Advisory Committee on Bankruptcy Rules
Recommends Sweeping Revisions to Bankruptcy Rule 2019

July/August 2010

Mark G. Douglas

Bankruptcy headlines in 2007 were awash with tidings of controversial developments in the chapter 11 cases of Northwest Airlines and its affiliates that sent shock waves through the "distressed" investment community. A New York bankruptcy court ruled that an unofficial, or "ad hoc," committee consisting of hedge funds and other distressed investment entities holding Northwest stock and claims was obligated under a formerly obscure provision in the Federal Rules of Bankruptcy Procedure—Rule 2019—to disclose the details of its members' trading positions, including the acquisition prices.

The ruling was particularly rankling to distressed investors, who play a prominent role in major chapter 11 cases, sometimes by virtue of collective participation in ad hoc creditor groups. Traditionally, these entities have closely guarded information concerning their trading positions to maximize both profit potential and negotiating leverage. Compelling disclosure of this information could discourage hedge funds and other distressed investors from sitting on informal committees, resulting in a significant shift in what has increasingly become a commonplace negotiating infrastructure in chapter 11 mega-cases.

Close on the heels of the rulings in Northwest Airlines, however, the Texas bankruptcy court presiding over the chapter 11 cases of Scotia Pacific Company LLC and its affiliates denied the debtors' request for an order compelling a group of noteholders to disclose the details of its

members' trading positions, ruling that an informal creditor group jointly represented by a single law firm is not the kind of "committee" covered by Rule 2019.

Developments in these and other cases have been monitored closely by the distressed investment community, including trading-industry watchdogs, such as the Loan Syndications and Trading Association ("LSTA") and the Securities Industry and Financial Markets Association ("SIFMA"), which have been actively lobbying to repeal or alter Rule 2019 since 2007. LSTA and SIFMA, two of the nation's leading industry groups in the debt and equity markets, have consistently expressed concern that construing Rule 2019 to apply to informal creditor groups "will have a serious detrimental impact on the willingness and ability of many stakeholders to participate in future chapter 11 cases."

The Rule 2019 ad hoc committee controversy lay relatively dormant for nearly two and a half years. Then, rulings handed down by no fewer than four bankruptcy courts at the end of 2009 and the beginning of 2010 breathed new life into the smoldering embers. The latest tally of bankruptcy courts considering this issue since 2007 shows three courts taking the position that Rule 2019 applies to informal creditor groups and three advocating the opposite approach. A detailed discussion of the rulings in the Northwest Airlines, Scotia Pacific, Washington Mutual, Six Flags, Philadelphia Newspapers, and Accuride chapter 11 cases as well as Rule 2019 and its legislative history is contained in the March/April 2010 edition of the *Business Restructuring Review*.

Bankruptcy Rule 2019

The present version of Rule 2019 (with emphasis added to the original) provides that, in a case under chapter 9 or chapter 11 of the Bankruptcy Code, "*every entity or committee*" (other than an official committee) "*representing more than one creditor or equity security holder*" and, unless otherwise directed by the court, every indenture trustee shall file a verified statement with the court disclosing the following information:

> (1) the name and address of the creditor or equity security holder;
>
> (2) the nature and amount of the claim or interest and the time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition;
>
> (3) a recital of the pertinent facts and circumstances in connection with the employment of the entity or indenture trustee, and, in the case of a committee, the name or names of the entity or entities at whose instance, directly or indirectly, the employment was arranged or the committee was organized or agreed to act; and
>
> (4) with reference to the time of the employment of the entity, the organization or formation of the committee, or the appearance in the case of any indenture trustee, *the amounts of claims or interests owned by the entity, the members of the committee or the indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.*

The Rules Committee's Initial Recommendation for Change

The Rule 2019 controversy and aggressive lobbying by LSTA and SIFMA created an impetus for the Advisory Committee on Bankruptcy Rules (the "Rules Committee") to consider revising the rule or even repealing Rule 2019 altogether. The Rules Committee initially recommended changes to Rule 2019 that would have required expanded disclosure. Under this proposal, the rule would have required disclosure not only by representative committees, but also by "every entity, group, or committee that consists of or represents more than one creditor or equity security holder."

Moreover, the required disclosures would have been expanded to include disclosure of each party's "disclosable economic interest," a term defined to mean "any claim, interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right that grants the holder an economic interest that is affected by the value, acquisition, or disposition of a claim or interest." Under the initial recommendation, the bankruptcy court would also have been given the authority to order the disclosure of amounts paid for claims or interests, but pricing disclosure would not have been required without a court order. The Rules Committee heard testimony on the proposed amendments to Rule 2019 on February 5, 2010. The comment period for the proposed changes closed on February 16. In connection with the comment process, LSTA submitted a letter to the Rules Committee opposing the required disclosure of proprietary price and date information.

The Rules Committee's Final Recommendation: Rule 2019 Defanged

The Rules Committee issued its final recommendation for changes to Rule 2019 on May 27. Instead of requiring enhanced disclosure, however, the recommendation adopts substantially all of the changes proposed by LSTA. Among other things, the amended rule (as compared to the Rules Committee's initial recommendation) would:

- Remove any absolute requirement to disclose the price paid for a bankruptcy claim or reveal the claimant's disclosable economic interest.
- Delete any requirement to disclose the acquisition date of the claimant's disclosable economic interest, except in rare cases where an unofficial group or committee claims to represent any entity other than its members (and even then, only the quarter and the year must be reported).
- Eliminate the authority of the court to order disclosure of the purchase price paid for a disclosable economic interest.
- Exempt administrative agents under credit agreements from the requirements of the rule.

- Exempt groups composed entirely of insiders or affiliates of one another from the requirements of the rule.

- Delete any obligation to file monthly supplemental statements; supplemental statements must be filed only when a fact disclosed in the most recent 2019 statement has changed materially, and the entity or group "takes a position before the court or solicits votes on the confirmation of a plan."

As amended in accordance with the Rules Committee's final recommendation, the full text of

Rule 2019 would read as follows:

Rule 2019. Disclosure Regarding Creditors and Equity Security Holders in Chapter 9 and Chapter 11 Cases

(a) **DEFINITIONS.** In this rule the following terms have the meanings indicated:

(1) "Disclosable economic interest" means any claim, interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right granting the holder an economic interest that is affected by the value, acquisition, or disposition of a claim or interest.

(2) "Represent" or "represents" means to take a position before the court or to solicit votes regarding the confirmation of a plan on behalf of another.

(b) **DISCLOSURE BY GROUPS, COMMITTEES, AND ENTITIES.**

(1) In a chapter 9 or 11 case, a verified statement setting forth the information specified in subdivision (c) of this rule shall be filed by every group or committee that consists of or represents, and every entity that represents, multiple creditors or equity security holders that are

(A) acting in concert to advance their common interests, and (B) not composed entirely of affiliates or insiders of one another.

(2) Unless the court orders otherwise, an entity is not required to file the verified statement described in paragraph (1) of this subdivision solely because of its status as:

(A) an indenture trustee;

(B) an agent for one or more other entities under an agreement for the extension of credit;

(C) a class action representative; or

(D) a governmental unit that is not a person.

(c) **INFORMATION REQUIRED.** The verified statement shall include:

(1) the pertinent facts and circumstances concerning:

(A) with respect to a group or committee, other than a committee appointed under § 1102 or 1114 of the Code, the formation of the group or committee, including the name of each entity at whose instance the group or committee was formed or for whom the group or committee has agreed to act; or

(B) with respect to an entity, the employment of the entity, including the name of each creditor or equity security holder at whose instance the employment was arranged;

(2) if not disclosed under subdivision (c)(1), with respect to an entity, and with respect to each member of a group or committee:

(A) name and address;

(B) the nature and amount of each disclosable economic interest held in relation to the debtor as of the date the entity was employed or the group or committee was formed; and

(C) with respect to each member of a group or committee that claims to represent any entity in addition to the members of the group or committee, other than a committee appointed under § 1102 or 1114 of the Code, the date of acquisition by quarter and year of each disclosable economic interest, unless acquired more than one year before the petition was filed;

(3) if not disclosed under subdivision (c)(1) or (c)(2), with respect to each creditor or equity security holder represented by an entity, group, or committee, other than a committee appointed under § 1102 or 1114 of the Code:

(A) name and address; and

(B) the nature and amount of each disclosable economic interest held in relation to the debtor as of the date of the statement; and

(4) a copy of the instrument, if any, authorizing the entity, group, or committee to act on behalf of creditors or equity security holders.

(d) **SUPPLEMENTAL STATEMENTS.** If any fact disclosed in its most recently filed statement has changed materially, an entity, group, or committee shall file a verified supplemental statement whenever it takes a position before the court or solicits votes on the confirmation of a plan. The supplemental statement shall set forth the material changes in the facts required by subdivision (c) to be disclosed.

(e) **DETERMINATION OF FAILURE TO COMPLY; SANCTIONS.**

> (1) On motion of any party in interest, or on its own motion, the court may determine whether there has been a failure to comply with any provision of this rule.
>
> (2) If the court finds such a failure to comply, it may:
>
> > (A) refuse to permit the entity, group, or committee to be heard or to intervene in the case;
> >
> > (B) hold invalid any authority, acceptance, rejection, or objection given, procured, or received by the entity, group, or committee; or
> >
> > (C) grant other appropriate relief.

Where Do We Go From Here?

Although the Rules Committee has unanimously recommended that the most recent changes be approved, the recommended revisions to Rule 2019 must be approved by the Standing Committee on Rules of Practice and Procedure, the Judicial Conference, and the U.S. Supreme Court before they become effective. Assuming that the recommendation is ultimately approved, the changes are unquestionably a welcome development for hedge funds and other distressed investors, which closely guard trading information, such as the acquisition price of stock or claims, disclosure of which to the public might compromise the funds' ability to maximize investment returns. Hedge funds and other distressed investors have made and continue to make enormous investments in all levels of the capital structures of distressed companies. As a

consequence, these funds and investors have regularly assumed prominent roles in major chapter 11 cases. As amended, Rule 2019 would preserve this dynamic.

In re Northwest Airlines Corp., 363 B.R. 701 (Bankr. S.D.N.Y. 2007).

In re Scotia Development LLC, Case No. 07-20027-C-11 (Bankr. S.D. Tex. Apr. 18, 2007).

In re Washington Mutual, Inc., 419 B.R. 271 (Bankr. D. Del. 2009).

In re Premier Int'l Holdings, Inc., 423 B.R. 58 (Bankr. D. Del. 2010).

In re Accuride Corp., Case No. 09-13449 (Bankr. D. Del. Jan. 20, 2010).

In re Philadelphia Newspapers, LLC, 422 B.R. 553 (Bankr. E.D. Pa. 2010).