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10 Attorneys for the Official Committee of Unsecured
Creditors

11 **UNITED STATES BANKRUPTCY COURT**
12 **SOUTHERN DISTRICT OF CALIFORNIA**

13 In re:) Case No.: 06-00510-LA
14 **SERACARE LIFE SCIENCES, INC.,**) Chapter 11
15 Debtor.) **OBJECTION OF THE OFFICIAL**
16) **COMMITTEE OF UNSECURED**
17) **CREDITORS TO MOTION OF AD HOC**
18) **COMMITTEE OF EQUITYHOLDERS**
19) **FOR APPOINTMENT OF AN OFFICIAL**
20) **COMMITTEE OF EQUITYHOLDERS**
21)
22)
23) Date: May 24, 2006
24) Time: 2:00 p.m.
25) Place: Dept. No. 2, Rm. 118
26) 325 West "F" Street
27) San Diego, CA 92101
28)

23 The Official Committee of Unsecured Creditors (the "Creditors' Committee") of SeraCare
24 Life Sciences, Inc. (the "Debtor"), hereby submits this objection (the "Objection") to the *Motion of*
25 *Ad Hoc Committee of Equityholders for Appointment of an Official Committee of Equityholders* (the
26 "Motion"). The Motion was originally filed on April 3, 2006, and has been re-noticed for a hearing
27 on May 24, 2006. The Motion states, at page 2, that it is brought pursuant to Section 1102(b) of the
28 Bankruptcy Code – this section, however, applies only upon the actual appointment of a committee.

1 The Creditors' Committee assumes that the Motion is brought pursuant to Section 1102(a)(2)
2 because the equity holders did not request the United States Trustee to consider the appointment of
3 an equity committee, as contemplated by Section 1102(a)(1).

4 The Creditors' Committee is informed that the Ad Hoc Committee of Equityholders (the "Ad
5 Hoc Committee") currently represents nearly one-third of the outstanding shares of the Debtor.¹

6 MEMORANDUM OF POINTS AND AUTHORITIES

7 PRELIMINARY STATEMENT

8 1. The Creditors' Committee does not oppose the right of the Ad Hoc Committee to
9 appear on matters affecting shareholder interests in these chapter 11 cases. The Ad Hoc Committee
10 is free to participate in the case and advance its position just as any other claim or interest holder -- a
11 fact capably demonstrated by the filing of the Ad Hoc Committee's objection to the Debtor's motion
12 to use cash collateral.²

13 2. It is unclear, however, what will be gained by the appointment of an official equity
14 committee in a case where equity is currently well-represented and all constituents expect to see the
15 Debtor repay its creditors in full and emerge from bankruptcy as an ongoing business, with its
16 existing shareholders unaffected. The Ad Hoc Committee seems to want an equity committee to
17 fund the cost of confronting, or replacing, existing management (through a shareholders' meeting)
18 and perhaps even to seek the appointment of a trustee or, alternatively, dismissal of the case. See
19 Motion at ¶¶20-22. For instance, the Ad Hoc Committee believes "there may be reasons for the
20 bankruptcy petition to be deemed invalid." The Ad Hoc Committee thus appears mostly concerned
21 with control over the company, not the inadequate representation in the case of the shareholder class
22 generally.

23 3. If these are the objectives of the Ad Hoc Committee, why is an equity committee
24 necessary (other than to force the Debtor to bear the cost of the shareholders' grievances with

25 _____
26 ¹ According to the *Verified Statement of Ropes & Gray LLP and Klee, Tuchin, Bogdanoff & Stern LLP Pursuant to*
27 *Rule 2019 of the Federal Rules of Bankruptcy Procedure* filed on or about April 13, 2006 ("2019 Statement"), the Ad
28 Hoc Committee represents holders of approximately 4.55 million shares of the Debtor, which constitutes approximately
32.5% of the total outstanding shares of the Debtor.

² Curiously, for a shareholder group, the Ad Hoc Committee took the position that none of the "Investigative Costs"
(e.g., accounting investigation and restatement) associated with restoring the public reporting status of the company
should be funded at this time.

1 management)? Corporate governance issues can be addressed by disaffected equity holders without
2 an official committee. Moreover, if the Ad Hoc Committee has its sights set on the appointment of a
3 trustee or the dismissal of the case, it is difficult to see how the Congressional purpose of an official
4 committee (to assist the debtor to formulate a plan) will be served.

5 4. Regardless of the Ad Hoc Committee’s motives, it is also far from certain at this stage
6 of the case that equity is “in the money.” The Debtor faces various near-term operational challenges
7 and has limited cash to run its business (not taking into account the funds that may be necessary to
8 pay off the Debtor’s secured lenders). Although this may appear to be a case with *Enron*-type issues
9 (e.g., internal accounting irregularities, management turnover, government investigations), it
10 certainly does not enjoy *Enron*-type resources. The Debtor’s focus at this stage of the case should be
11 on conserving liquidity, reducing expenditures and stabilizing the business. This is not the time to
12 burden the Debtor with the expense of an official equity committee. There are simply too many
13 uncertainties that remain before creditors, much less equity holders, can be paid.

14 5. It also bears emphasis that shareholders are adequately represented in this case. The
15 Ad Hoc Committee (which represents nearly one-third of all outstanding shares) has been active in
16 the case. Further, the Ad Hoc Committee appears to primarily consist of various well-heeled
17 investors and investment firms (e.g., according to the 2019 Statement, Fidelity, Harbinger Capital
18 and the Wolfson Group), who can also adequately protect their own interests. At the same time, the
19 Creditors’ Committee is informed that certain members of the Debtor’s board of directors also hold a
20 significant amount of the Debtor’s outstanding shares. The interests of the board and the Ad Hoc
21 Committee (not to mention the Creditors’ Committee) are clearly aligned in terms of maximizing the
22 Debtor’s enterprise value.

23 6. Under these circumstances, the Creditors’ Committee submits that little will be
24 gained by the appointment of an equity committee, particularly given the underlying reasons listed
25 for the Ad Hoc Committee’s request (e.g., “circumstances of this bankruptcy filing are highly
26 suspect”). At present, all constituencies are focused on stabilizing operations, minimizing expenses,
27 and attaining the highest possible value for the estate.

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BACKGROUND

7. On March 22, 2006, the Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtor continues to operate its business and manage its property as a debtor-in-possession. No trustee or examiner has been appointed herein.

8. On April 11, 2006, the United States Trustee appointed the Creditors' Committee in the Debtor's bankruptcy case pursuant to section 1102 of the Bankruptcy Code.

ARGUMENTS & AUTHORITIES

9. Section 1102(a)(2) of the Bankruptcy Code provides that "[o]n request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders **if necessary to assure** the adequate representation of creditors or of equity security holders." 11 U.S.C. § 1102(a)(2) (emphasis added).

10. The decision whether to appoint an equity committee is discretionary. In re Williams Communications Group, Inc., 281 B.R. 216, 220 (Bankr. S.D.N.Y. 2002). Because there is no statutory definition of "adequacy of representation," the determination of whether an equity committee should be appointed is generally made on a case-by-case basis. In re Leap Wireless Int'l, Inc., 295 B.R. 135, 137 (Bankr. S.D. Cal. 2003); Williams Communications, 281 B.R. at 219-220; see also In re Edison Bros. Stores, Inc., 1996 WL 534853 (D. Del. Sept. 17, 1996); In re Wang Laboratories, Inc., 149 B.R. 1 (Bankr. Mass. 1992). The decision to appoint an official equity committee, however, should be the "rare exception." Williams Communications, 281 B.R. at 223.

11. Moreover, the statute itself requires the Court to consider whether a committee is *necessary* to assure adequate representation, not merely whether a committee might be preferable than individual representation, or whether a committee might be useful to advance the interests of shareholders. Rather, the Court must determine whether a committee meets the higher standard of necessity – a burden that is not satisfied here.³

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³ The moving party bears the burden of proof. See In re Edison Bros., 1996 WL 534853 at *4 ([movants] "have the initial burden of developing a factual record to demonstrate the need for adequate representation"); In re Johns-Manville Corporation, 68 B.R. 155, 158 (S.D.N.Y. 1986) ("the burden of demonstrating the need for adequate representation . . . is borne, in the first instance, by the party seeking appointment").

1 12. Movants requesting the formation of an equity committee must typically satisfy a
2 two-part test. The movants must demonstrate that (i) there is a substantial likelihood that they will
3 receive a meaningful distribution in the case, and (ii) they are not adequately represented in the case
4 or unable to adequately represent their interests without an official committee. See Leap Wireless,
5 295 B.R. at 140; Williams Communications, 281 B.R at 223.

6 13. Other factors often considered by courts in the exercise of their discretion include:
7 the number of shareholders, the complexity of the case, whether the cost of the additional committee
8 significantly outweighs the concern for adequate representation, the delay associated with
9 appointment of the committee, and whether the debtor is hopelessly insolvent. Leap Wireless, 295
10 B.R. at 135.

11 **A. The Ad Hoc Committee Has Failed to Establish a Substantial Likelihood**
12 **That Equity Will Receive a Meaningful Distribution in this Case**

13 14. The fact that the Debtor’s principal lenders are oversecured does not establish a
14 substantial likelihood that the Debtor’s equity holders will receive a meaningful distribution in this
15 case; neither does the positive book value of the Debtor’s assets or the Debtor’s projections of
16 profitable operations in the future. This case is in its early stages and several uncertainties remain.
17 Specifically, it is unclear whether the Debtor will be able to sustain long-term operations, meet
18 revenue projections, cut costs and generate ongoing profits. The Debtor is presently in the midst of
19 a concerted cost-cutting campaign (for instance, its facilities relocation plans) that is intended to free
20 up as much liquidity as possible to sustain operations while simultaneously, and prudently, making
21 every effort to maintain its existing cash reserves.

22 15. The Creditors’ Committee is focused on assisting the Debtor to take the necessary
23 steps to stabilize operations, maintain positive cash flows, and implement internal controls that will
24 ensure fulsome and accurate financial reporting, all of which are aligned with the task of maximizing
25 the value of the Debtor’s estate for all constituencies.

26 16. As things stand today, however, there is not a “substantial likelihood” that the Debtor
27 will be successful in its reorganization efforts and that equity will therefore be entitled to a
28 meaningful distribution in the case. One thing is certain, however, the additional expense of an

1 official equity committee will make it more difficult for the Debtor to operate its business.

2 17. The Debtor already faces substantial constraints on cash. Setting aside the funds that
3 the Debtor may need to pay off its secured lenders, the Debtor has a slim margin of surplus funds to
4 operate its business and a limited runway to return to positive cash flows (for instance, cash
5 collateral authority expires on May 26, 2006). It appears that the most expedient way to turn things
6 around is to operate profitably. To do that, the Debtor must be as lean as possible and is clearly
7 focused on cutting costs.

8 18. The Debtor, the Creditors' Committee and equity holders have consistent goals at this
9 stage of the case: sustaining operations and maximizing going concern value. This is not a case
10 where "100% plus interest" recoveries to creditors are absolutely guaranteed, rendering the
11 Creditor's Committee a superfluous participant in the Chapter 11 process – rather, the Creditors'
12 Committee is as keenly aware as the Debtor and the secured lenders of the urgent need to re-assure
13 customers, scrutinize expenses and motivate the employees. The Creditors' Committee, thus, fulfills
14 a function that, at this time, is completely aligned with and also serves the interests of shareholders,
15 namely, restoring customers' and vendors' confidence in the long term viability of the company.

16 **B. The Ad Hoc Committee Has Failed to Establish that Equity Holders**
17 **Are Not Adequately Represented in the Case or Unable to Represent**
18 **Their Interests Without an Official Committee**

19 19. The Ad Hoc Committee has been active in this case and has every right to continue to
20 do so, but such involvement should not be at the expense of creditors. The Ad Hoc Committee
21 appears to be completely capable of continuing to fund its ongoing participation in the case without
22 the assistance of the Debtor.

23 20. The Ad Hoc Committee currently represents nearly one-third of the outstanding
24 shares of the Debtor. The Creditors' Committee is informed that additional significant holders are
25 members of the Debtor's board of directors. In this regard, the interests of the board are aligned with
26 non-insider shareholders because the Debtor's directors are just as interested in maximizing value as
27 any other public investor. Commodities Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355
28 (1985) ("A company's board of directors acts for the shareholders and the insolvency of a company
does not absolve the board of its fiduciary duties to the shareholders.").

1 21. The fact that, in the insolvency context, such directors also owe fiduciary duties to
2 creditors as well as equity holders does not change this analysis. See In re Edison Bros., 1996 WL
3 534853 at *4 (rejecting the argument that management was incapable of adequately representing
4 non-insider shareholder interests, saying: “the statutory focus of § 1102(a)(2) is not whether
5 shareholders are ‘exclusively’ represented, but whether they are ‘adequately’ represented”); see also
6 Leap Wireless, 295 B.R. at 140 (quoting Williams Communications, 281 B.R. at 222) (same quote).

7 22. Taken together, the Ad Hoc Committee and the Debtor’s board accounts for a
8 significant number of the Debtor’s outstanding shares. Under these circumstances, it is rather
9 disingenuous for the Ad Hoc Committee to argue that equity holders are not adequately represented
10 in this case. They are adequately and actively represented by at least two separate constituencies.

11 23. In Leap Wireless, this Court ruled that the economic interests of the creditors’
12 committee and the shareholders in that case were sufficiently aligned to preclude the need for an
13 additional committee. 295 B.R. at 139-140. The Court found that the interests of both parties were
14 to realize “the highest realistic value for the company” and it was the fiduciary duty of the creditors’
15 committee to do so. Id.

16 24. In the instant case, the Court is faced with a similar scenario. The Creditors’
17 Committee’s goal at this stage of the case is to sustain the Debtor’s operations and thereby maximize
18 the estate’s going concern value. There is no need for another committee to duplicate this effort.

19 25. The Ad Hoc Committee’s attempts to distinguish between the interests of unsecured
20 creditors and equity holders are unavailing. Any questions that the Ad Hoc Committee may have
21 with respect to the members of the Debtor’s management team or the Debtor’s underlying authority
22 for the bankruptcy filing (see Motion at ¶¶ 20-22) can be raised by the Ad Hoc Committee itself, if
23 and when necessary. “Section 1109(b) gives [the Ad Hoc Committee] the right to raise and be heard
24 on any issue in this case.” Leap Wireless, 295 B.R. at 140. There is no need for an official
25 committee to voice the Ad Hoc Committee’s objections or for the estate to bear the cost thereof.
26 Equity holders are already well represented in this case by the Ad Hoc Committee and the board.

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1 **C. Other Relevant Factors Also Weigh Against Appointing**
2 **an Equity Committee in This Case**

3 26. Other factors considered by courts in determining whether to appoint an equity
4 committee are the number of shareholders involved, the complexity of the case, whether the cost of
5 the additional committee significantly outweighs the concern for adequate representation, the delay
6 associated with appointment of the committee, and whether the debtor is hopelessly insolvent. Leap
7 Wireless, 295 B.R. at 135. Although some of these factors are encompassed in the discussion above,
8 the Creditors' Committee submits that, to the extent relevant to this case, each of these factors
9 (except perhaps delay) weighs against appointing an equity committee in this case.

10 27. First, although the Debtor has numerous shareholders and is publicly traded, a
11 substantial portion of the Debtor's outstanding shares are already represented by the Ad Hoc
12 Committee and the Debtor's board of directors. Moreover, it appears that any shareholder may elect
13 to join the Ad Hoc Committee and the membership of such committee continues to grow. Given the
14 extent of equity holders' existing involvement in the case, appointing an official committee is
15 unnecessary.

16 28. Second, this is not a large or complex case. The Debtor generates revenues in the
17 range of only \$50 million per year and positive EBITDA is likely to total less than \$10 million on an
18 annualized basis. The Debtor operates on a tight budget and has very little free cash to fund its
19 business. The Debtor simply cannot afford to add another layer of unnecessary expense.

20 29. Third, the cost of appointing an equity committee does not outweigh the concern for
21 adequate representation because, as addressed above, there is no such concern in this case. There
22 can be no question that the interests of equity holders are already adequately represented.

23 30. Fourth, even though there has been no delay in seeking the appointment of an official
24 equity committee, that does not mean that an equity committee is necessary. Indeed, appointing an
25 equity committee at this early stage in the case when so much uncertainty remains may simply be
26 premature.

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1 31. Finally, the issue of solvency is still at play. As addressed above, the Ad Hoc
2 Committee has failed to establish a substantial likelihood that its constituency will be entitled to a
3 meaningful recovery. It is unclear whether the Debtor will be successful in its efforts to stabilize
4 operations, minimize expenditures, and turn a profit. Although the Creditors' Committee would
5 certainly not characterize the situation as "hopeless," the Creditors' Committee submits that there are
6 enough pending issues and questions that appointing an equity committee is unnecessary at this time,
7 particularly given the Debtor's tight finances and the ongoing involvement of the Ad Hoc
8 Committee in the case.

9 **WHEREFORE**, the Creditors' Committee respectfully requests that the Court enter an order
10 denying the Motion and granting the Creditors' Committee such other and further relief to which it
11 may be entitled.

12 Dated: May 15, 2006

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14 By /s/ Henry C. Kevane
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18 Unsecured Creditors