Global Restructuring Review

The Art of the Ad Hoc

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

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Introduction

James M Peck[1]

Contemplating, with some creative licence, what the debtor–creditor relationship might have been like in ancient times, I can envision an angry mob of creditors (think of it as a disorderly committee in need of more enlightened governance procedures) breaking the bench of an insolvent Roman merchant (that breakage being the presumed root of the term bankrupt) and then taking the miserable merchant away to spend his remaining days as a debt slave. I have no idea how things actually worked in those days, but it seems likely to me that creditors, speaking conversational Latin, must have spread the word to one another that a particular merchant was rumoured to be in financial difficulty or, as we still say, broke.

Committees, both official and unofficial, are nothing new, but not quite as ancient as suggested above. In the United States, committees predate the era of modern bankruptcy law and include some now abandoned and disfavoured approaches, such as the 'protective committees' that assumed total control of negotiations for bondholders in railroad reorganisation cases in the nineteenth century. Insolvency practice, from its origins, has depended on committees as a means to coordinate the thinking and preferences of creditors.

I have seen and experienced the tremendous value of committees throughout my career as a bankruptcy lawyer and judge. Committees are an essential part of the restructuring process and function as the wheels and gears that make possible the collective action that may ultimately lead to a successful restructuring. Committees are watchdogs that investigate and verify financial assumptions and data, and, importantly, they are also negotiators who formalise and harmonise the occasionally disjointed thinking of creditors, assembling what may be disparate individual points of view into a coherent expression of the business objectives and restructuring expectations of a representative body of creditors. This volume will address the growing importance of informal committees as essential market participants.

1 James M Peck is senior of counsel at Morrison & Foerster LLP.

The title of this publication reveals a great deal about both the essence of the subject matter of this publication and the point of view of our contributing authors. This is a book about what the editors have styled an art, not a science, suggesting that creativity, improvisation, intuition and occasional inspiration, not just dry logic, are central to the reorganisation process and to the increasingly vital role played by informal committees in that process.

Unofficial or ad hoc committees have become leading actors in global restructurings. These committees, often composed of aggressive and activist stakeholders, now populate and occasionally dominate restructuring negotiations. The business judgment, negotiating tactics and goals of their members and the character and reputations of their chosen professional advisers are the engines that drive outcomes.

Ad hoc committees collect, organise and harmonise the views of members of a class of par or distressed investors and transform those views into actionable restructuring aims and binding agreements. This can happen before a filing as a way to achieve a pre-negotiated consensus or to exert litigation leverage, or after a filing as a means to advocate for or against debatable reorganisation propositions.

The collective objective is a sustainable transaction or series of transactions to optimise value for members of the class represented by the committee, that from the company's perspective will also promote a restructuring that benefits all parties in interest.

Ad hoc committees are highly variable in character, and they defy easy classification. Like the institutions that are members or the professionals that are engaged to represent them, each committee has a distinctive personality ranging from combative to reasonably compliant. That personality will depend upon the multiple variables and political factors that make corporate restructuring such a fascinating challenge for those of us who practise in the field.

The editors have collected the observations and experiences of distinguished practitioners who have a deep understanding of how these committees are formed, are organised and function, and what makes them tick. Importantly, the chapters that follow also reveal the state of the 'art' as it has evolved and the know-how that promotes successful outcomes.

It is not an overstatement to declare that ad hoc committees now rule the restructuring world. Learning about the inner workings of these informal and opaque committees is essential to a better understanding of the global restructuring market.

These committees are examples of freedom of assembly. Parties join or exit at will, working together with shared professionals, often with access to confidential information. Material non-public information is evaluated in settlement discussions during periods when investors choose to be restricted, limiting their ability to freely trade. The negotiation of customary non-disclosure agreements is itself an art.

No one is compelled to join an ad hoc committee, but the desire to profit from special situations is a strong motivation. Like-minded stakeholders who join an ad hoc committee in a distressed credit naturally function as coherent counterparties to the debtor and other stakeholders, and they are far more formidable together than they would be if acting on their own.

Thus, an ad hoc committee is an expedient means to an economic end. Groups of bondholders are stronger and can exercise greater leverage together than they can separately, and the costs of the restructuring exercise can be shared by other creditors or reimbursed by the distressed borrower entity.

This volume explains how the process of forming, governing and representing these creditor groups has evolved and identifies current best practices. The chapters that follow will also

explain how market practices developed in US restructurings can provide useful guidance to participants in the United Kingdom and in other restructuring regimes. The rules of engagement described in this volume are well developed, but that was not always the case.

My own experience with ad hoc committees dates back to my first bankruptcy case some 40 years ago, when I represented institutional holders of private placement notes. Those holders formed an ad hoc committee that was defined by the terms of a joint engagement letter. The group functioned informally and was governed by a steering committee composed of those creditors having the greatest exposure. In ad hoc committees, even then, size matters.

Another example from the early days of my career involved workout discussions for a steel company that had been through a recent Chapter 11 and was in serious financial trouble less than a year after emergence. The new equity owners wanted to avoid a Chapter 22, but needed a responsible and representative party with whom to engage and negotiate possible concessions. Company counsel invited the largest unsecured creditors to attend an organisational meeting to form an ad hoc committee. These were industry players, suppliers who were angry about the situation, but who also felt the need to avoid another bankruptcy if that were reasonably possible.

The first decision made by the committee was whether to accept the proposition that it was in their economic interest to organise at all. The refusal to organise would be devastating for the company leaving it with no practical choice other than to file promptly for another Chapter 11, and leading inevitably to a liquidation. The group decided to organise, recognising that the ad hoc committee, while a necessary life line for the company, also benefited creditors.

That theme is as true today as it was over 30 years ago – ad hoc committees exist to serve the economic objectives of creditors and debtors alike. That is why companies offer in workout discussions to reimburse committee expenses. The resolution of distress can only occur when creditors have organised themselves as an effective negotiating counterparty, one that is viewed as legitimate both by the debtor company and other creditors. That legitimacy depends upon the engagement of experienced and respected restructuring advisers.

These contextual observations from decades ago take on greater significance in a contemporary restructuring world where hedge funds have become ubiquitous. Their commercial incentives and restructuring sophistication distinguish these funds, and when they come together in ad hoc committees, quite often they will negotiate and litigate from a muscular, goal-oriented point of view. These committees are proactive, analytical and focused.

I recall an experience that illustrates the benefits and flexibility of ad hoc committees and some of the reasons why they have become such a familiar feature in corporate restructurings. The year was 1999, and the distressed situation was The Loewen Group, the second-largest company of its kind in North America. The business model was not working and the business itself was – well – a bit moribund.

Morbid might be a better term. Loewen resulted from the consolidation of numerous funeral home and cemetery businesses throughout the United States and Canada. Loewen also had a dauntingly confusing capital structure. This was memorable as a 'death care' restructuring, and it unfolded within related mega Chapter 11 and CCAA cases. Creditors had to tackle questions of how to properly determine the priority and perfection of certain tranches of notes within a *sui generis* debt stack characterised by confusion caused by the failure of the administrative agent to follow prescribed lien perfection procedures.

There were no easy answers, but one point became immediately clear: the priority issue was atypical, heavily disputed, legally uncertain and would be both time-consuming and expensive to resolve. Members of the distressed investor community that had acquired notes in the secondary market (colloquially, those notes were called the 'good, the bad and the ugly') either could argue with one another or work together. The group I am about to describe decided to do the latter and create value for all instruments, including those burdened with conspicuous legal infirmities.

Three hedge funds and their lawyers saw the advantage of cooperation. We started working together as a single group of like-minded creditors that had made investments across the Loewen capital structure. This was an early prototype of the current ad hoc committee. By today's standards, the approach was quite informal, but the group functioned at a very high level. The situation is also memorable because of the high profiles of the other lawyers who worked with me and the visibility of our respective clients who were among the first funds to recognise the value of a coordinated approach for distressed investors having aligned economic interests. This group acted jointly in developing strategy and in plan negotiations.

Our common goal was to advance an agenda that would improve and accelerate the timing of recoveries. An incidental and unplanned benefit of the arrangement was that case administration became more efficient for everyone. In helping ourselves and our clients, we were also making this very challenging case more manageable for others.

Our informal creditor group consisted of Cerberus, Angelo Gordon and Oaktree Capital Management. The lawyers in addition to me were Bob Drain, then of Paul Weiss and now a highly respected US bankruptcy judge, and David Friedman, then a name partner with the Kassowitz firm and now the US ambassador to Israel. Others took notice of the fact that we decided to cooperate with each other and work together. It was a marriage of convenience that worked well in practice. Looking back, it was seamless.

We created an ad hoc committee in which mutual trust and respect compensated for the lack of any formal structure. Ours was a collaboration with no formal rules, just the shared recognition that our individual clients would be better served if we teamed up.

This group approach to the pursuit of common objectives was taking place early in the history of ad hoc committees within the distressed community, and we had limited precedent to guide us. I was not concerned about the structural informality. We worked without bylaws or internal governance procedures and structures, but we were compatible colleagues. I believe the only thing in writing to bind us was a fairly basic joint interest agreement. We conferred regularly and reached consensus on how best to achieve shared goals. I can recall no major disagreements.

Maintenance of this informal ad hoc group was quite easy. We each made contributions and managed to develop and adopt a single strategy, while also providing independent advice to our separate clients. It was quite civil and most effective. The advantages of this collaborative arrangement became immediately obvious.

Working together offered benefits within the group and also strengthened our hand in negotiations with others. For me, this was empirical proof of the direct and indirect advantages of ad hoc committees. The informal committee structure benefits the stakeholder members of the committee, but also provides a systemic benefit by coordinating the restructuring process and making that process more efficient.

My experience in *Lehman* as the presiding judge further supports the conclusion that ad hoc committees can be most helpful in building consensus and promoting the aims of a complex restructuring.

The *Lehman* cases continue to occupy the courts nearly a decade after the dramatic filing, but the plan process itself took just over three years to conclude. That comparatively quick resolution was remarkable and resulted from agreements made by a diverse group of creditors with materially adverse views regarding some heavily contested and uncertain legal issues.

My impression from the bench is that ad hoc committees of distressed investors played a very constructive role in helping to resolve that dispute, yielding a comprehensive settlement that was viewed by an overwhelming majority of creditors as both pragmatic and favourable.

The point is a significant one and often overlooked. Ad hoc committees of highly motivated economic actors can be good for the system and promote consensus even in the largest and most contentious cases. This happens when economic self-interest aligns with the goals of collective action. Well-advised parties in interest will recognise the virtues of an appropriate compromise. Assuming that the economics are right, such a compromise saves time, achieves certainty of enhanced distributions and avoids the burdens and cost of litigation.

The editors and authors hope that this volume will provide useful information to the global restructuring community and that the state of the art of the ad hoc committee will continue to develop for the benefit of stakeholders and the improved administration of corporate debtors.

Appendix 1

About the Authors

James M Peck
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James M Peck, formerly a United States Bankruptcy Judge in the Southern District of New York, retired from the bench in 2014 and is now global co-chair of Morrison & Foerster's business restructuring and insolvency group.

During his judicial career, Judge Peck presided over the Chapter 11 and SIPA *Lehman Brothers* cases and other major cases including the *Iridium*, *Quebecor*, *Charter Communications*, *Extended Stay Hotels* and *ION Media* Chapter 11 cases, and the *Japan Airlines* Chapter 15 case. As a sitting judge, he successfully mediated some of the most complex Chapter 11 cases, including *American Airlines*, *MF Global*, *Residential Capital*, *General Motors* and *Excel Maritime*.

Judge Peck is a frequent speaker at insolvency conferences domestically and worldwide, including INSOL International's Quadrennial Congress in Sydney. In international insolvency practice, he has been engaged on a number of occasions as an expert witness and has been appointed to selective international mediation panels including the Mediation College of INSOL International and The Singapore Mediation Center.

Judge Peck is a fellow of the American College of Bankruptcy, recently completed his term as president of the International Insolvency Institute and currently serves as board member and member of the executive committee of the International Insolvency Institute. Judge Peck is an adjunct professor of finance at NYU's Stern School of Business, where he teaches courses in corporate reorganisation. He is a graduate of Dartmouth College and NYU School of Law.

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

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

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

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