BUSINESS BANKRUPTCY COMMITTEE
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REPORT OF THE BUSINESS BANKRUPTCY COMMITTEE SPECIAL TASK FORCE ON BANKRUPTCY RULE 2019

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Introduction

The Judicial Conference of the United States Advisory Committee on Bankruptcy Rules has asked the Business Bankruptcy Committee to comment on a proposal to repeal or amend Bankruptcy Rule 2019. The Chair of the Business Bankruptcy Committee established the Special Task Force on Bankruptcy Rule 2019 (the "Task Force") to review and provide comments, suggestions and recommendations on the proposal to repeal or amend Bankruptcy Rule 2019. The Task Force was comprised of the Chairs or Vice-Chairs of the following Subcommittees: (1) Rules Subcommittee, (2) Avoiding Powers Subcommittee; (3) Trust Indentures; (4) Corporate Governance, (5) Bankruptcy Crimes, Fraud and Abuses of Bankruptcy Process, (6) E-Newsletter; (7) Claims Trading, (8) Secured Creditors; (9) Legislation; (10) Current Developments; (11) Partnerships and Limited Liability Entities in Bankruptcy; and (12) Legislation.

The following is the report of the Task Force **THIS REPORT DOES NOT REPRESENT THE OFFICIAL POLICY OR POSITION OF THE AMERICAN BAR ASSOCIATION.**

Background

A History of Rule 2019

Rule 2019 provides, in relevant part, as follows:

> (a) Data Required. In a chapter 9 municipality or chapter 11 reorganization case. .every entity or committee representing more than one creditor or equity security holder. shall file a verified statement setting forth
>
> (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) .. in the case of a committee, the name or names of the entity or entities at whose instance...the employment was arranged or the committee was organized and agreed to act, and

> (4) .. the amounts of claims or interests owned by the entity, the member of the committee or the indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof

Fed. R Bankr. P. 2019 (a).

Bankruptcy Rule 2019 (and its predecessor rules) has existed for nearly 70 years. It is a disclosure rule designed to facilitate open and fair negotiations in reorganization proceedings. Bankruptcy Rule 2019 is derived from Rule 10-211 of the former Chapter X of the Bankruptcy Act. Rule 10-211 was enacted following the SEC Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1937) (the "SEC Report").

The SEC Report examined perceived abuses by unofficial committees in corporate reorganizations The SEC Report examined the then common practice of the formation of "protective committees," which were formed to protect the interests of security holders, but in practice were often dominated by insiders, financial advisors or other parties with potential or actual conflicts. The SEC Report noted that other security holders may be misled by such groups' participation in a reorganization by the mistaken belief their cause would be well served by the committees *In re Northwest Airlines,* 363 B.R. 701 at n.6 (S.D N.Y 2007)(quoting SEC Report at 880) As such, the SEC Report recommended "that persons who represent more than 12 stockholders . . be required to file with the court a sworn statement containing the information now required by Rule 2019." *Northwest*, 363 B R. at 704. Bankruptcy Rule 2019 is substantially the same as its predecessor rule under Chapter X of the Bankruptcy Act

B The Northwest and Scotia Decisions

Courts in the past often have not required strict compliance with the disclosure requirements of Bankruptcy Rule 2019 However, as hedge funds and other distressed security investors began to participate more frequently in reorganization proceedings, parties in interest began to focus more on Bankruptcy Rule 2019 and whether Bankruptcy Rule 2019 was being followed, because these parties are more likely to form unofficial committees and actively trade debt prior to and after the commencement of a Chapter 11 case

A dispute over the scope of the disclosure required by *ad hoc* committees recently erupted in the *Northwest* case. In *Northwest*, an *ad hoc* committee of equity security holders entered an appearance in the case and filed a Bankruptcy Rule 2019 disclosure statement that did not include the amounts of claims or interests owned by members of the committee, the times when acquired, the amounts paid for the interests, and any sale or disposition of the interests. *Northwest*, 363 B R. at 701. The Debtors filed a motion seeking to compel the *ad hoc* committee to disclose this information and the *ad hoc* committee opposed its disclosure. The *ad hoc* committee contended that this information was confidential proprietary information and that disclosing it would be highly

prejudicial. The Court found that Bankruptcy Rule 2019 required the members of the *ad hoc* committee to disclose this information. In support of its ruling, the Court noted that *ad hoc* committees play an important part in the reorganization process and by appearing as a committee, the members purport to speak for a group and ask the Court and other parties to give their positions a level of credibility that is appropriate for a large group. *Id.* at 703. In a subsequent decision, the court denied the committee's request to file the disclosures under seal *In re Northwest Airlines Corp*, 363 B.R. 704, 706 (Bankr. S.D N.Y 2007).

This issue also surfaced in *In re Scotia Development, LLC*, Case No. 07-20027 (Bkrtcy. S.D. Tex). Many of the same arguments (both for and against disclosure) were raised in *Scotia*. However, the Court never reached the merits of how Bankruptcy Rule 2019 should be applied. In *Scotia*, a group of noteholders claimed that they were not subject to the disclosure requirements of Bankruptcy Rule 2019 because they were just a group of different noteholders represented by the same law firm The Court agreed It found that the *ad hoc* group of noteholders appearing before it was not a committee but rather "just one law firm representing a bunch of creditors " Tr. of Hearing, at 5 The *Scotia* Court went on to remind counsel for such creditors that counsel has an ethical obligation to disclose conflicts The *Scotia* Court did not elaborate on the basis for its determination or publish an opinion on the matter.

Subsequent to the *Northwest* and *Scotia* decisions, issues involving Bankruptcy Rule 2019 have been raised in reorganization proceedings with greater frequency.

C The Proposal to Repeal or Amend Bankruptcy Rule 2019

The Loan Syndications and Trading Association ("LSTA") and the Securities Industry and Financial Markets Association ("SIFMA") are currently seeking to have Bankruptcy Rule 2019 repealed. The primary issue which they have raised as a concern is the requirement that *ad hoc* committee members in Chapter 11 cases disclose the purchase price and purchase date of distressed securities that they hold. LSTA and SIFMA contend this type of information, *i e.*, the trade date and purchase price of distressed securities, is proprietary information confidential to the purchaser and that requiring the disclosure of the purchase price and trade date will have a chilling effect on the willingness of distressed security investors to (a) trade in such distressed securities in the future, and (b) participate in the bankruptcy process. They further contend that the chilling effect on distressed security investors will result in more expense and time for Bankruptcy Courts because, without ad hoc committees, the Courts will be clogged with duplicative pleadings filed by similarly situated claimholders.

Comments, Suggestions and Recommendations

The Task Force has reviewed numerous materials regarding the issues associated with the proposed repeal of Bankruptcy Rule 2019 including the November 30, 2007 letter by LSTA and SIFMA, relevant case law on the subject, law review articles and other information addressing these issues. Upon careful consideration, the Task Force believes

that Bankruptcy Rule 2019 should not be repealed. The Task Force believes that disclosure of certain minimum information is necessary and important for understanding the motivations of parties in negotiations in the reorganization process.[1]

The Task Force believes that several modifications should be considered to clarify the language contained in Bankruptcy Rule 2019 and to help achieve the main purpose of Bankruptcy Rule 2019, namely transparency

1. Bankruptcy Rule 2019 should be amended to apply uniformly to *ad hoc* committees, official committees, and all other groups of claim or equity holders who band together through shared professionals to advance common positions and strategies.

2. Bankruptcy Rule 2019 should be amended to include a provision giving the Bankruptcy Court authority, upon the showing of good cause by a party in interest, to enter an order waiving the requirement of disclosure of the purchase price or trade date information or other information that a claim or equity holder believes is confidential proprietary information. The burden to establish good cause should be on the party in interest seeking relief from the disclosure requirements of Bankruptcy Rule 2019. In determining whether good cause exists, the Bankruptcy Court should take into consideration, among other things, whether the information sought to be withheld is a confidential trade secret that would more properly be filed under seal and whether the group of claim or equity holders at issue represents a material portion of the holders of such claims or equity interests

3. Bankruptcy Rule 2019(a)(4) should be amended to provide more clarity as to when supplemental disclosure is required. Bankruptcy Rule 2019(a)(4) should not be triggered every time that a trade is made. There should be a cumulative trading threshold before Bankruptcy Rule 2019(a)(4) is triggered. Additionally, it is advisable to clarify in the Rule the timing for when supplemental disclosures are required.

The Task Force believes that the disclosure requirements of Bankruptcy Rule 2019 are important to maintaining the transparency of the bankruptcy process. The proposed amendments will help further the transparency and openness that is necessary to facilitate fair and orderly negotiations in reorganization proceedings

[1] The Task Force understands that the National Bankruptcy Conference is also examining Bankruptcy Rule 2019 Specifically, the National Bankruptcy Conference is focusing its review of Bankruptcy Rule 2019 on the issue of cross-voting, *i e* , one holder holds debts or securities in different parts of the capital structure and votes against the remaining holders' interests in one class to further its interest in another class

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