disclose all "connections," no matter how remote. [*FN:* See*In re* Lee, 94 B.R. 172, 176 (Bankr. C.D. Cal. 1988) (declaring that attorney must disclose all relevant facts to determine whether they are disinterested); Diamond Lumber Inc. v. Unsecured Creditors' Comm. of Diamond Lumber Inc. (*In re* Diamond Lumber Inc.), 88 B.R. 773, 776 (Bankr. N.D. Tex. 1988) (finding that attorney who seeks to represent debtor must disclose fully in its application for employment all connections with debtor, creditors or other parties in interest).]

The rule that employment applications must disclose all connections with the debtor, creditors or any parties in interest has been broadly construed to require disclosure of "[a]ll facts that *may* be pertinent" to the inquiry into the applicants' interests. [*FN:In re* Hathaway Ranch Partnership, 116 B.R. 208, 219 (Bankr. C.D. Cal. 1990).] Professionals cannot pick and choose which connections are irrelevant or trivial. [*FN:* See*In re* EWC Inc., 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992) (citing*In re* Roberts, 75 B.R. 402, 410 (D. Utah 1987)). The disclosure rules are extremely demanding because the court cannot properly approve employment or compensation without a thorough knowledge of all the facts and possible conflicts of interest. See id. at 279−80.] "No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it." [*FN:* See id. at 281 .] The burden is on such professional "to come forward and make full, candid and complete disclosure." [*FN:In re* B.E.S. Concrete Prods. Inc., 93 B.R. 228, 237 (Bankr. E.D. Cal. 1988) (holding that not duty of bankruptcy court to investigate or seek possible conflicts of interest outside application and declarations required by Fed. R. Bankr. P. 2014).]

Full disclosure with respect to counsel's compensation includes not only the fact that a professional has a fee arrangement with a party to the proceeding, but also, all of the details of such a fee arrangement. [*FN:* See, *e.g.* , *In re* Bob's Supermarkets Inc., 146 B.R. 20, 25 (Bankr. D. Mont. 1992) (stating that debtor's counsel must provide all its dealings regarding compensation) (citations omitted);*In re* Plaza Hotel Corp., 111 B.R. 882, 883 (Bankr. E.D. Cal. 1990) (stating that duty entails complete disclosure of all facts);*In re* Glen Elec. Sales Corp., 99 B.R. 596, 599 (D.N.J. 1988) (indicating that any employment arrangements which implicate adverse or non−neutral interest must be disclosed to courts).] This requires a statement of the precise nature of the fee arrangement, including all payments received or promised

as well as the sources of such payments. [*FN:* See 11 U.S.C. §329 (1994) (requiring that attorney file statement of compensation paid total amount of compensation and source of compensation); Fed. R. Bankr. P. 2016(a) (requiring attorney file application which includes what payments have been made and promised and source of compensation).] The facts of all fee transactions must be directly and comprehensively disclosed. [*FN:* See Neben & Starrett Inc. v. Chortell Fin. Corp. (*In re* Park Helena), 63 F.3d 877, 880−81 (9th Cir. 1995). In Park Helena , the debtor's counsel was denied all fees because it knowingly did not disclose its receipt of a retainer from the debtor's president until it made an application for compensation, and even then it failed to disclose the full details of the transaction. See id.]

C. Impact of Conflicts on the Qualification and Compensation of Counsel

The standards stated in Bankruptcy Code section 1103 for employment of committee counsel do not raise prospective counsel's disinterestedness as a barrier to employment. [*FN:* See 11 U.S.C. §1103.] This barrier is, however, raised in Bankruptcy Code section 328, [*FN:* 11 U.S.C. §328.] which provides the limitations upon compensation of professionals. [*FN:* Section 328(c) provides in relevant part: the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or represents an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed. 11 U.S.C. §328(c) (emphasis added).] Thus, although an order appointing an interested person or firm as committee counsel may be deemed valid under section 1103, interested counsel to a committee should anticipate that the court will likely deny compensation. [*FN:* See United States Trustee v. Price Waterhouse, 19 F.3d 138, 142 (3d Cir. 1994) (interpreting section 328 to authorize court to deny compensation to professionals who are not disinterested when they begin employment or cease to be disinterested).]

Currently, most courts exercise discretion to decide whether to deny compensation to a professional failing to meet the requirement of full disclosure of all "connections" but not holding an undisclosed adverse interest. [*FN:* See *In re* National Liquidators Inc., 182 B.R. 186, 196−97 (S.D. Ohio 1995) ("absent an actual disqualifying interest, justice requires that a court retain discretion whether to deny fees as a sanction for failure to disclose.").] However, where a committee professional is aware of, but does not disclose an adverse interest, courts will deny compensation. [*FN:* See Michel v. Federated Dep't Stores Inc. (*In re* Federated Dep't Stores Inc.), 44 F.3d 1310, 1320 (6th Cir. 1995) (requiring valid professional appointment under section 327(a) as prerequisite to award of compensation).]

The bankruptcy court in *In re National Liquidators Inc.*, [*FN:* 182 B.R. 186 (S.D. Ohio 1995).] for example, was held to have abused its discretion when it denied compensation *in toto* to a firm that had been appointed counsel to the

unsecured creditors committee, but had failed to disclose a material connection to the debtor. [*FN:* See id. at 196−97.] The *National Liquidators* court reasoned that it would "not eviscerate the prophylactic protection [of the disclosure requirements] against actual conflicts of interest," and remanded for a determination of when the person or persons at the firm who performed services for the committee learned of the firm's representation of the co−chair, with a direction that fees be denied for services performed by such persons subsequently to the acquisition of such knowledge. [*FN:* See id.] In that case, the firm disclosed, at the time of its final fee application, that the firm had simultaneously represented the co−chair of the committee in connection with testimony given by the co−chair in an action by the Securities and Exchange Commission alleging securities law violations by the debtor. [*FN:* See id. at 191.] Although the district court found that the firm's representation of the committee co−chair created no interest adverse to the committee and held that bankruptcy courts, in such situations, must retain discretion regarding whether to award fees, it found the firm's failure to disclose intolerable. [*FN:* See id. at 197.]

The sanctions imposed by the *National Liquidators* court are comparable to the penalties imposed by courts considering disclosure and conflict issues involving other estate retained professionals. [*FN:* See, e.g.,*In re* Patterson, 53 B.R. 366, 374 (Bankr. D. Neb. 1985) (denying all compensation to non−disinterested law firm).] It is not unusual for courts to deny all or significantly reduce compensation to professionals who are not disinterested or who hold undisclosed adverse interests. [*FN:* See, *e.g.* ,*In re* Leslie Fay Cos. Inc., 175 B.R. 525, 538−39 (Bankr. S.D.N.Y. 1994) (finding that disgorgement and denial of fees to conflicted firm were proportioned according to actual harm caused to estate as result of firm's conflict as well as payment of costs of examiner and committee in dealing with disinterestedness issues including $800,000 examiner's professional fees); Grey v. English, 30 F.3d 1319, 1321−24 (10th Cir. 1994) ($91,576 fees disallowed as sanction, roughly 20% of total fees sought; $375,147 fees allowed; counsel also required to pay $28,977 expenses in replacing trustee); Anderson v. Anderson (*In re* Anderson), 936 F.2d 199, 201−02, 206 (5th Cir. 1991) ($82,500 allowed; $318,830 sought); *In re* Rusty Jones Inc., 134 B.R. 321, 347 (Bankr. N.D. Ill. 1991) (60% reduction in requested fees); In re Al Gelato Continental Desserts Inc., 99 B.R. 404, 409 (Bankr. N.D. Ill. 1989) (10% reduction in fees); *In re* Kendavis Indus. Int'l Inc., 91 B.R. 742, 762 (Bankr. N.D. Tex. 1988) (50% reduction in fees).] In some cases all compensation is denied. [*FN:* See, *e.g.* , Electro−Wire Prods. v. Sirote & Permutt, P.C. (*In re* Prince), 40 F.3d 356 (11th Cir. 1994) (finding denial of all fees appropriate where "firm operated under intolerable conflicts of interest which unduly prejudiced the Debtor"); Rome v. Braunstein, 19 F.3d 54, 62−63 (1st Cir. 1994) (finding denial of all fees well within bankruptcy court's discretion under Code section 328(c) where disqualifying conflict of interest is found and attorney's services "produced virtually no benefit" to debtor).] In other cases, court's *quantum meruit* may mitigate the imposition of such a harsh sanction. [*FN:* See, *e.g.* ,*In re* Grabill Corp., 983 F.2d 773, 777 (7th Cir. 1993) (reasoning quantum meruit might mitigate section 327(a) sanctions under very limited circumstances; *In re* Weibel, 161 B.R. 479 (Bankr. N.D. Cal. 1993), aff'd , 176 B.R. 209 (N.D. Cal. 1994).]

The Sixth and 3rd Circuits recently interpreted the Code's retention requirements more strictly than do the courts that use discretion regarding compensation when a professional's disinterestedness results in disqualification after services are rendered. [*FN:* See United States Trustee v. Price Waterhouse, 19 F.3d 138, 142 (3d Cir. 1994) (rejecting argument that use of "may" in section 328(c) allows bankruptcy court discretion in appointment of interested persons under section 327(a)); Childress v. Middleton Arms, L.P. (*In re* Middleton Arms, L.P.), 934 F.2d 723, 725 (6th Cir. 1991) (concluding courts may not disregard unambitious language of section 327(a) which provides bankruptcy court may not approve employment of interested persons regardless of lack of adverse interest); Hunter Sav. Ass'n v. Baggot Law Offices Co., L.P.A. (*In re* Georgetown of Kettering, Ltd.), 750 F.2d 536, 540 (6th Cir. 1984) (concluding that, even if counsel had sustained burden to demonstrate propriety of nunc pro tunc appointment, application for compensation must be denied where actual conflict of interest exists).] In *Michel v. Federated Department Stores Inc. (In re Federated Department Stores Inc.),* [*FN:* 44 F.3d 1310 (6th Cir. 1995).] the 6th Circuit held that the bankruptcy court's authority to award fees under Bankruptcy Code section 330(a)(A)(2) requires a valid professional appointment. [*FN:* See id. at 1320.] Both the *Federated* and *United States v. Price Waterhouse* [*FN:* 19 F. 3d 138 (3d Cir. 1994).] courts found that the prohibition of bankruptcy code section 327(a) about disinterestedness is absolute and prevents courts from making equitable determinations as to the best interest of the debtors in situations involving professionals. [*FN:* See Federated, 44 F. 3d at 1318; Price Waterhouse , 19 F.3d at 142; Middleton Arms , 934 F.2d at 725 (concluding section 327(a) forbids employment of all interested persons, thereby, "preventing individual bankruptcy courts from having to make determinations as to the best interests of the debtors"). But see Neben & Starrett Inc. v. Chartwell Fin. Corp. (*In re* Park Helena Corp.), 63 F.3d 877, 881 (9th Cir. 1995); Prince , 40 F.3d at 361 (courts held to retain discretion regarding compensation issues, even where professional holds disqualifying interest).] Under this rule, bankruptcy courts have no discretion under section 328(c) of the Code to grant or deny compensation to professionals who should have been disqualified, but were retained despite their disinterestedness or the existence of an adverse interest. [*FN:* See Federated , 44 F.3d at 1319−1320 (finding section 328(a) requires valid appointment under section 327(a) in order that court may make decision to grant or deny compensation). Accord Price Waterhouse , 19 F.3d at 142 (concluding court lacked discretion to compensate or employ disinterested accountant and financial advisory firm).]

Although Bankruptcy Code section 1103 does not prohibit the committee's retention of "interested" professionals, disinterestedness remains a component of the compensation decision under section 328(c) of the Code. [*FN:* See 11 U.S.C. §328(c) (1994).] Thus, the rule that results from *Federated* and *Price Waterhouse* should sound a warning bell to committee professionals: a retention order is not a guarantee of compensation if a disqualifying interest is lurking in any professional's background. This should provide ample impetus for all professionals to fully disclose all connections no matter how remote, in the hope that if any disqualifying interest exists, it will come to light before the professional renders services. [*FN:* The rule stated in Federated also cautions against rendering services before an order approving employment is entered, even where full disclosure is made, if the counsel to be employed has an interest that may limit a fee award under section 328(c). See Federated , 44 F.3d at 1320. For example, a firm that is disqualified because it derives a large percentage of its revenues from a creditor, even though it does not represent the creditor in the case, has disclosed the situation and obtained a conflict waiver from the creditor and debtor, and even though there was no actual conflict when services were rendered, would not be entitled, under the Federated standard, to compensation for services rendered after commencement of the case. However, in*In re* American Printers & Lithographers Inc., 148 B.R. 862 (Bankr. N.D. Ill. 1992), the court allowed compensation under these facts because it had authorized the firm's temporary employment until a decision could be made on the retention application. See id. at 864. Under the rule to be applied in the Third and 6th Circuits, the interim approval of services would have been invalid because of the firm's disqualifying interest and the court would have had no discretion to grant compensation. See Federated , 44 F.3d at 1320.]

D. Procedures for Identifying "Connections" that Must be Disclosed Prior to Retention

Attorneys, and their firms, who routinely represent committees and other parties in interest in bankruptcy proceedings, should re−consider the adequacy of their current conflict databases. While most firms retain records of current clients and adverse parties, these records are unlikely to contain the amount of detail necessary to determine all connections that must be disclosed prior to retention in a bankruptcy case. [*FN:* See*In re* King Resources Co., 20 B.R. 191, 200 (D. Colo. 1982) (explaining that attorneys should not only notify parties of former representations, but also, evaluate for themselves as well as their clients any potential for impropriety).] For example, most firms' conflicts databases would not disclose that an individual client was a board member or a partner of a significant creditor (or even a debtor) in a bankruptcy proceeding in which the firm sought retention, unless the firm's representation had specifically involved that individual's status as board member or partner.

A measure that would assist in making all necessary disclosure would include retaining lists of all parties and entities that are related to clients of the firm, members of clients' board of directors, members of the boards of directors of any subsidiaries or affiliates of firm clients, members of partnerships that control or are controlled by firm clients and partners of individual clients and the partnerships in which firm clients are partners. In addition, firms could retain lists of all entities and persons against which major clients of the firm are known to be competitors or to have a significant adverse interest.

The permutations of "connections" that must be disclosed are endless. Therefore, firms that represents large clients with many affiliates will likely find maintenance of "connection" databases and "conflict" databases to be cost−prohibitive. However, the costs must be weighed against the expense that may be incurred when an unrecognized and undisclosed connection results in the firm's disqualification and possible disgorgement of fees.

Conclusion

Representing committees and avoiding conflicts in bankruptcy proceedings requires, first and foremost, a free flow of information between and among the committee members and the committee's professionals including full disclosure by all parties of all interests and connections in the proceedings. As the case proceeds, as well as from time to time as needed, counsel may need to educate the committee members regarding the committee process in order to obtain the disclosures and exchange of information necessary for the proper functioning of the committee. Thereafter, counsel must continually strive to ensure that all committee members are acting in a representative capacity and are able to represent claimants of a similar nature within the committee.

In addition, committee counsel must ensure that, when committee members need to protect their individual interest, they do not take action within the committee that impairs the committee's ability to function. Thus, counsel must provide adequate guidelines for proper individual action by the committee members as well as the adequate guidelines for collective action by the committee. Formulating such guidelines will require forethought and often creativity based

upon the information provided to counsel by the committee.

Finally, counsel to a committee must be guided both by his or her own personal and professional integrity and the recognition that, with respect to all action taken by the committee, the integrity of the bankruptcy process must be maintained. Like the committee, counsel's primary fiduciary duty is to the class of claimants that the committee represents. The best interests of the creditor class and ultimately the bankruptcy estate should be the guiding principle for counsel's representation and the official committee's actions.