

THE MERIDIAN GROUP

223 Fourth Avenue, Suite 1700

Pittsburgh, Pennsylvania 15222-1713

(412) 232-0113 / (412) 232-0502 Facsimile

**THE ROLE OF THE
UNSECURED CREDITORS
COMMITTEE**



THE MERIDIAN GROUP

Most turnaround/workout situations are not recognized by management until the company is having serious cash flow problems. Unsecured creditors are usually the last to be informed of the severity of the situation. It is common that by the time notice of the bankruptcy filing is received, they have extended credit far beyond a reasonable level.

The purpose of this presentation is to provide some direction for the members of the Unsecured Creditors Committee. Members may be unfamiliar with the bankruptcy process and, all too frequently, the Committee reacts too slowly to events taking place. This “reactionary” response ultimately hurts the unsecured creditors. By providing the Committee with a methodology that permits it to be more proactive in addressing issues, we believe that the final outcome will be much more positive.

The Meridian Group is a privately-owned company specializing in turnaround consulting, corporate finance, and merger & acquisition activities. Each member of the Unsecured Creditors Committee must analyze the Debtor’s Plan for reasonableness and feasibility, and may be called upon to understand the effect of a sale of the bankrupt estate, and/or may have to determine the probability of success of a Third-Party Plan that intends to bring new capital. Meridian has the expertise to address all of these issues. On a combined basis, our associates have over 150 years of financial experience, many of which relate to bankruptcy work. Our depth of knowledge enables us to address many problem areas simultaneously.



*UNSECURED
CREDITORS
COMMITTEE*



UNSECURED CREDITORS COMMITTEE

GOAL OF COMMITTEE

- To assist in maximizing the dollar amount paid to all unsecured creditors from the bankruptcy estate.
- To react on a timely basis, so that unnecessary delays do not cause a devaluing of the ultimate recovery to the unsecured creditors.
- To quickly achieve consensus among the Committee members. This is particularly important if there is a mix of sub-debt and trade credit participants serving on the Committee.
- To serve in a fiduciary capacity in representing all unsecured creditors.
- To be proactive in defining and assessing alternatives, seeking the best method for maximizing value for the unsecured creditors.



UNSECURED CREDITORS COMMITTEE

HOW IS IT FORMED?

- The U.S. Trustee appoints a committee of unsecured creditors as soon as it is practicable after the order of relief is filed.
- Usually the Committee is formed within 30 days of the filing date.
- A chairperson of the Committee will be elected, typically a representative from the largest unsecured creditor.
- After its formation, the Unsecured Creditors Committee has the right to hire professionals that are paid for by the Estate.



UNSECURED CREDITORS COMMITTEE

HOW ARE THE MEMBERS OF THE COMMITTEE CHOSEN?

- The Unsecured Creditors Committee usually consists of the seven largest unsecured creditors who are willing to serve. The Committee will consist of no fewer than 3, and not more than eleven, unsecured creditors .
- The U.S. Trustee will occasionally appoint committees larger than seven members where it is believed necessary to assure adequate representation of the class.
- On request of a party in interest, and after notice and a hearing, the U.S. Trustee and/or the Bankruptcy Court may change the composition of the Committee if it is determined that it is not sufficiently representative.

Committee members can recover out-of-pocket expenses from the Estate.



UNSECURED CREDITORS COMMITTEE

WHAT ARE ITS OFFICIAL DUTIES?

- To review and advise the Court of the Committee's position on motions or other legal actions.
- To consult with the Debtor throughout the case in regard to the administration of the case.
- To investigate the Debtor's pre-petition conduct for possible causes of action against insiders that would benefit the estate (e.g., preferential transfers).
- To determine the desirability of the continuance of such a business.
- To participate in the formulation of the Debtor's Plan.
- To request the appointment of a Chapter 11 Trustee or Examiner, if it deems necessary.
- To advise other unsecured creditors on whether to accept or reject the Plan(s).
- To appear at various hearings as a party in interest.
- To prepare and file its own Plan, when the Debtor ceases to have the exclusive right to do so. This Creditors' Plan should maximize the recovery to the Committee's constituency.
- To consult with other parties in interest throughout the case.
- To hire professionals (attorneys and financial consultants).



UNSECURED CREDITORS COMMITTEE

FIDUCIARY DUTY OF THE COMMITTEE

- Requires that Committee members place the interests of the Committee's constituents, other creditors and the Debtor above their own personal interests.
- Counsel to the Committee owes a fiduciary duty to the Committee and its constituency, and to the Bankruptcy Court.
- Committee members do not have absolute immunity but do enjoy qualified immunity. This immunity extends to conduct within the scope of the Committee's statutory or Court-ordered authority.
- The fiduciary duty of the Committee does not extend to the Debtor.
- Actions such as willful misconduct or activities beyond those authorized by the statute or by Court order may fall outside of the Committee's qualified immunity.
- The Committee's legal counsel will advise the members of their duties and responsibilities.



*COMMON
MISCONCEPTIONS
ABOUT
BANKRUPTCY*



COMMON MISCONCEPTIONS

Myth 1: Bankruptcy cures business problems.

Truth: *85% of bankruptcy filings end in the death of the company.*

Myth 2: Banks' claims always come before unsecured creditors.

Truth: *Banks and other lending institutions must have a perfected lien in order to have a claim that takes priority over unsecured creditors; if not, they are part of the unsecured pool.*

Myth 3: It is better to approve a Debtor's Plan than look for other alternatives, because the trade creditors will maintain an on-going relationship with the Debtor.

Truth: *Debtor Plans may often be the least attractive opportunity for the unsecured creditors. Frequently, buyers exist that have more capable management, better capital, and a strong desire to continue the trade relationships after a sale.*

Myth 4: The role of the Unsecured Creditors Committee is to be reactive to information presented to it (e.g., the Debtor's reorganization plan).

Truth: *The Unsecured Creditors Committee should be proactive. At the first meeting, it should begin to develop alternative strategies for maximizing the value of the Estate.*



COMMON MISCONCEPTIONS

Myth 5: No new equity is required for a Debtor's Plan.

Truth: Plans that include provisions for fresh capital have a much higher success rate and tend to be more beneficial to unsecured creditors, especially where the Plan calls for extended payments.

Myth 6: Unsecured Creditor Committee members have like goals and collaborative relationships.

Truth: Intra-creditor issues exist throughout the process and require strong, objective leadership in the form of a committee chairperson. Also, committee members have a fiduciary responsibility to all unsecured creditors, beyond the individual agendas of their respective companies.

Myth 7: Unsecured creditors have a good chance of recovering 100% of their pre-petition claims.

Truth: In most cases, unsecured creditors will incur sizable losses, far above their expectations.

Myth 8: The bankruptcy process is quick. Normal relations should be back in place within 3 to 6 months.

Truth: The typical Chapter 11 case lasts 12 to 18 months.



COMMON MISCONCEPTIONS

- Myth 9:** The Company's financial problems were not the fault of management.
Truth: An overwhelming number of bankruptcies are tied to mismanagement. After filing, most companies maintain the same management team. Interim management options may need to be explored.
- Myth 10:** Unsecured creditors have to either accept or reject the Debtor's Plan.
Truth: The Unsecured Creditors Committee should aggressively negotiate with the Debtor and other parties in interest to maximize recovery. Negotiations can include earnouts, warrants and stock.
- Myth 11:** Unsecured creditors have no control over the process.
Truth: The Unsecured Creditors Committee can express its views to the Bankruptcy Court and can exert pressure on the Debtor and secured creditors to expedite the process.



COMMON MISCONCEPTIONS

Myth 12: Unsecured creditors can keep all pre-petition payments.

Truth: Payments made to trade creditors within 90 days of the filing date may be considered a preferential transfer.

Myth 13: The bankruptcy process will provide adequate financial information to all creditor groups.

Truth: The Unsecured Creditors Committee must specifically define their data requirements and encourage the Debtor to provide this information on a timely basis.

Myth 14: The Unsecured Creditors Committee is an independent and passive group in the bankruptcy process.

Truth: The unsecured creditors need strong leadership and professional representation because they are at high risk of financial loss. The Committee members must be involved in on-going dialogue with the other claimant groups throughout the duration of the case.



*RECOMMENDED
PROCESS*



RECOMMENDED PROCESS

BENEFITS PROVIDED BY FILING FOR CHAPTER 11

- The automatic stay.
- The ability to abandon burdensome property.
- The ability to reject executory contracts and leases.
- The ability to avoid preferential and fraudulent transfers.
- The ability to alter secured and unsecured claims.
- The ability to bind dissenting creditors to the reorganization plan.

These benefits are available to the Debtor and to the creditors, should they take charge of the reorganization process.



RECOMMENDED PROCESS

“PERFECT WORLD” OBJECTIVES

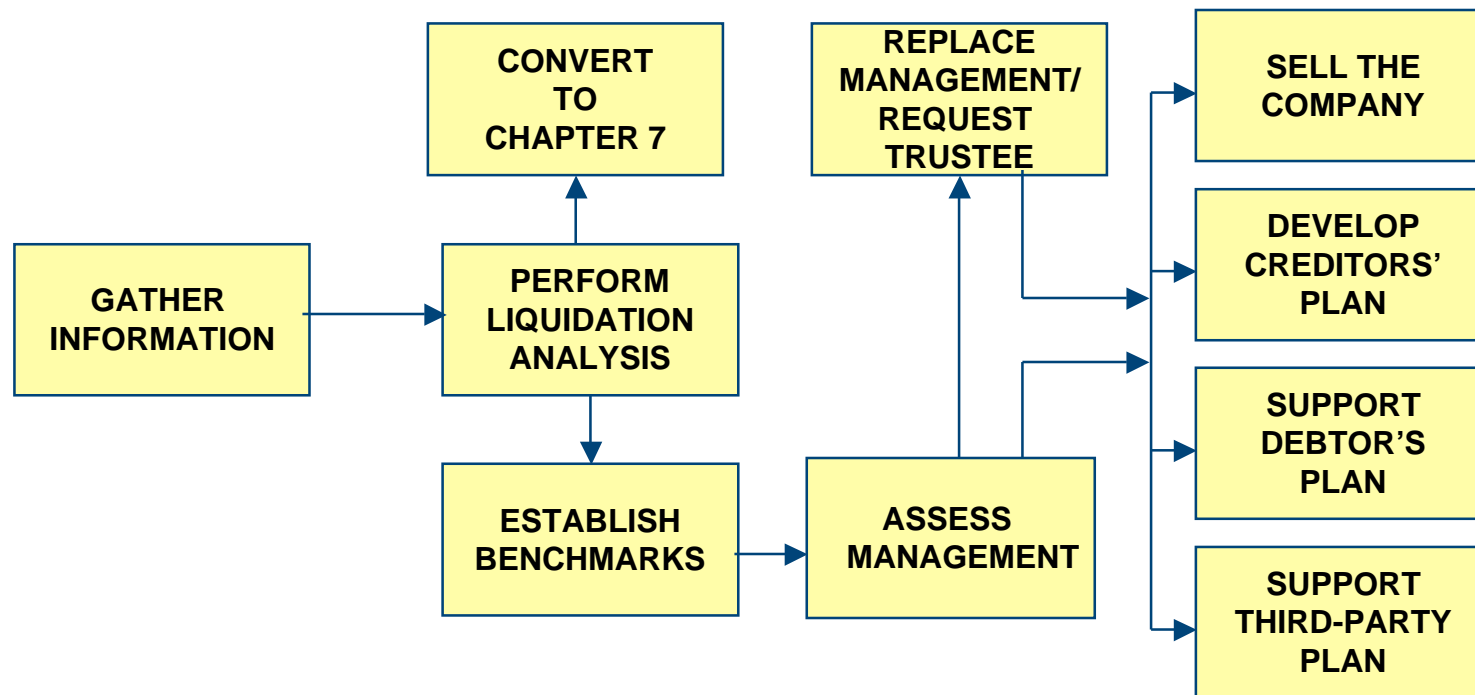
- Secured Creditors - Get paid in full, including interest, plus be reimbursed for all expenses.
- Priority Creditors - Get paid in full.
- Unsecured Creditors - Get paid in full, at the time that the Plan is executed, and exit Chapter 11 with a continuing relationship with the Debtor (customer).
- Stockholders - Exit Chapter 11 with their stock and remain in control of company.

*Unfortunately, this usually does not happen.
Ultimate recoveries are reduced according to the status of the claimants.*



RECOMMENDED PROCESS

FLOWCHART OF RECOMMENDED PROCESS





RECOMMENDED PROCESS

GATHER INFORMATION

- Gain an understanding of the cause of the Company's financial failure.
- Identify issues that will force a quick devaluation of the assets.
- Analyze the financial performance of the Debtor. Review agings of accounts receivable, inventory, and accounts payable. Determine the competitive position and operational effectiveness of the business.
- Review appraisals of inventory, real estate, and equipment, if they exist. If none exist, develop a process for determining the market and liquidation values of all of the assets of the Debtor.
- Review utilization of assets. Determine which assets are available for sale.
- Analyze cash flow and financial statement projections.
- Understand the positions of the secured creditors. Do they have perfected liens? Are they oversecured or undersecured? Are there priority tax claims?
- Estimate how much negotiating room the Committee has with regard to the secured creditors and the Debtor?
- Investigate whether preferential transfers were made. Are there other causes of action?



RECOMMENDED PROCESS

INVESTIGATE CONVERTING TO A CHAPTER 7

- As soon as possible, perform a liquidation analysis to determine the amount of funds available, if the assets were sold. Make sure to include the cost of liquidation in the analysis.
- Once determined, calculate the recovery amount for each creditor class. It is important to understand the value on a class-by-class basis, because this gives insight into how each class will react to any given plan.
- The liquidation value establishes the “worst case” scenario, and assists the Committee in understanding the potential pay-out to the unsecured creditors.
- The liquidation value provides a basis for making decisions going forward.

The established liquidation value will determine the “minimum” threshold for recovery of claims by the unsecured creditors.

It is important to preserve this value throughout the process.



RECOMMENDED PROCESS

CONSIDER CONVERSION TO A CHAPTER 7 WHEN:

- The Debtor continues to lose money, further reducing the liquidation value.
- There is an absence of a reasonable likelihood of rehabilitation.
- The Debtor is unable to develop and implement a reorganization plan that is acceptable to creditors.
- There are unreasonable delays by the Debtor that could cause harm to the creditors.
- Creditors are refusing to confirm the proposed Plan and objecting to a request made for additional time for filing another Plan or modification of a Plan.
- The order of confirmation has been revoked by the Bankruptcy Court.
- The Debtor is unable to successfully implement a previously confirmed Plan.
- The Debtor is in material default with respect to a confirmed Plan.
- The assets are dissipating as a result of fraud or gross mismanagement.



RECOMMENDED PROCESS

ESTABLISH BENCHMARKS

- Each Debtor will have its own unique set of benchmarks that should be established early in the process. These will require that management commit to certain levels of performance.
- Some recommended benchmarks include:
 - Cash flow
 - Backlog or sales revenue (may be established based on a breakeven analysis)
 - Headcount
 - Working capital
 - Inventory
 - Asset sales (liquidation of non-performing/underutilized assets)
- At a minimum, benchmarks should be on a monthly schedule, with strict reporting requirements. These reports should not be late.
- Benchmarks need to be tighter for smaller companies, because they are typically more volatile with less staying power.



RECOMMENDED PROCESS

ASSESS MANAGEMENT

- Some key indicators as to whether management is in control of the business are:
 - *Is management adhering to deadlines?*
 - *Does the Committee feel that there is an open line of communication?*
 - *Are commitments made and then broken?*
 - *Are the accounts receivable under control with little debts in the over 60 days category?*
 - *Is inventory at a reasonable level for the industry? If not, why?*
 - *Have underutilized assets (e.g., equipment) been sold?*
 - *Are worker's compensation claims high?*
 - *Is pricing set to "make any sale"?*
 - *Has management engaged professional bankruptcy advisor(s), other than legal counsel?*
 - *Is management suspected of engaging in malfeasance, self-dealing, or any other questionable activities?*



RECOMMENDED PROCESS

ASSESS MANAGEMENT

- Poor management decisions may result in financial failure.
- The established benchmarks should be a leading indicator of management's ability to effectively run the business.
- Close monitoring of the condition of the Debtor will enable the Committee to be proactive in taking the necessary steps with regard to the management of the Company.
- The Committee may also chose to request that an Examiner be appointed to assist in assessing the competency of management.



RECOMMENDED PROCESS

REPLACE MANAGEMENT

- If on-going problems point to continued mismanagement, the Committee should consider whether it is necessary to replace management. It is better to react quickly, than allow management to further reduce the economic value of the Estate.
- The Committee may chose to either directly replace management with interim management, or it may request the appointment of a Chapter 11 Trustee, who will determine if management should remain in place.
- A Trustee may be appointed for cause; including fraud, dishonesty, incompetence or gross mismanagement of the affairs of the Debtor by current management, either before or after the commencement of the case. The Trustee takes over total control of the Debtor. Once appointed, it is the Trustee's decision as to whether management should be replaced.

*Initially, professional management may be more expensive,
but results will be better than an indecisive and weak management team.*



RECOMMENDED PROCESS

MONITOR THE PROGRESS OF THE DEBTOR

- Financial reporting
- Performance versus projections
- Performance versus benchmarks
- Cash flow
- Backlog
- Asset dispositions
- Rationalization of employment force
- Cost cutting initiatives
- Revenue impact due to filing (e.g., contract cancellations)

Continually monitor the operations to make sure that the liquidation value is not diminishing through on-going financial losses.



RECOMMENDED PROCESS

KEY INDICATORS THAT THE DEBTOR IS ON THE RIGHT TRACK

- Financial reporting is accurate and supported by outside professionals.
- Accounts Payable is stable and not increasing.
- Debtor is adhering to forecast.
- Debtor has positive cash flow from operations (before legal and other professional fees associated with the Chapter process) reasonably soon after filing.
- Debtor's backlog is stable and not declining.
- Debtor is not resisting advice from paid professionals.



RECOMMENDED PROCESS

INDICATORS FOR TAKING A NEW DIRECTION

- When professional advisors are recommending that the Committee change course.
- At the very first sign that the Debtor does not have the management capabilities to effectively run the Company.
- The first month that the Debtor has a negative cash flow from operations after a reasonable time has been allowed to make changes (e.g., three months) - recommend addressing this issue no later than month four.
- Debtor has chosen to limit outside advisor's role.
- Projections and benchmarks are not being met.
- Commitments have been broken and deadlines missed.

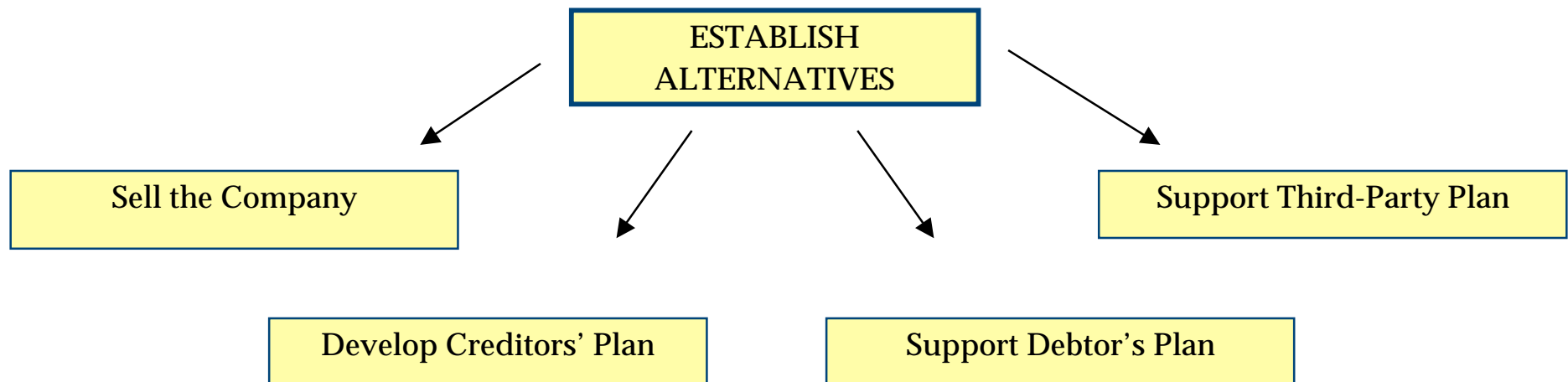


*REORGANIZATION
ALTERNATIVES*



REORGANIZATION ALTERNATIVES

**THE COMMITTEE SHOULD BEGIN TO INVESTIGATE
THE REORGANIZATIONAL ALTERNATIVES
EARLY IN THE PROCESS**





REORGANIZATION ALTERNATIVES

SELL THE COMPANY

- It is never too soon to test the waters for potential buyers. By testing the market, the Committee will gain a sound understanding of the value of the Company in the market place.
- Confidentiality will always be a concern, but most financial information is of public record.
- This process needs to be managed in such a way as to not alarm customers and employees about their future with the Company.
- Meetings with prospective buyers will give the Committee an opportunity to hear constructive criticism as to how the Debtor is operating the business.
- By starting this process early, the Committee could reduce the time to find a “stalking horse,” should one be needed in the process.

Sell while there is still a business to sell. It will take a minimum of three months and perhaps as long as nine months to sell the Company. Begin the process early. It can always be terminated.



REORGANIZATION ALTERNATIVES

DEVELOP CREDITORS' PLAN

- In most instances, the creditors do not submit their own Plan. However, it should always be considered an alternative in the event that the Debtor's Plan is unsatisfactory.
- The Creditors' Plan may range from (1) a liquidation plan; (2) an orderly sale of the business; (3) a plan similar to the Debtor's but with a variation to the pay-out streams; (4) a plan where the creditors become the new shareholders of the Company; or (5) a combination of the above.
- A Creditors' Plan should be developed prior to receiving the Debtor's Plan so that an objective analysis of the Debtor's Plan can be made. By developing its own Plan first, the Committee will have already determined its position on what is fair to all parties in interest.
- A Creditors' Plan will provide a base from which to negotiate with the Debtor and the secured creditors. It increases the Committee's bargaining position.



REORGANIZATION ALTERNATIVES

SUPPORT THE DEBTOR'S PLAN

- The Debtor's Plan should not be considered until all other alternatives have been defined and it should provide the best economic value for the unsecured creditors.
- If extended payments terms are required, the Committee needs to objectively assess the likelihood of these being made. Emotions and personal feelings should not interfere with this analysis. Members may have a strong personal liking for the shareholders, but their fiduciary responsibilities should outweigh these feelings.
- The Committee should remain objective in determining the risk level associated with the Debtor's Plan. The risk associated with being paid the amounts outlined in the Plan is significantly higher than the risk of payment on a U.S. Treasury bond.

If at any time in the process, the liquidation value appears to be higher than the discounted cash flow value of the Debtor's Plan, then conversion to a Chapter 7 should be considered.



REORGANIZATION ALTERNATIVES

EVALUATING THE DEBTOR'S PLAN

- Compare the liquidation value to the Debtor's Plan. If the Debtor's Plan contains extended payment terms, discount the value of the payment stream to present, factoring in the appropriate risk level.
- Does the Plan satisfy the "best interest of the creditors test", meaning that the creditors are receiving as much as they would via a liquidation?
- Does the Plan treat the unsecured creditors "fairly", giving them a reasonable portion of the reorganization value of the Debtor? Is the cash flow being distributed once the secured and priority claims have been satisfied? Is the Debtor using it to strengthen the Company's financial position? If so, are the unsecured creditors benefiting via stock ownership?
- Is the Plan feasible?
- If the unsecured creditors are to receive payments over time, does the Plan contain sufficient covenants to protect their interests?
- Are there any viable alternatives to the Plan?
- Are there any other reasons for accepting the Plan?



REORGANIZATION ALTERNATIVES

NEGOTIATING POINTS FOR DEBTOR'S PLAN

- Key negotiating elements of the Debtor's Plan include:
 - *Cash at disposition*
 - *An interest-bearing loan*
 - *An earnout provision*
 - *Security/collateral against future payment streams*
 - *Equity in reorganized enterprise*
 - *Warrants*
 - *Future business relationship(s)*

Compromises are part of the process, frequently causing unsecured creditors to forego an early cash payoff in exchange for making the Plan feasible.



REORGANIZATION ALTERNATIVES

WHEN TO SUPPORT OR SPONSOR A COMPETING PLAN

- **GENERAL RULE - MOVE QUICKLY BEFORE IT IS TOO LATE**
- When the economic value of the Debtor's Plan is below that of the other alternatives.
- When there is a viable selling opportunity.
- When the Committee's primary economic reason for voting for the Debtor's Plan is the belief that the unsecured creditors will benefit from keeping the Company as a customer after bankruptcy.
- When the Debtor's Plan calls for a significant portion of the unsecured creditors' recovery to be paid over an extended period of time.
- When the Stockholders have no additional capital to invest in the business.



*ROLE OF THE
FINANCIAL CONSULTANT
WORKING FOR THE
UNSECURED CREDITORS COMMITTEE*



ROLE OF FINANCIAL CONSULTANT

- A financial consultant working for the Unsecured Creditors Committee should:
 - *Establish performance benchmarks.*
 - *Monitor performance versus projections and benchmarks.*
 - *Assist in finding and negotiating with prospective buyers.*
 - *Analyze financials.*
 - *Monitor cash flow.*
 - *Develop alternative plan(s) of reorganization and recommend when it is time to act on them.*
 - *Act quickly should the Debtor's performance continue to deteriorate.*