BUSINESS LAW SECTION
INSOLVENCY LAW COMMITTEE]
THE STATE BAR OF CALIFORNIA
180 Howard Street
San Francisco, CA 94105-1639

09-BK-114

February 12, 2010

Peter G. McCabe
Secretary of the Committee on Rules of Practice and Procedure
Administrative Office of the United States Courts
Thurgood Marshall Federal Judiciary Building
Washington, D.C. 20544

Re: Proposed amendments to Bankruptcy Rules (Aug. 12, 2009)

Dear Secretary McCabe:

We write on behalf of the Insolvency Law Committee (the "ILC") of the Business Law Section of the State Bar of California (the "California Bar") regarding certain proposed amendments to the Federal Rules of Bankruptcy Procedure (the "Rules" or "Proposed Rules") submitted for public comment under cover of a memorandum dated August 12, 2009, from the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States (the "Rules Committee"). Specifically, we write regarding Proposed Rules 2019, 3001, 3002.1, and 4004.[1]

The ILC applauds the Rules Committee for the work it is doing to revise the Rules. We appreciate the opportunity to comment on the Proposed Rules.

I. The Insolvency Law Committee.

The ILC was established by the Business Law Section of the California Bar to assist in carrying out its duties. The Business Law Section is a group consisting of some 8,800 licensed attorneys. Sections of the California Bar are established under the Rules of the California Bar to serve the profession, the public, and the legal system by helping their members maintain expertise in various fields of law and expanding their professional contacts.. (*See* Rules of the California Bar, Title 3, Division 2, Chapter 1.) Subject to and in accordance with the review and approval procedures adopted by the California Bar's Board of Governors, the Business Law Section and its committees, including the ILC, provide comments and recommendations on legislation and rules, and also offer their own proposals, at the state, federal and administrative levels Other Sections of the California Bar engage in similar activities.

[1] The members of the ILC who drafted this comment letter are Peter Califano of Cooper, White & Cooper, LLP, Robert G. Harris of Binder & Malter, LLP, and Neil W. Bason of Duane Morris, LLP.

The Business Law Section is administered by an Executive Committee of 16 members, which reviews and approves all proposed legislation and legislative and regulatory comments. The Section also has 13 standing committees and other ad hoc committees from time to time, many of which initiate such participation in the legislative and regulatory process under the umbrella of the Section. The approximately 200 members of these committees all volunteer their time and energy to the activities of the Sections and are expert in and interested in the area of law covered by the committee. Often, members are leaders in their field. The members come from solo or small firms, large firms, in house corporate counsel, law school faculties and legal departments of government agencies. Committee members must have five years of legal experience before they are eligible to serve on those committees. The members of the Executive Committee have all served on at least one standing committee, in most cases as Chair of co-Chair of it.

II. Rule 2019.

The ILC opposes adoption of Proposed Rule 2019 as currently drafted because (1) it purports to authorize sanctions and determinations that go beyond any apparent constitutional, statutory or inherent authority of the bankruptcy court; (2) it requires an apparently excessive and unworkable volume of disclosure; (3) read literally, it would require virtually any creditor or interest holder to file a Rule 2019 statement or risk sanctions; and (4) the official Rules Committee Note offers no explanation why official committees are the only entities as to which the bankruptcy court has no discretion to order disclosures. Some of these problems are also true of the current version of Rule 2019 and therefore the ILC encourages the Rules Committee to propose alternative amendments.

(A) Current Rule 2019. Any indenture trustee and any entity or committee – other than an official committee – representing "more than one creditor or equity security holder" (a "Represented Party") must make a number of disclosures in a "verified statement" under current Rule 2019, in a chapter 9 or 11 case.

(B) Proposed Rule 2019. The Rules Committee has recommended a much broader scope for Proposed Rule 2019, requiring that a statement be filed not just by any ad hoc committee, indenture trustee or other representative but also by (a) any "group," if such group "consists of or represents more than one creditor or equity security holder," and (b) any other entity who "seeks or opposes the granting of relief," if the bankruptcy court so orders. *See* Proposed Rule 2019(b). The ILC opposes adoption of Proposed Rule 2019 as presently drafted for the following reasons.[2]

[2] The ILC takes no position on a separate issue that has generated considerable recent controversy. Some courts have applied current Rule 2019 to require groups of hedge funds to disclose the amount paid by them for claims or equity interests in the debtor, on the basis that those hedge funds have been acting in concert as an ad hoc committee. *See, e.g., In re Northwest Airlines Corp.*, 363 B.R. 701 (Bankr S.D.N.Y. 2007), *on further proceedings*, 363 B.R. 704 (Bankr. S.D.N.Y. 2007) (denying motion to seal Rule 2019 information). The Rules Committee has opted, in Proposed Rule 2019, to leave disclosure of the "amount paid" for claims or interests to the discretion of individual

(1) **Purported authority to hear non-bankruptcy disputes and impose sanctions.** Proposed Rule 2019(e)(1) purports to grant the bankruptcy court authority to determine not only a violation of Rule 2019 itself but also whether there has been "any failure to comply with **any other applicable law** regulating the activities and personnel of **any** entity, group, committee, or indenture trustee" or "**any impropriety** in connection with "any solicitation."[3] (Emphasis added.) Proposed Rule 2019(e)(3) purports to authorize the court to (A) refuse to permit the offending entity, group etc. "**to be heard** or intervene in the case," (B) "**hold invalid any authority, acceptance, rejection, or objection** given, procured, or received by" such persons, or (C) "grant other appropriate relief" (emphasis added).

The current version of Rule 2019 includes very similar language, so there is precedent for these provisions of Proposed Rule 2019. Nevertheless, the ILC questions whether a procedural rule can constitutionally authorize an Article I bankruptcy court to determine violations of all "other applicable law" (presumably including non-core matters, securities law violations, etc.) or to impose what appear to include not just coercive but punitive sanctions. *See also* 28 U.S.C.A. § 2075 (rules "shall not abridge, enlarge, or modify any substantive right"). It is also unclear whether the disclosures under Proposed Rule 2019 are intended to be broader than regular discovery or subject to the usual rules regarding relevance and protection of secrets and confidences etc. (*see, e.g.*, 11 U.S.C. § 107(b) and Rule 9019).

The ILC recognizes that it may be possible to work around these problem by interpreting Rule 2019 narrowly or, as to jurisdictional problems, by using tools such as abstention, remand, or withdrawal of the reference from the federal district court to the bankruptcy court. But such solutions are likely to entail considerable litigation and expense. The ILC recommends that Rule 2019 be amended so as not to purport to grant such sweeping powers to determine non-bankruptcy issues. Alternatively, the ILC recommends that the official Rules Committee Note be amended to provide further guidance as to the limits of Rule 2019 and what bankruptcy goals are sought to be accomplished.

(2) **Apparently unworkable volume of disclosure.** Proposed Rule 2019(a) and (c) require disclosure of information about "each member" of the group and each "disclosable economic interest." Proposed 2019(d) requires "monthly" supplements. These requirements seem burdensome if not unworkable for large groups or securities held in street name. In addition, for an ad hoc "group" that has no governing documents it is unclear whether each member would have an obligation to file a Rule 2019 statement. The ILC recommends that Proposed Rule 2019 be revised to address these issues.

(3) **Who must file 2019 statements?** Proposed Rule 2019(b) requires "every entity, **group**, or [unofficial] committee that **consists of** or represents more than one

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bankruptcy judges. *See* Proposed Rule 2019(c)(2)(B) and (3)(B). The ILC's various constituencies may have divergent interests on this issue and therefore, as noted above, the ILC takes no position on it at this time.

[3] It is unclear whether the "solicitation" referred to in both current and proposed Rule 2019 refers to a solicitation of the purchase or sale of a claim, or of votes on a proposed plan, or perhaps other things as well, such as joinder in a motion.

creditor or equity security holder" (in a chapter 9 or 11 case) to disclose various matters pertaining to any "disclosable economic interest." (Emphasis added.) Proposed Rule 2019(a) defines a "disclosable economic interest" to include *inter alia* any derivative instrument, claim, 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." (Emphasis added.)

It is hard to know what limits apply to the above-quoted language. Arguably almost every creditor is part of some "group" (*e.g.*, general unsecured creditors), and arguably by definition any claim (or other "right or derivative right") grants the holder an "economic interest" that is inevitably "affected by" the "value, acquisition, or disposition" of "a" claim (either the holder's own claim, or claims held by others – *e.g.*, the disposition of claims affects voting dynamics). So arguably every creditor must file a 2019 statement — an absurd result that we believe illustrates the need for clarification of Proposed Rule 2019.

(4) Unexplained exclusion of official committees. Proposed Rule 2019 vests the bankruptcy court with discretion to require the disclosure of the "amount paid" for a claim or interest by any creditor or equity security holder represented by an entity, group or committee, "**other than a committee** appointed pursuant to §§ 1102 or 1114." Proposed Rule 2019(c)(3) (emphasis added). The ILC takes no position whether the exclusion of official committees is appropriate, but the ILC recommends that the Rules Committee either explain in the official Rules Committee Note why official committees are excluded or alternatively provide the bankruptcy court with discretion to require the same disclosures from members of official committees as all other entities.

III. Rule 3001.

Proposed Rule 3001 creates new information requirements for proofs of claim where the debtor is an individual involving either secured and unsecured creditors. However, failure to comply with these requirements results in the creditor being barred from "proving up" its claim unless the court determines that the failure was justified or harmless, and furthermore allows the court to award attorneys' fees and costs. This sanction is unnecessarily harsh and invites judicial oversight that is not required or desirable. The ILC believes that a better approach to enforce the new disclosure requirements is found in 11 U.S.C. § 502(d) – there a claim is disallowed until an avoidable transfer that the creditor has received is returned to the estate. In a similar manner, the creditor's claim should only be temporarily disallowed for failing to make the necessary disclosures, giving the creditor an opportunity to cure the deficiency before the claim is barred.

In addition, Proposed Rule 3001 requires the last credit card statement of individual debtors to be filed with the creditor's proof of claim. Since proofs of claim are filed in the public record, in order to address legitimate privacy concerns of the debtor, it is suggested that details of the transactional entries be redacted (similar to what is currently done with the debtor's social security number in the petition) or that the creditor provide a summary of the last statement with its proof of claim.

IV. Rule 3002.1.

Proposed Rule 3002.1 sets forth new and extensive information requirements in Chapter 13 cases regarding claims secured by an individual debtor's home. There is also a similar evidence bar and an ability to sanction the creditor, as provided in Proposed Rule 3001. The ILC suggests the same alternative approach in addressing enforcement as set forth above, regarding Proposed Rule 3001.

V. Rule 4004.

Proposed changes to Federal Rule of Bankruptcy Procedure 4004 would enhance the ability of creditors to extend the time to file a complaint objecting to a debtor's discharge through (a) a straightforward procedural change to the method of requesting the extension[4], and (b) a substantive modification. The ILC has confirmed that the proposed amendment of Rule 4004 was drafted to address grounds for revocation of discharge beyond Bankruptcy Code section 727(d)(1) – that the discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge. The proposed comment of the Rules Committee note, however, seems to refer only to section 727(d)(1). The ILC respectfully submits that the comment should be amended to explain the full extent of the expansion of actionable grounds for revocation of discharge for the reasons set forth below. The comment provides as follows:

> . . . This amendment addresses the situation in which there is a gap between the expiration of the time for objecting to discharge and the entry of the discharge order. If, during that period, a party discovers facts that would provide grounds for revocation of discharge, it may not be able to seek revocation under § 727(d) of the Code because the facts would have been known prior to the granting of the discharge. In that situation, subdivision (b)(2) allows a party to file a motion for an extension of time to object to discharge based on those facts so long as they were not known to the party before expiration of the deadline for objecting.

The ILC supports the proposed Rule's referral to section 727(d) generally without specifying a sub-section as it will then include limited conduct in the gap period between the time to file a complaint under section 727(a) and entry of discharge that would, were it to occur after a discharge had entered, be grounds for revocation of discharge. Thus, a debtor's acquisition of property in the gap period that is knowingly and fraudulently not reported or not delivered or surrendered (11 U.S.C. section 727(d)(2)) will now form the basis for a motion to extend the time to seek denial of discharge (if the discharge hasn't yet been entered by the time the creditor discovers the conduct in question and seeks relief) or a complaint to revoke the

[4] The ILC has no opposition to the extent to which Rule 4004(a) is amended to allow a timely-filed motion to extend the time to object to discharge to be granted after notice and opportunity for hearing rather than requiring an actual, noticed hearing.

discharge (if the discharge has been entered by then). Similarly, failure in the gap period to obey a lawful order of the court or to answer a material question approved by the court or invoking the privilege against self-incrimination in response to material approved by the court after a grant of immunity will form the basis for a complaint under Rule 4004 as amended (11 U.S.C. section 727(d)(3)). Finally, a debtor who, in the gap period, makes a material misstatement in connection with or failure to produce records or information in connection with an audit by the United States Trustee under 28 U.S.C. section 586(f) will form the basis for a complaint under Rule 4004 as amended (11 U.S.C. section 727(d)(4)).

The ILC notes the authority and analysis set forth by Judge Wesley Steen in *In re Shankman*, 2009 WL 2855731 (Bankr. S.D. Tex. 2009) as to other conduct which the Bankruptcy Code and the concern expressed therein that the proposed change in Rule 4004 is not sufficiently broad. The ILC believes that the proposals in *In re Shakman* extend beyond the purview of the proposed harmonization of the Bankruptcy Rule 4004 and the Bankruptcy Code and cannot be addressed in the scope of a comment on revisions to the Rule. While many of the above issues might be capable of resolution by litigation, it would seem to be far more efficient to revise the Rules Committee comment to clarify the intent of the change. An explicit reference to sections 727(d)(1) through (d)(4) in the Rule itself would be an acceptable alternative.

Disclaimer: The positions expressed herein are only those of the ILC. They have not been adopted by the Business Law Section or its overall membership or by the California Bar's Board of Governors or its overall membership, and are not to be construed as representing the position of the State Bar of California. Membership in the ILC and the Business Law Section is voluntary and funding for its activities, including all legislative activities, is obtained entirely from voluntary sources.

We hope the foregoing is useful in your deliberations. Please do not hesitate to contact the undersigned at (510) 622-7514 if you would like to be in touch with a representative of the ILC versed in the matters covered by this letter and authorized to speak on its behalf. We will be happy to put you in touch with such person.

Respectfully,

Elizabeth Berke-Dreyfuss
Co-Chair

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