

1 Thomas E. Patterson, Esq. (SBN 130723)
Martin R. Barash (SBN 162314)
2 **KLEE, TUCHIN, BOGDANOFF & STERN LLP**
2121 Avenue of the Stars, 33rd Floor
3 Los Angeles, California 90067
Telephone: (310) 407-4000
4 Telecopy: (310) 407-9090

5 Mark Bane (MB-4883)
ROPES & GRAY LLP
6 45 Rockefeller Plaza
New York, New York 10111
7 Telephone: (212) 841-5700
Telecopier: (212) 841-5725

8
9 D. Ross Martin (BBO#629853)
ROPES & GRAY LLP
One International Place
10 Boston, Massachusetts 02110
Telephone: (617) 951-7000
11 Telecopier: (617) 951-7050

12 Counsel for the Ad Hoc Committee of Equityholders
13
14

15 **UNITED STATES BANKRUPTCY COURT**
16 **SOUTHERN DISTRICT OF CALIFORNIA**
17

18
19 In re)

CASE NO. 06-00510-LA

20 SERACARE LIFE SCIENCES, INC.,)
21 A California Corporation)

Chapter 11 Proceeding

22 Debtor and Debtor-in-)
23 Possession)

**THE REPLY OF THE AD HOC
COMMITTEE OF
EQUITY HOLDERS TO THE OBJECTIONS
OF THE DEBTOR AND THE OFFICIAL
COMMITTEE OF UNSECURED CREDITORS
TO THE MOTION OF THE AD HOC
COMMITTEE OF EQUITY HOLDERS FOR
APPOINTMENT OF AN OFFICIAL
COMMITTEE OF
EQUITY HOLDERS**

24
25
26
27 **DATE:** May 24, 2006
TIME: 2:00 p.m.
PLACE: Dept. 2
28

Cash	25,248,336.96
Inventory	10,528,697.06
Receivables	6,681,506.43
Real Estate (net of mortgage)	1,020,529.00
Total	43,479,069.45

Bank Debt	20,262,500.00
Subordinated Secured Debt	4,000,000.00
Priority Claims	896,762.00
Unsecured Claims (less 10b-5)	7,306,015.37
Total	32,465,277.37

This shows a very conservative \$11 million of value for shareholders on a purely liquidation basis, and does not include various other potentially valuable other assets, such as intellectual property that the Debtor's schedules value at \$6 million. This does not include what is likely substantial going-concern value: in the affidavit that the Debtor has attached to its opposition the Debtor's Director of Finance states that the revenues of the company remain at an annual level of \$55 million, which is the same as was projected prepetition. At the Section 341 meeting held just last week, the Debtor's interim CFO and Director of Finance both concurred that the inventory and receivables amounts listed in the schedules remain the same even 60 days following the commencement of this case.

In its objection the Debtor makes a centerpiece of its argument that the Equity Committee Motion is relying on "contested affidavits" of the Debtor and the banks, which were filed in connection with the contested cash collateral proceedings at the outset of the case. First, it is highly disingenuous for the Debtor to file affidavits seeking to forcibly use cash collateral, stating that the Debtor is solvent, and now, in the face of an equity-committee motion, to attempt to repudiate those statements. Moreover, the Equity Committee Motion only relies on the Debtor and bank affidavits insofar as they do not contradict each other. For example, the banks state that the Debtor never had to draw on the bank facilities for liquidity purposes, and all agreed that

1 the amount of cash collateral exceeded the amount of the bank debt. These agreed facts were,
2 and are, significant evidence of solvency.¹

3 A party cannot oppose a motion by asserting that there is no evidentiary support for a
4 position that the party itself concedes is true. This is perhaps even more true here than in the
5 usual case. The Debtor, a public company, having not filed a public financial statement in nearly
6 a year, now tries to assert that an equity committee should be denied because the independent
7 public equity does not put forward any financial statements for the company. That this is
8 preposterous is self-evident.

9
10 Interestingly, in this case the OCC is in no different position than the Debtor on this
11 score. The OCC has three members, and its member with the largest claim is Alix Partners, a
12 consulting and accounting firm. Alix Partners is owed substantial money (between \$500,000 and
13 \$1 million) for accounting services that it performed for a special committee of the board of
14 directors of the Debtor investigating alleged accounting irregularities. The Debtor has asserted
15 that it terminated various executives following a report by Alix Partners and counsel to that
16 special committee. If anyone is in a position to know if the schedules and statements, as well as
17 affidavits of the Debtor, are so incorrect as to make the Debtor insolvent (as opposed to merely
18 lowering the value of equity from its former value of over \$20/share), it would be the OCC –
19 whose lead member already investigated these questions in great detail. Instead, the
20 Committee’s argument seeks to “wave away” the Debtor’s affidavits as well as the schedules and
21 statements, which were of course filed under pains and penalties of perjury.

22
23
24 It is almost as if the Debtor’s and the OCC’s arguments are a shell game: the Debtor
25 having stated under oath that it is highly solvent (showing the independent shareholders the little
26 rubber ball), the OCC having stood nearby not contradicting, and now the Debtor and the OCC
27

28

¹ Note that neither the banks nor the subordinated secured lenders have opposed the formation of an equity committee. Obviously they retain their rights regarding any proposed use of cash collateral to pay fees and expenses of such a committee, but such relief has not yet been sought (and may or may not be sought).

1 covering and moving the ball around by insisting that independent shareholders should be denied
2 an official voice in the case, simple because the independent shareholders cannot precisely
3 identify exactly how solvent this debtor is. All the while the Debtor and the Committee know
4 what the financials really are, and yet they protest “lack of evidence.” In most, if not all, solvent
5 public company bankruptcies there will be some lapse in the public securities filings. To allow a
6 company to block formation of an official equity committee in the very cases where it is most
7 likely needed (solvent public companies) because the independent shareholders have no access to
8 precise financial information, would completely eviscerate the statutory right to seek, and court
9 authority to appoint, equity committees.
10

11 *Independent Equity Holders Deserve Official Representation*

12 The Debtor and the OCC then go on to put forward a smattering of arguments regarding
13 “adequate representation,” asserting that no official equity committee is needed. At the outset it
14 is notable that both the Debtor and the OCC affirmatively state that equity holders should be
15 heard in this case, and that they are a party-in-interest that should not be disregarded. This alone
16 belies much of their “adequate representation” argument; if public equity holders should be
17 heard, why is it so wrong to have an official committee? The reasons they give for their position
18 do not withstand scrutiny.
19

20 For example, the Debtor and OCC contend that there are not enough shareholders to
21 justify an official committee. There are over 200 shareholders of record: moreover, as is
22 common with most public companies, one of those “shareholders of record” is the Depository
23 Trust Company, which holds a global stock certificate that represents most of the publicly
24 trading shares. There are likely many more beneficial owners of shares, entitled to vote on a
25 plan. *See* Bankruptcy Rule 3017(e) (court should recognize beneficial ownership in the context
26 of a chapter 11 reorganization). Furthermore, there is no support in the statute for the notion that
27 an official equity committee is appropriate only in cases the size of *Worldcom* and others of the
28

1 largest cases in history. The common stock of SeraCare is currently trading at over \$4/share.
2 See Exhibit 3 hereto. Thus there is over \$50 million of current market value (even setting aside
3 what some long-standing shareholders may have as a cost-basis in the stock) in the equity. That
4 is more than eight times the \$7-8 million of general unsecured claims that exist in this case.
5 Obviously the Bankruptcy Code provides for automatic official representation of the unsecured
6 creditors, but it would be a bizarre result if the Bankruptcy Code precluded official
7 representation of another, widely-held constituency eight times larger in size.

9 Another argument proffered in opposition to the Equity Committee Motion is that the
10 Debtor should not bear the costs of the committee, and that the large holders should. There is a
11 twisted logic at work here: the argument appears to be that because over 40% of the equity (of a
12 solvent debtor) wants an official committee, some subset of that group – consisting of the largest
13 holders, should subsidize the 60-70% of smaller holders by freely providing them with “adequate
14 representation.” Any ad hoc committee that would adequately represent all the equity holders
15 would have imposed upon it a “free-rider problem.” And it cannot seriously be expected that a
16 group of hundreds of record and beneficial holders, in a marketplace where shares trade freely
17 every day, each separately receive and pay their *pro rata* share of fees necessary to represent
18 their interests in the case. That would be a logistical nightmare, turning on its head the supposed
19 efficiencies and collective-proceeding advantages of a chapter 11 bankruptcy case.

22 The Debtors and the OCC then go on to argue that a few large holders of the common
23 shares can provide “adequate representation” for all of the shares. The facts of this case undercut
24 any such argument. First, as shown in the Rule 2019 statement of Ropes & Gray LLP, there are
25 many small holders as well as large holders; small and large holders may have different interests.
26 Indeed, the largest holders have bought all, or some substantial parts of, their shares within the
27 last six months: Harbinger and Black Horse Capital purchased their shares after the petition date,
28 and Fidelity’s stake grew to in excess of 5% of the total shares only some time in the last six

1 months,² while various smaller holders (as well as some larger holders, such as the so-called
2 Wolfson Group) have held SeraCare stock for years. This is exactly the situation, much like
3 diverse creditors committees, in which an official committee is needed to provide adequate
4 representation to all the holders, since the official committee can be rapidly formed with a
5 diverse group of independent equity holders.
6

7 Another argument put forward is that the Debtor's current board and management can
8 "adequately represent" the equity holders, because they allegedly hold "16% of the equity on a
9 fully diluted basis." First, this 16% figure apparently includes options, most of which are out-of-
10 the-money (according to the Debtor's own Motion to Reprice Options) and therefore cannot
11 possibly have interests in alignment with current shareholders. Second, every member of the
12 current board of directors has substantial potential conflicts with the interests of other
13 shareholders, simply by virtue of the pending securities-fraud and breach-of-fiduciary-duty
14 litigation against them.³ To be clear, the Ad Hoc Equity Committee takes no position as this
15 time as to the truth or falsity of the allegations in those lawsuits. Rather, the fact that the board
16 members and officers have been sued and will certainly defend themselves in securities-fraud
17 actions, where the company is also named as a defendant and there are contributions claims
18 back-and-forth among the directors, officers and the company. Any liability of the company in
19 such actions is, moreover, subordinated pursuant to Bankruptcy Code Section 510(b). Also, the
20 estate itself is now the proper plaintiff in the derivative actions, and thus existing equity holders
21 would benefit from any recoveries, while the board and officers are directly opposed because
22 they are the defendants in such actions. Directors and officers will likely seek indemnity from
23 the company for some or all of these matters, creating another issue on which the directors and
24 the Debtor (under their governance) have competing interests. Directors and officers may
25
26
27

28 ²See Schedule 13G of Fidelity, filed with the SEC on February 14, 2006.

1 actually compete with the equity holders for the value of the directors-and-officers insurance
2 policy (disclosed in the schedules), because any recoveries from that policy for fiduciary-duty
3 actions would benefit shareholders, while individual directors and officers may want the funds
4 for defense costs and to deal with any securities-fraud liability.

5
6 All these potential conflicts are but part of a host of complex issues in this case, which
7 belies another argument of the Debtor: that the case is simple and shareholders will be
8 unimpaired. The reorganization of this solvent debtor will essentially revolve around the
9 competing interests of three groups: (a) the directors and officers, regarding their indemnity
10 claims and potential liability, if any, (b) the existing shareholders and (c) the securities-fraud
11 plaintiff class. Bankruptcy Code Section 510(b) makes the securities fraud class “of the same
12 priority” as the common stockholders, and thus as a matter of law the Debtor is incorrect that
13 common stock will be unimpaired. Whatever value is available after creditors are paid will have
14 to be divided, on a fair and equitable basis, between the disputed, unliquidated claims of the
15 members of the securities-fraud class and the members of the common stockholder class. There
16 may be substantial legal disputes about rights and valuations, and even the allowance of
17 securities-fraud claims. These are exactly the types of issues in which an official equity
18 committee should be involved: they are at the core of any restructuring process for this solvent
19 debtor.
20
21

22 Finally on the adequate representation issue, other recent developments in the case make
23 it even more imperative that there be an official equity committee. In early May a subset of the
24 Ad Hoc Committee (consisting of Harbinger, Black Horse and the Wolfson Group, the
25 “Financing Holders”) approached the Debtor with a financing proposal to pay off the bank
26
27
28

³ Judicial notice of the existence of these suits should be taken (as noted in the original Equity Committee Motion). Copies are attached of (i) the order of the Federal District Court consolidating, and appointing a lead plaintiff in, the securities-fraud actions and (ii) one of the five derivative fiduciary-duty actions brought against the directors.

1 lenders in full and ensure that all other creditors are paid in full.⁴ That financing is currently
2 being negotiated between the Financing Holders and the Debtor, and would likely (if agreement
3 is reached) involve an agreement under which the Financing Holders would obtain a share of any
4 equity issued in a plan of reorganization.

5
6 This clearly implicates the rights of other shareholders. The Financing Holders each have
7 their own substantial stakes in the existing common shares of the company, and therefore they do
8 not have incentive to engage in any dilutive financing. They believe that they have proposed
9 market terms. However, the Financing Holders also understand that in a bankruptcy case any
10 such offer must be court approved and should be subject to notice and opportunity for other
11 equity holders to be heard on the matter. The pendency and availability of such financing
12 undercuts any notion that Financing Holders should be thought of as surrogates for the other
13 equity holders. The Financing Holders thus welcome the formation of an official equity
14 committee, which could speed the approval of a financing and assuage any concerns about the
15 terms thereof. The Financing Holders would likely not serve on any such official committee
16 (and if they did, they would of course recuse themselves from any deliberations, negotiations and
17 decisions regarding the financing). However, the mere fact that they continue to actively support
18 the Equity Committee Motion demonstrates conclusively that such a committee should be
19 formed immediately, so that this case can move forward in a way that greatly enhances value to
20 creditors, as well as to shareholders.
21
22
23
24
25
26
27
28

⁴ The OCC has also been informed of this proposal.

1 NOW THEREFORE, the Ad Hoc Committee prays that this court order the appointment
2 of an official equity committee, order that the United States Trustee solicit and appoint members
3 of that committee within 14 days, and grant such other relief as is appropriate under the
4 circumstances.
5

6
7 AD HOC EQUITY HOLDERS COMMITTEE

8 By its Attorneys

9 /s/ Thomas E. Patterson

10 Thomas E. Patterson, Esq. (SBN 130723)
11 Martin R. Barash (SBN 162314)
12 KLEE, TUCHIN, BOGDANOFF & STERN LLP
13 2121 Avenue of the Stars, 33rd Floor
14 Los Angeles, California 90067
15 Telephone: (310) 407-4000
16 Telecopy: (310) 407-9090
17 Email: tpatterson@ktbslaw.com

18 /s/ Mark Bane

19 Mark Bane (MB-4883)
20 ROPES & GRAY LLP
21 45 Rockefeller Plaza
22 New York, New York 10111
23 Telephone: 212-841-5700
24 Telecopier: 212-841-5725
25 Email: mark.bane@ropesgray.com

26 -and-

27 D. Ross Martin (BBO#629853)
28 ROPES & GRAY LLP
One International Place
Boston, Massachusetts 02110
Telephone: 617-951-7000
Telecopier: 617-951-7050
Email: ross.martin@ropesgray.com