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Introduction to Ad Hoc Committees In Distressed Situations


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An ad hoc committee is an informal group of holders of the same or similar economic interests. The holders organize to achieve the benefits of collective action, such as strength through size and shared costs. Ad hoc committees are most prevalent in the distressed and bankruptcy arenas and may be unfamiliar to practitioners without experience in these fields. As such, this article provides an introduction to ad hoc committees, including insights into their benefits and operations and also provides an overview of certain legal considerations unique to such committees.

Overview

Ad hoc committees are a "loose affiliation" of similarly situated stakeholders that jointly retain counsel to take collective action.[1] The stakeholders may hold, as examples, the same or similar stocks, bonds, bank debt, trust certificates, or even litigation claims.[2] Ad hoc committees usually are not formal business entities; they seldom incorporate or otherwise officially organize. Unlike official committees in bankruptcy cases, ad hoc committees are not contemplated in the Bankruptcy Code and are not appointed by a judge or governmental body. Moreover, unlike official committees in bankruptcies, ad hoc committees are not fiduciaries; they act for themselves and have no obligation to protect non-committee members.[3]

Benefits

Ad hoc committees provide several strategic benefits through collective action.

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First, power through size. Ad hoc committees purport to speak for a group and "implicitly ask the court and other parties to give their positions a degree of credibility appropriate to a unified committee with large holdings."[4] Ad hoc committees enable holders that, individually, have minority positions to join forces and act as a large block. For example, organizing allows smaller bondholders or bank lenders the ability to meet contractual holdings thresholds for exercising rights or giving directions. Also, within a bankruptcy proceeding, an ad hoc committee may be able to secure more than one third of the amount of allowed claims in a given class, so it can vote down a plan, giving its members significant negotiating leverage.[5]

Second, savings through cost sharing. Working through an ad hoc committee typically lowers each member's individual legal and other professional expenses. Usually, members agree to share professional fees pro rata based on their holdings of the relevant interests. While this means that a member with the largest position pays most, even that member's share usually is less than if the member independently retained its own professionals to do the same things.

Moreover, in the bankruptcy context, courts have noted that ad hoc committees are better positioned to have their fees reimbursed by the estate than individual stakeholders. However, it is important to note that, unlike official committees or the bankrupt company, ad hoc committees are not guaranteed to have their professional fees paid by the estate in a bankruptcy. The Bankruptcy Code does not explicitly provide for such payment. Thus, for an ad hoc committee to recover its professional fees, it generally needs to prove that it made a "substantial contribution" to the estate pursuant to §503(b)(3) of the Bankruptcy Code. Courts have held that substantial contribution should be "narrowly construed," and a substantial

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contribution analysis involves an extremely fact intensive inquiry.

Formation

Ad hoc committees form when two or more persons or entities, holding the same or similar interests in a company, align to accomplish a common goal. In the distressed context, ad hoc committees often form well before a bankruptcy is commenced.[6] For instance, an ad hoc committee of bondholders likely will form at the first sign that the issuer may be experiencing financial or operational problems. Indeed, when large corporations experience turbulence, it is common for several ad hoc committees to form at different levels of the capital structure (e.g., at the parent level versus the operating level) and for different instrument priorities (e.g., first lien bonds versus subordinated bonds versus common stock).

Inasmuch as ad hoc committees are not formal business organizations, there is no uniform formation process once the members agree to unite. Most often, the engagement letter with counsel will confirm the existence of the committee and its initial members will confirm the joint retention and will reflect an agreement to share fees. Such engagement letters usually provide a mechanism to subsequently add more committee members, or conversely, for members to leave the committee, usually based on trading activity.

Ad hoc committees may also put in place by-laws or other corporate governance tools. Membership in an ad hoc committee is typically at will, and, as such, the committee usually cannot bind members absent their consent. Thus, without an arrangement to the contrary, unanimous approval would be required on all decisions.[7] Committees, however, can agree to formalize their relationship through by-laws which may provide, for instance, that decision-making is made by majority vote—either by head count, or in accordance with each member's holdings—or perhaps that select group members forming a steering group are vested with the power to bind all members. By-laws also often provide an ability for a majority of members (or perhaps counsel) to force a member to resign in the event it becomes known that its economic interest is no longer aligned with the others (e.g., an outsized short position).

Confidentiality and Privilege

An ad hoc committee's engagement letter with counsel and its by-laws typically will impose confidentiality on various categories of information. Most sensitive often is each member's holdings information, which may be reported directly to counsel under strict directions not to be shared with other members.[8] Committee members, therefore, often only know the aggregate holding of the entire committee. However, keeping holdings information confidential becomes very difficult within a bankruptcy proceeding. Federal Rule of Bankruptcy Procedure 2019 requires, among other things, that groups disclose the name and individual holdings of each group member.[9] Accordingly, ad hoc committees that appear in bankruptcy cases routinely file statements that publicly disclose the identity and holdings of their members.

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Finally, ad hoc committees present unique privilege issues. Depending on the circumstances, counsel may represent the committee members, individually, or may represent the committee itself. In either case, given that legal advice will be made available to multiple persons and/or entities, steps are taken to maintain privilege. Often, counsel's engagement letter and/or the by-laws will confirm the members' understanding and agreement that they share a common interest concerning the subject matter of the engagement, and that for the privilege to be waived, each member must consent.[10] Also, certain committees, in particular when litigation is present, may execute a joint defense agreement further memorializing their common interest.

Conclusion

Ad hoc committees are unique, informal groupings of similarly situated stakeholders offering several key benefits, through collective action, that may be attractive to individual holders looking to have a stronger voice and/or to defray costs.

1. *In re Washington Mut.*, 419 B.R. 271, 274-75 (Bankr. D. Del. 2009).
2. See, e.g., *In re Leslie Controls*, 437 B.R. 493 (Bankr. D. Del. 2010).
3. It should be noted, however, that certain bankruptcy courts have made statements that imply a potential willingness to impose fiduciary duties on ad hoc committees. See *Official Comm. of Equity Sec. Holders of Mirant v. The Wilson Law Firm, P.C. (In re Mirant)*, 334 B.R. 787, 793-94 (Bankr. N.D. Tex. 2005); *In re Washington Mut.,* 419 B.R. at 278-79 ("The case law, however, suggests that members of a class of creditors may, in fact, owe fiduciary duties to other members of the class").
4. *In re Nw. Airlines*, 363 B.R. 701, 703-04 (Bankr. S.D.N.Y. 2007).
5. See 11 U.S.C. §1126(c) (providing that a class of claims accepts of plan, "if such plan has been accepted by creditors … that hold at least two-third in amount … of the allowed claims of such class held by creditors …").
6. In addition, pre-petition ad hoc committees often request to be appointed as the official committee once a bankruptcy petition is filed. See, e.g., *Tri–State Outdoor Media Group v. Official Comm. of Unsecured Creditors (In re Tri State Outdoor Media Grp.)*, 283 B.R. 358, 361 (Bankr. M.D. Ga. 2002).
7. *In re Washington Mut.*, 419 B.R. at 275, 275 n.6 (noting that, otherwise, dissenting members will leave the committee).
8. For this reason, counsel usually prepares an individualized invoice for each committee member that reflects that member's share of the bill based on its pro rata holdings.
9. See Fed. R. Bankr. Proc. 2019(c).
10. See, e.g., *In re Tri State Outdoor Media Grp.*, 283 B.R. at 363 (recognizing the applicability of the common interest doctrine to ad hoc committees).