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09-BK-028

February 3, 2010

Mr. Peter G. McCabe
Secretary
Committee on Rules of Practice
and Procedure of the Judicial
Conference of the United States
Administrative Office of the United States Courts
Thurgood Marshall Federal Judiciary Building
One Columbus Circle, N.E.
Washington, D.C. 20544

Re: Proposed Amendment of Federal Rule of Bankruptcy Procedure 2019

Dear Mr. McCabe:

Richards Kibbe & Orbe LLP ("RK&O") submits the following comments and suggested modifications to the proposed amendment to Federal Rule of Bankruptcy Procedure 2019 ("Proposed Rule 2019").

Executive Summary

RK&O supports the vast majority of Proposed Rule 2019 -- the full disclosure of all Claims (as defined below) held by informal or *ad hoc* committee members enables judges, debtors and other parties in interest to readily identify the economic interests of parties actively participating in a bankruptcy proceeding. In this respect, Proposed Rule 2019 responds to the increasingly complex world we live in and represents a positive and necessary development in

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modern bankruptcy proceedings. We believe that the efforts of your Committee will be appreciated by all participants in those proceedings.

However, RK&O respectfully disagrees with two details of Proposed Rule 2019 -- disclosure of (i) "the amount paid for" a Claim, and (ii) the "date" when the Claim was acquired. We believe that Proposed Rule 2019 will function as intended without requiring disclosure of this information, and we believe that there are good legal and practical reasons not to require such disclosure.

First, we believe Proposed Rule 2019's requirement to disclose the "date" a Claim is purchased is tantamount to a requiring disclosure of the amount paid for a Claim. A requirement to disclose the "date" of purchase is a *de facto* requirement to disclose "price" because price can be determined from date of purchase due to the liquidity of the modern claims market. Accordingly, we disagree with a requirement to disclose the date a Claim is purchased on the same grounds we disagree with price disclosure because "date of purchase" is a proxy for price.

Second, although Proposed Rule 2019 does not require specific disclosure of price unless directed by a court, we believe the opportunity to compel price disclosure will invite the same litigation now being waged by parties that seek to use current Rule 2019 merely to gain negotiating leverage in a bankruptcy proceeding.

Any purported benefit obtained by requiring the disclosure of purchase price, directly or indirectly through "date of purchase", would be far outweighed by the potential mis-use of pricing information to subvert fundamental legal and equitable principles of bankruptcy law. In many cases, disclosure of purchase price – which is proprietary and confidential to the purchaser – would substantially affect negotiating positions of parties in ways that are inimical to two

bedrock principals of bankruptcy law: (i) the price paid for a Claim is irrelevant to determining how the holder of the claim should be treated in the bankruptcy proceeding, and (ii) similarly situated creditors should receive equal treatment when seeking to enforce their rights.

We submit that Proposed Rule 2019 will function well (and as intended) by providing courts, debtors and parties-in-interest with a complete picture of the financial interests of members of *ad hoc* committees without inadvertently promoting the erosion of fundamental principals of bankruptcy law or limiting the active and beneficial participation of *ad hoc* committees in bankruptcy proceeding that would occur if parties must disclose the price or date of a Claim purchase or sale. Price and date disclosure may unintentionally (i) dissuade stakeholders from participating in the bankruptcy process, (ii) create pricing uncertainty and thereby threaten liquidity in the Claims market, (iii) alter the balance of negotiations between debtors and creditors and among groups of creditors, (iv) further divide creditor constituencies into two camps (original holders and secondary purchasers), and (iv) otherwise disrupt and distort key components of the modern bankruptcy process.

More specifically, mandatory disclosure of pricing information by *ad hoc* committee members may dissuade the formation of such committees, which would have unfortunate repercussions for modern bankruptcy proceedings. *Ad hoc* committees allow similarly situated parties to advance common interests in an efficient and cost-effective manner. The participation of a*d hoc* committees in bankruptcy cases increases the likelihood that creditors will participate in critical DIP, exit financing and related rights offerings. Finally, *ad hoc* committees allow debtors to negotiate key issues and promote their reorganization process most efficiently and successfully, which in turn helps debtors preserve and maximize value for the benefit of all parties.

Limiting participation in useful *ad hoc* committees may force debtors to (i) negotiate with individual creditors and litigate common issues of law on multiple occasions, (ii) work even harder to attract necessary financing, and (iii) postpone successful reorganization plans due to the inability of debtors to efficiently communicate and negotiate with multiple parties with common issues and claims.

Accordingly, as more fully set forth below, RK&O submits that the Committee should modify Proposed Rule 2019 to eliminate any requirement for direct or indirect price disclosure, including the requirement to disclose the date a Claim was purchased or sold.

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Background of RK&O

For two decades, RK&O has represented buyers and sellers of stressed and distressed financial instruments, including but not limited to bank debt, bonds, notes and trade claims and related derivative instruments, collectively "Claims." RK&O also represents holders of Claims in restructurings and bankruptcy proceedings.

Relying on one of the most fundamental tenants of bankruptcy law and equity – that similarly situated creditors must receive equal treatment – holders of Claims have worked to create informal or *ad hoc* groups or committees to more efficiently describe, enforce and protect their individual and common rights in bankruptcy proceedings. The firm also represents such groups and committees of claim holders.

In the course of its practice, RK&O has counseled clients on the disclosures required by the current Rule 2019. RK&O expects to continue to counsel clients and prepare disclosures required by Proposed Rule 2019. In all of these capacities, RK&O submits this letter in advance

of its testimony before the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States.

1. EVOLUTION AND BENEFITS OF LIQUIDITY IN THE CLAIMS MARKET

Substantial changes in the financial system and the fixed-income markets have occurred over the past two decades. Those changes have been supported and influenced by the positive, powerful effects of the modernization of the bankruptcy process -- the innovations ushered in by the Bankruptcy Code and the Bankruptcy Rules. Those innovations have helped transform the financial system and the fixed income markets in ways that are both obvious and subtle.

Twenty years ago, banks operated under a "relationship banking" model -- they sought to develop borrowers as long-term customers and to originate loans primarily to borrowers with established banking relationships. Banks typically had large workout and restructuring departments, and their business models accepted that, as a cost of doing business, the bank would be actively involved in the bankruptcy process for a given number of borrowers.

However, the corporate "relationship banking" model declined as its shortcomings became clear in the early 1990's. Banks with strong borrower relationships tended, naturally, to have portfolios of loans that were "over-concentrated" in geographical regions or specific industry sectors. Banks that applied the relationship banking model were at greater risk for regional economic downturns or industry-specific economic cycles.

To spread borrower credit risk and to diversify their portfolios of loans, banks could decide either to (i) open new regional branches in different parts of the country and develop lending expertise and focus in new industries, or (ii) start to trade their inventories of loans with other (similarly situated) banks. By and large, banks chose to trade loan inventories with other

banks. The decline of the relationship banking model and the ascendancy of the trading model is shown most clearly in the evolution of "transfer provisions" in credit agreements. Since 1990, loan transfer provisions have become less restrictive (i.e., increasingly permissive), as definitions of an "eligible assignee" have expanded from the rigid test of "banks and insurance companies only" to include non-traditional lenders (including, in many cases, entities that are merely "accredited investors" under the securities laws). At the same time, the "minimum transfer" (or lot size) for permitted loan transfers under specific credit agreements has declined dramatically from as much as $50,000,000 to as little as $1,000,000.

The robust and liquid secondary market for loans in the United States is a recent development. The market provides borrowers and lenders liquidity and flexibility in the issuance, management, and, when necessary, restructuring of corporate debt. The development of the secondary market has freed more capital to flow where it is needed and permitted investors to respond nimbly to changes in their own circumstances or changes in market conditions. The investor base also has been enlarged, bringing additional capital into the market.

2. DEBTORS AND THEIR CREDITORS HAVE LONG BENEFITTED FROM DISTRESSED INVESTMENT

A more liquid secondary loan market, and the increasing transactional certainty introduced by the Bankruptcy Code led naturally to the growth of the Claims market. The ability to trade distressed assets in particular is an important contributor to liquidity throughout the market. It provides a liquid "exit" for banks and other lenders that may have less tolerance for risk, enabling them to reallocate their capital and shift the risk of non-payment to others more willing and able to take it. Loans are originated and traded at par more freely and inexpensively because of this liquid "exit." Purchasers of distressed debt, including hedge funds and

investment managers with longer investment horizons and focused expertise in restructuring debt obligations, are specialists in analyzing these complex and more risky investments. Active competition among such purchasers raises the bid for distressed debt, and originating banks and lenders and other upstream investors are the beneficiaries – those investors can "wash their hands" of a bad investment at a fair price and redeploy the sale proceeds.

The liquidity of the Claims trading market has benefited restructurings in other ways as well. The claims trading market has played a strong role in transferring claims from those investors that do not have the wherewithal and desire to enforce all of their rights and remedies to investors that have both the incentive and the resources to fight for a fair recovery for their claims. The ability of trade creditors to sell their claims has also allowed a debtor's vendors to mitigate their financial problems caused by a debtor's financial distress by providing them with an opportunity to receive at least a portion of their claims sooner and to redeploy such sale proceeds into their businesses. Thus, liquidity of trade claims (and the ability of a trade vendor to quickly sell its claims at a competitive price) can help create a firewall around the bankruptcy of a key company and stop the contagion of financial failure from spreading to its closely-linked suppliers and vendors.

The participation of sophisticated distressed investors in bankruptcy proceedings has also greatly increased the probability of those companies exiting bankruptcy and successfully reorganizing. When the market for Claims is liquid, debtors that have improved their long-term prospects during their bankruptcy cases will see the prices of Claims rise in response to the favorable news. Those higher prices will reflect increasing market confidence, which will help generate interest in exit financing, rights offerings and other such financial accommodations that lead to a successful reorganization—a fundamental purpose of the bankruptcy process.

Moreover, it is the very investors that are purchasing claims who will be more likely to participate in DIP financing and exit financing in order to provide the debtors with the necessary funds to operate in bankruptcy and to exit chapter 11. Moreover, these investors are also more likely to provide debtors with important assurances for a plan of reorganization by providing a commitment to purchase sufficient shares of the reorganized entity in order to confirm a plan of reorganization.

3. DISCLOSURE OF PRICING INFORMATION RUNS COUNTER TO FUNDAMENTAL BANKRUPTCY PRINCPLES

The price paid for Claims is irrelevant as a matter of law with respect to the treatment of that claim in the bankruptcy proceeding or the holder's legal status. Indeed, the law is well established that the price paid for a Claim cannot impact the holder's status and rather, it is largely the debtor's obligation that determines the rights of the holder.[1] For these same reasons, acquisition date is largely irrelevant when determining the legal rights related to such claim and the ability of the purchaser to enforce those rights.

4. DISCLOSURE WILL ALTER THE DISTRESSED INVESTMENT LANDSCAPE WHICH COULD HAVE SERIOUS UNINTENDED REPERCUSSIONS

The price paid for Claims and the date of acquisition are closely guarded by distressed investors as proprietary and confidential information. Indeed, disclosure of this information is tantamount to disclosing a party's investment strategy – the very thing that allows it to operate

[1] Hon. Robert D. Drain, *Are Bankruptcy Claims Subject to the Federal Securities Laws*, 10 Am Bankr. Inst. L. Rev. 569, 575 n.31 (2002) ("[A] discounted purchase price is irrelevant to the ability to enforce the claim in full."). *See also Stockholders' Protective Comm. for Moulded Prods., Inc. v. Barry (In re Moulded Prods., Inc.)*, 474 F.2d 220, 225 (8th Cir. 1973); *In re Pittsburgh Rys. Co.*, 159 F.2d 630, 632 (3d Cir. 1947); *In re Lorraine Castle Apartments Bldg. Corp.*, 149 F.2d 55, 57-58 (7th Cir. 1945); *Mokava Corp. v. Dolan*, 147 F.2d 340, 344-45 (2d Cir. 1945); *Standard Gas & Elec. Co. v. Deep Rock Oil Corp.*, 117 F.2d 615, 619 (10th Cir. 1941); *Texas Hotel Sec. Corp. v. Waco Dev. Co.*, 87 F.2d 395, 399 (5th Cir. 1937); *Sec. First Nat'l Bank of Los Angeles v. Rindge*, 85 F.2d 557, 561 (9th Cir. 1936); *Fairfield Executive Assocs. v.. Hyperion Credit Capital Partners (In re Fairchild Executive Assocs.)*, 161 B.R. 595, 602 (D.N.J. 1993); *In re Automatic Equip. Mgf. Co.*, 106 F. Supp. 699, 705-06 (D. Neb. 1952); *In re V-I-D, Inc.*, 101 F. Supp. 71, 75 (N.D. Ind. 1951); *In re Util. Power & Light Corp.*, 29 F. Supp. 763, 770 (N.D. Ill. 1939); *In re Indiana Cent. Tel.*, 24 F. Supp. 342, 344 (D. Del. 1938); *In re Oaks Partners, Ltd.*, 141 B.R. 453, 460 (Bankr. N.D. Ga. 1992); *In re Executive Office Ctrs., Inc.*, 96 B.R. 642, 649-50 (Bankr. E.D. La. 1988); *In re W.T. Grant Co.*, 4 B.R. 53, 77 (Bankr. S.D.N.Y. 1980).

and exist. If forced to disclose this information, investors would have to choose whether to invest passively, not invest at all or invest actively, but disclose the very information that allows it to operate successfully to competitors. When viewed in this context, it is likely that parties will exit the Claims market and the market for Claims will suffer.

First, by reducing the number of distressed investors in the market, creditors that no longer desire to have financial exposure to a debtor will find fewer participants to sell their Claims. This will place downward pressure on purchase prices and limit the ability of sellers to make subsequent investments in other distressed or healthy companies – if the seller is a financial market participant – or simply meet their ongoing financial obligations – if the seller is a vendor or supplier to the debtor. Similarly, some sellers lack the authority or expertise to manage distressed investments for their investors. The prospect of selling into an inefficient market may prevent these parties from selling their Claims, which in turn could force investors to either take artificial losses or not deploy capital efficiently, neither of which would be a good outcome for the financial markets or investors.

Second, the threat that pricing information may influence recovery and settlement negotiations may cause distressed purchasers to question whether they will truly be able to assert the full face value of their claims. If distressed investors do not believe that they can assert the full face value of their claims they will be unlikely to purchase claims for their true value. This will depress the prices for Claims and create inefficient markets which, as described above, will frustrate sellers and not permit parties to deploy capital in an efficient manner.

The Rules Committee is aware of these serious and real concerns and previously decided that the material terms of a Claims trade should not be disclosed. For example, in 1991, when

amending Bankruptcy Rule 3001(e) -which mandates what information claim buyer's must disclose to a court following a transfer - the Rules Committee did not require buyers to disclose the price paid for a claim or the date the transfer took place. In fact, the amendment's purpose was to increase liquidity in the market for Claims that was frustrated by pricing disclosure. Andrew P. Logan III, Note. *Claims Trading: The Need For Further Amending Federal Rule of Bankruptcy Procedure 3001(e)(2)*, 2 Am. Bankr. Inst. L. Rev. 495, 500-01 (Winter 1994).

5. AD HOC COMMITTEES HAVE GREATLY BENEFITTED BANKRUPTCY PROCEEDINGS

    a. Ad Hoc Committees Allow Creditors With a Common Position to Join Together and Advance their Interests

Bankruptcy proceedings have greatly benefited from the participation of *ad hoc* committees. First, the formation of ad hoc committees allows creditors with smaller claims to join together to advance a common position in bankruptcy proceedings where it would not be economical for them to appear on their own in a bankruptcy case, given the cost versus the incremental benefit to such creditors.

Thus, ad hoc committees provide an opportunity for groups of similarly situated creditors such as bondholders, lenders, trade creditors, unions to pursue a common position. For example, in the VeraSun bankruptcy proceedings, a group of corn growers formed an ad hoc group in order to object to VeraSun's plan to accept or reject certain contracts on 10 days' notice to the corn growers. The ad hoc group continued to represent corn growers throughout the bankruptcy proceedings.

Lenders in a syndicated loan facility may also form *ad hoc* committees in situations where an agent has become ineffective or is limited by actual or potential conflicts, in order to press their concerns and views in bankruptcy proceedings. *See, e.g.*, Kurt F. Gwynne, *Intra-*

Committee Conflicts, Multiple Creditors' Committees, Altering Committee Membership and Other Alternatives for Ensuring Adequate Representation Under Section 1102 of the Bankruptcy Code, 14 Am. Bankr. Inst. L. Rev. 109, 122 (collecting cases). Similarly, bondholders with a passive or ineffective indenture trustee have found it invaluable to form an ad hoc group or committee and negotiate on behalf of such bondholders the key issues of the proceeding. *See id.*

Often, an *ad hoc* committee may be the only real party with an economic stake in the proceedings where there is no official committee of unsecured creditors or if the official committee has been rendered ineffective as a result of resignations by members of such official committee. Moreover, even in cases where an official committee has been established, a committee is often comprised of creditors holding claims at different levels of the capital structure and with differing claims against the debtors and therefore, may have inherent conflicts with a group that has varied economic interests which necessitates the need for separate representation. *See In re Microboard Processing, Inc.*, 95 B.R. 283, 285 (Bankr. D. Conn. 1989) (suggesting that conflicts between committee members are inherent and tolerable); Carl A. Eklund & Lynn W. Roberts, *The Problem with Creditors' Committees in Chapter 11: How to Manage the Inherent Conflicts Without a Loss of Functions*, 5 Am. Bankr. Inst. L. Rev. 129, 129-30 (1997) (commenting that there are inherent conflicts between committee members).

b. Ad Hoc Committees Increase Efficiency in Bankruptcy Cases

In addition to providing an important voice to creditors that would not otherwise find it economical to appear on their own, *ad hoc* committees also greatly contribute to the efficiency of bankruptcy proceedings. A*d hoc* committees eliminate the need for each creditor to file its own duplicative pleading, by permitting creditors to act in concert to press legal rights. Group representation not only reduces the cost to group members, but also reduces the costs to all other

constituents in the proceedings, in particular the debtor and the official creditors' committee, who would be forced to review and respond to each individual pleading. *See, e.g.*, Michael DeMarino, *Comment: Rule 2019: The Debtor's New Weapon*, 42 J. Marshall L. Rev. 165, 179-184 (Fall 2008).

Eliminating duplicative pleadings also conserves judicial resources by allowing parties to resolve disputes globally rather than through numerous separate, yet similar contested matters. These efficiencies generated by *ad hoc* committees inure to the benefit of all creditors in the form of reduced administrative expenses, quicker and more streamlined proceedings and ultimately, additional value available to be distributed to all creditors, not just those that are part of an *ad hoc* committee.

Ad hoc committees also increase efficiency in bankruptcy proceedings by providing debtors and other constituents with a common "address" to direct inquiries and negotiate critical business and legal issues. Absent *ad hoc* committees, debtors and other parties in the bankruptcy proceedings would have to conduct negotiations with important creditors on an individual basis. Given that similarly situated creditors must (i) receive equal treatment and (ii) vote as a single class on reorganization plans, it is not only efficient but logical to provide debtors with the ability to work with creditors in the collective. *Ad hoc* committees therefore represent a natural product of these legal principals and allow parties that must ultimately speak as a collective to actually do so when it matters most – negotiating key issues related to the reorganization with debtors, creditors' committees and other key creditor groups. Without *ad hoc* committees, it would be incredibly difficult for debtors to negotiate critical issues in their reorganization process and formulate a reorganization plan that is confirmable. Delays caused by such inefficiencies would be harmful for all parties-in-interest.

c. Ad Hoc Committees Promote Fairness in Bankruptcy Cases

Finally, *ad hoc* committees provide an important counterweight to debtors and other constituents who could otherwise take advantage of the disparate holdings of small creditors who do not have the economic wherewithal and/or incentive to be actively involved in bankruptcy proceedings. These creditors may face the real prospect of having a plan confirmed that is not in the best interests of such individual creditors and does not fairly take into account all of such creditors' legal rights and remedies. By forming an *ad hoc* committee sizeable enough to attract attention from debtors, creditors committees and other important constituents, creditors with disparate holdings can defeat such attempts and force these parties to confront the legitimate concerns and rights of a collective, similarly-situated, group.

6. TO THE EXTENT INVESTORS AVOID PARTICIPATING IN AD HOC GROUPS, BANKRUPTCIES WILL BE NEGATIVELY IMPACTED

If, for the reasons described above, distressed investors either retreat from (i) the distressed market in a significant manner or (ii) actively participating in bankruptcies, the benefits and efficiencies brought about by *ad hoc* committees will markedly decrease. If creditors are reluctant to form groups because they do not wish to disclose pricing information, small stakeholders are not likely to have a voice in bankruptcy cases as it is too cost prohibitive and inefficient to act individually. Individual creditors may therefore find themselves shut-out of the bankruptcy process if they cannot act in the stronger, more cost-effective manner offered by *ad hoc* committees.

Debtors (and their estates) are sure to suffer too. Artificially silencing parties active in the Claims market may also keep parties with the most experience and wherewithal from participating in the bankruptcy process. By keeping these sophisticated parties from actively

participating in the bankruptcy process, debtors jeopardize the continued input of parties that bring not only experience, but also capital to help debtors exit bankruptcy and finance future operations. Having these parties involved in the bankruptcy process surely inures to the benefit of all parties-in-interest.

Without *ad hoc* committees representing creditors with common interests, the process of negotiating key legal and business issues during a bankruptcy case will become bogged down as debtors will be forced to have discussions with key parties individually. Without *ad hoc* committees, filtering and distilling the opinions of similarly situated creditors into one voice that can speak for the collective in bankruptcy proceedings will be more difficult and such proceedings are bound to become bogged down. Given the tighter time constraints debtors now face in formulating plans, the inability to communicate efficiently is even more important.

Moreover, because recent amendments to the Bankruptcy Code favor pre-packaged and pre-negotiated plans, and because debtors put substantial efforts into negotiating reorganization plans pre-petition with *ad hoc* committees, it follows that in many instances (including the key negotiation of a plan support agreement) debtors will continue to work with and recognize *ad hoc* committees at the negotiating table post-petition.

Although official committees must act for the benefit of all creditors, statutory creditors' committees are comprised of a wide cross-section of creditors and it is difficult for them to adequately advocate a position on behalf of any one constituency.

Moreover, recoveries for all constituencies will suffer. Active investors not only invest in the purchase of Claims but also invest in the companies they believe will emerge from bankruptcy a stronger and more viable company. Absent a strong voice in the bankruptcy

proceedings, these creditors and investors will be less willing to invest their time, ingenuity and money. Distressed investors have figured prominently in many successful reorganizations. These investors rely on their knowledge, due diligence and ability to enforce their rights and remedies in determining whether to make continued investments. Without an efficient mechanism to be heard in the bankruptcy proceedings, these investors will be less willing to invest in DIP loans, exit financings or backstop rights offerings. As a result, there will be fewer successful reorganizations and recoveries for all constituencies will be harmed.

Conclusion

RK&O respectfully requests that Proposed Rule 2019 be revised such that the price paid for Claims and the date parties acquired such claims be removed from mandatory disclosure.

RICHARDS KIBBE & ORBE LLP