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On Creditors' Committees: Don't Forget to Change Your Hat when Sitting as a Committee Member

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In a recent criminal case arising out of the Neiman Marcus bankruptcy, the founder of a hedge fund serving on the unsecured creditors' committee was sentenced to six months in prison for committing bankruptcy fraud and violating his fiduciary duties. In chasing profits for his hedge fund, the founder failed to act in the interest of all unsecured creditors as required by all members of an unsecured creditors' committee. The case provides a cautionary tale and a reminder of the importance of respecting fiduciary duties when appointed to an unsecured creditors' committee ("Committee"). Our firm often represents Committees. We focus our Committee members' attention on the special role they play and the responsibilities that come with it.

A business may seek to confront its financial distress using the United States Bankruptcy Code provisions for reorganization. Generally, the three most important parties in a chapter 11 case are the debtor, its secured lenders, if any, and its unsecured creditors. Recognizing that the debtor and its secured lenders will be represented by counsel, Congress provided for representation of the unsecured creditors as a group through a Committee. A Committee may be represented by professionals, including legal counsel, financial consultants, and investment bankers, each of whom are paid from the debtor's estate and not by the individual creditors.

A Committee is appointed by the Office of the United States Trustee ("US Trustee") pursuant to section 1102(a)(1) of title 11 of the United States Code (the "Bankruptcy Code"). A Committee is generally composed of seven to nine members holding the largest claims but may vary from case to case depending upon circumstances. 11 U.S.C. § 1102(b)(1) (providing that a Committee "ordinarily consist[s] of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee . . . .").

After a bankruptcy case is filed, the US Trustee will send a questionnaire to the top 20 unsecured creditors inquiring whether they are willing to serve on a Committee and asking them to complete a questionnaire indicating the nature of their claim. In appointing creditors to the Committee, the US Trustee seeks to create a

representative Committee reflecting the various types of unsecured claims. Insiders and other special creditors may be disqualified from serving on the Committee.

Unsecured creditors are encouraged to sit on the Committee for a variety of reasons including the experience and networking opportunities it provides. Committee members also have the ability to play a pivotal role influencing the outcome of the chapter 11 case. Additionally, the Committee is privy to confidential information which may not be available to the general creditor body.

The cardinal rule of sitting on a Committee is that members act on behalf of all creditors and not on behalf of their own interests. *See* 11 U.S.C. § 1103(c)(5) (providing that a Committee may "perform such other services as are *in the interest of those represented*.") (emphasis added); *In re Adelphia Commc'ns Corp.*, 544 F.3d 420, n.1 (2d Cir. 2008) ("[A] committee owes a fiduciary duty to the class it represents, but not to the debtor, other classes, or the estate."). As such, when issues arise where a Committee member's fiduciary duty to all creditors is in conflict with their own company's interest, they may be asked to recuse themselves from deliberations and decision making. In serving on a Committee, members must "act with undivided loyalty for the benefit of all of the unsecured creditors." *In re ABC Auto. Prods. Corp.*, 210 B.R. 437, 441 (Bankr. E.D. Pa. 1997).

A recent case stemming from the bankruptcy of the department store chain Neiman Marcus in the Southern District of Texas provides a stark lesson of the importance of respecting one's fiduciary duties while serving on a Committee. A copy of the complaint ("Complaint") in *United States of America v. Daniel Kamensky* (S.D.N.Y. Case No. 20-mj-09381) is available at https://www.justice.gov/usao-sdny/press-release/file/1312746/download.

Neiman Marcus filed for chapter 11 in May 2020. Complaint, ¶ 12(b). A nine-member unsecured creditors' committee was appointed, including creditor Marble Ridge ("MR"), one of Neiman Marcus' largest unsecured creditors. *Id*., ¶ 12(c). MR, a hedge fund that invested in securities in distressed situations, including bankruptcy, was led by Daniel Kamensky ("Kamensky"). *Id*., ¶ 7. The US Trustee appointed MR to the committee only after Kamensky signed an acknowledgment that he understood that the members of the committee are fiduciaries representing all unsecured creditors as a group. *Id.*, ¶ 12(d).

As is normal, the committee participated in negotiations with the debtor and debtor's equity owners and other creditors. As part of the resolution of an alleged pre-petition fraudulent transfer, the committee negotiated to obtain shares in a profitable subsidiary, one of the most valuable assets of Neiman Marcus. *Id*., ¶ 12(e). In connection with this settlement, the committee was also considering potential "cashout options" for its creditors. Under this option, any unsecured creditor who preferred to receive cash instead of the shares could sell the shares. *Id.*, ¶ 12(f).

The "cashout options" being considered included a proposal by MR which also sat on the committee. In late July 2020, MR, through Kamensky, proposed that MR purchase the subject shares for twenty cents per share from any unsecured creditor wishing to sell them. *Id*., ¶ 13(a). During the subsequent negotiations, an investment bank advised the committee professionals that its client was prepared to offer a higher price for the shares. *Id*., ¶ 13(b)-(c). At approximately 3:15 p.m. on July 31, 2020, committee professionals notified Kamensky that a competitor was offering more for the shares.

Shortly thereafter, Kamensky exchanged chat messages and calls with employees of the investment bank handling the competing offer and admonished it to back off and not submit a competing bid. *Id.*, ¶ 13 (e)-(g). MR was also a client of the investment bank and Kamensky allegedly threatened the investment bank with loss of future business from MR. *Id.*, ¶ 13(g). Around 3:45 p.m., in what was a clear conflict of interest, fighting for his own company's best interest against those of the committee, an allegedly "highly agitated" Kamensky demanded that the investment bank stand down. *Id.*, ¶ 13(g).

Within approximately one hour of notifying the committee that its client was interested in making a competing bid, the investment bank agreed not to make the bid and informed the committee's counsel that it was withdrawing from making a bid because Kamensky had asked it to. *Id.*, ¶ 13(i). After committee counsel informed MR's counsel regarding investment bank's reason for withdrawal from making a bid, Kamensky, compounding his wrongdoing, contacted an employee of the investment bank around 8:00 p.m. and asked the employee to say that "it was a misunderstanding". *Id.*, ¶ 13(j)-(k). Notably, Kamensky was well-versed in bankruptcy law as he was trained as a lawyer, practiced bankruptcy law at a well-known international law firm, and worked as a distressed debt investor at prominent financial institutions prior to opening MR. *Id.*, ¶ 7. As such, he was well acquainted with the rules. In pressuring the employee of the investment bank, Kamensky noted that he could go to jail for what he had done. *Id.*, 13(l).

Kamensky's actions were "in violation of his fiduciary duties" and he "engaged in a scheme to defraud the unsecured creditors" of the debtor. *Id.*, ¶ 1. Bankruptcy crimes can be prosecuted by the United States Department of Justice and Kamensky was charged with, among other things, fraud and obstruction of justice.

Kamensky pled guilty in February 2021. *See* Press Release, U.S. Department of Justice, New York Hedge Fund Founder Sentenced For Bankruptcy Fraud (May 7, 2021) ("DOJ Press Release"), https://www.justice.gov/usao-sdny/pr/new-york-hedge-fund-founder-sentenced-bankruptcy-fraud. In sentencing Kamensky, the District Court Judge acknowledged she found Kamensky "deeply remorseful" but noted that he "betrayed his profession, his duty to others, his relationships." *New York hedge fund founder Kamensky sentenced to prison in Neiman Marcu fraud*, Reuters (May 7, 2021), https://www.reuters.com/article/usa-crime-kamensky-idCNL1N2MU1PQ. Kamensky was sentenced to six months in prison and a fine of $55,000. *See* DOJ Press Release.

U.S. Attorney Audrey Strauss said: "Daniel Kamensky committed bankruptcy fraud – undermining the integrity of bankruptcy proceedings and violating his fiduciary responsibility – in an effort to take extra profits for himself and his hedge fund. As he himself predicted, this fraud has now landed Daniel Kamensky in prison." *See* DOJ Press Release.

Thus, in a matter of hours, as a result of an otherwise inexplicable lack of common sense and professional ethics, the importance of respecting the fiduciary role of members of a Committee was highlighted.

Each day brings developments in the law. We look forward to your questions and bringing you more news on these issues as the law continues to develop.

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Practices

- Bankruptcy and Creditors' Rights

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