

You Want Me to Give a Proxy to Who?

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My first job was working for the United States Trustee (“UST”) for the Southern District of New York. The UST program came about with the amendments to the Bankruptcy Code in 1979. Congress decided that administrative functions – such as appointing examiners, creditors’ committees and trustees – should be performed by an independent party rather than by the presiding Bankruptcy Judge. As a financial analyst and attorney for the UST, we oversaw cases where no one else would have done it, we assured compliance with the Bankruptcy Code and with the Federal Rules of Bankruptcy Procedure and we made appointments that were in the best interests of creditors as well as debtors. Congress was smart to implement the UST program.

Representing creditors’ committees in Chapter 11 cases is a big business. There can be a lot of fees earned by attorneys, financial advisors, investment bankers, appraisers, claims agents and disbursing agents representing a creditors’ committee. If creditors do not watch over the fees charged and, as a result there is less money to pay a dividend, the creditors only have themselves to blame.

How do creditors’ committees get appointed? When a debtor commences a Chapter 11 case it submits a list of its 20 largest general unsecured creditors. The list is supposed to exclude insiders, related parties and creditors whose claims have priority status. The UST uses that list to solicit interest in serving on an official creditors’ committee. Each of the UST districts handles solicitation and appointments differently. Some hold an in-person meeting of the interested creditors. Some do everything by mail without a meeting. Some may organize committees by conference call. At some in-person meetings the creditors and the professionals seeking to be retained by the committee are all in the same room. In other venues, creditors are in a different room than the professionals who are seeking to be engaged.

In appointing the committee, the UST may consider such factors as who will add value to the case as a committee member, who has the time and willingness to serve as an effective committee member, whether the creditors are competitors and whether the creditors add diversity to the committee. For example, the UST would not want seven shoe manufacturers on a seven-person committee in a sporting goods retailer Chapter 11 case even if the seven shoe manufacturers had the seven largest claims. The UST has much discretion. I have never seen that discretion used arbitrarily or capriciously.

The process of selecting professionals by a creditors’ committee is a democratic vote. One person, one vote. The size of the creditor’s claim does not matter. A small claim may be more important to a small creditor than a large claim is to a large creditor. The committee, once formed, decides which professionals to interview to represent the committee and then votes based [supposedly] on who will do the best job of protecting the interests of the creditors. Each professional interviewed is invited to explain their understanding of the issues, what would be their case strategy and how the value that they will add to the creditors’ recovery will be greater than the fees charged by the professional. The professionals selected to represent the committee very much can impact the outcome of the case. Among other things, different professionals have different levels of industry expertise and industry contacts.

In many instances, bankruptcy petitions are filed in Bankruptcy Courts far away from the real home base of the debtor. And, if the UST has called an in-person meeting to appoint a creditors’ committee, creditors may be far away from the location of the committee formation meeting. Therefore, travel expenses and travel time can make seeking a seat on the committee an expensive proposition.

It now has become common for people to “cold call” creditors and offer to help get them onto the creditors’ committee. The caller offers to get a proxyholder to attend the meeting for the creditor on a “courtesy” basis. The proxyholder attends the committee formation meeting; but the actual creditor may not understand the risk of giving a proxy to someone that it does not really know. I am not talking about the situation where a creditor simply cannot travel and asks its known, regular legal counsel to find a local attorney (presumably checked out with its regular legal counsel) to attend the meeting.

Behind the scenes there may be several things agreed to or unsaid when giving a proxy. Examples are who the proxyholder will vote for as committee counsel, who the proxyholder will vote for as a financial advisor to the committee, whether preferences will be pursued and who will serve as litigation or liquidation trustee. The proxyholder is not simply enabling the creditor to become a committee member. The proxyholder also will vote for counsel and for financial advisor. Giving a proxy is very far from a ministerial act. Who serves as counsel, who serves as financial advisor, which candidate has the best understanding of the industry, which candidate has the best strategy for increasing the dividend for unsecured creditors - are decisions that really affect the outcome of the case. That power should not be given away lightly. In addition, counsel and financial advisors to a creditors’ committee can, under certain circumstances,

expose committee members to liability. So, the creditor has even more at stake in choosing a professional to support.

When a creditor is cold called, the first question to be asked of the caller should be, "Where did you get my name from?" Most likely the creditor's contact information was on the "top 20" creditors list which is filed with the Bankruptcy Court. If this is the case, then you know that it is a "cold call." If the caller identifies someone else as the referral source (such as someone else in the industry), stop the call and speak to the referral source before continuing the conversation with the cold caller. If the caller offers to find a proxyholder for you - especially for free - you have confirmed that the real agenda is to seize control of your voting power. People rarely do things for free anymore!

No one respects the UST program more than I do. However, the UST's control over cold calling creditors and over the solicitation of proxies has become lax in many jurisdictions. Cold calling for proxies has become akin to "dialing for dollars." The process whereby members of a creditors' committee make fully **informed** choices in a completely transparent process - which is so critical to the proper

functioning of the system of reorganization in Chapter 11 - has become severely distorted. One way to assist the UST in performing its important duties is for creditors to "just say no" when they are cold called. If your claim is important to you, you should know how to find a representative on your own to attend the committee formation meeting who truly has **your** interests at heart. It's really not that hard.

About the author:

Kenneth A. Rosen, Esq is Partner, Chair, Bankruptcy, Financial Reorganization & Creditors' Rights of Lowenstein Sandler. Mr. Rosen, advises on the full spectrum of restructuring solutions, including Chapter 11 reorganizations, out-of-court workouts, financial restructurings, and litigation.

In his spare time, Mr. Rosen serves on several philanthropy and nonprofit boards primarily devoted to health care and education.



An advertisement for CAB (Creditors Adjustment Bureau). The top half shows three business professionals in a meeting: a man on the left, a man in the center shaking hands with a woman on the right. In the background, the CAB logo is displayed, consisting of the letters 'CAB' in white on a blue rectangular background, with the text 'Creditors Adjustment Bureau' below it. At the bottom of the image, the website 'WWW.CABCOLLECTS.COM' and phone number '1(800) 800-4523' are listed.

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