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GEORGETOWN UNIVERSITY LAW CENTER

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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:

I am an Associate Professor of Law at Georgetown University Law Center, where I teach courses in bankruptcy, secured credit, payment systems, structured finance, and contracts. In the fall of 2009, I was the Robert Zinman Resident Scholar at the American Bankruptcy Institute.

My scholarship has dealt extensively with the market in bankruptcy claims,[1] and it is because of this academic interest that I am writing to comment on the proposed amendment of Federal Rule of Bankruptcy Procedure 2019 (Proposed Rule 2019). I have no personal financial interest whatsoever, direct or indirect, in the proposed amendment.

The expanded disclosure requirements of Proposed Rule 2019 serve a legitimate purpose of ensuring that parties' economic interests in a reorganization are disclosed. The proposed disclosure requirements, however, go too far in providing for the disclosure of claims' purchase price and requiring the disclosure of claims' purchase date. There is almost no legal significance to either the price or the date on which a creditor purchased a claim, and requiring the disclosure of purchase price and date information would expose distressed debt investors' trading strategies and risks chilling the robust market that has developed in distressed debt. Disclosure of purchase price and date information is not necessary to ensure the integrity of the bankruptcy process, and requiring such disclosures is in effect a policy judgment on bankruptcy claims trading that is beyond the proper scope of judicial rulemaking.

[1] Adam J. Levitin, *Bankruptcy Markets: Making Sense of Claims Trading*, 4 BROOKLYN J. CORP., FIN. & COMM. L. 64 (forthcoming 2010), *available at* http://ssrn.com/abstract=1537488; Adam J. Levitin, *Finding* Nemo*: Rediscovering the Virtues of Negotiability in the Wake of* Enron, 2007 COLUM. BUS. L. REV. 83 (2007); *The Limits of* Enron*: Counterparty Risk in Bankruptcy Claims Trading*, 15 J. BANKR. L. & PRAC. 389 (2006).

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1. The Price and Date on Which a Claim Is Purchased Has No Inherent Legal Significance

There is almost no legal significance to either the price or the date on which a creditor purchased a claim, and none that would justify the disclosure requirements in Proposed Rule 2019. At most, the purchase price—just like many other facts—could be circumstantial evidence of grounds for designation of a creditor's vote under section 1126(e),[2] but this is hardly grounds for requiring disclosure by all entities representing more than one creditor or equity holder (including indenture trustees), as well as authorizing disclosure from other parties upon motion.[3]

Similarly, the only legal significance of a claim's purchase date is to determine the record holder for voting. Unless there is disagreement between a claim seller and purchaser regarding who holds the voting rights, however, the purchase date is not information that needs to be generally disclosed.

2. Disclosure of Claim Purchase Price and Date Would Chill Distressed Debt Investment

Requiring the disclosure of purchase price and date information would expose distressed debt investors' trading strategies and risks chilling the robust market that has developed in distressed debt. Distressed debt investors perceive the secrecy of their trading strategies as critical to their ability to invest in the bankruptcy market. Whether these concerns are in fact legitimate, I do not know, but they are widely expressed, and perception may well be sufficient. Purchase prices enable other distressed debt investors to discern trading strategies of competitors. Similarly, purchase dates can often be used as a proxy for purchase prices.

The disclosure of a purchase price (and purchase date as a price proxy) is akin to requiring a creditor to disclose its reserve price for settlement. If a creditor has purchased a claim for 40 cents on the dollar, the debtor will know that the creditor's willingness to settle the claim (if disputed) or accept a plan increases significantly once the creditor has recovered 40 percent of the face value of the claim. Similarly, other investors will be better able to perceive the claim holder's willingness to sell its claim or accept a plan (proposed by the debtor or others). Requiring purchase price and date disclosure is similar to requiring a poker player to show her cards before bidding.

To be sure, there is nothing that currently stops a party from making a motion for another party's claims' purchase price and date to be disclosed. Providing a formal mechanism for such a motion, however, legitimates such requests, and in so doing presents a danger of Rule 2019 being used for harassment litigation. Proposed Rule 2019 will likely be used as a sword to discourage distressed debt investor participation in reorganizations, rather than a shield to protect the integrity of the reorganization process.

3. Distressed Debt Investment Has Provided a Major Source of Liquidity for Distressed Companies and Reorganizations

In its proposed form Rule 2019 could have a chilling effect on the distressed debt market. The development of a robust market in distressed debt has been the single most important development in bankruptcy since the enactment of the 1978 Code. Whether the distressed debt market assists or hinders the reorganization process is a matter of considerable academic debate;

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[2] 11 U.S.C. § 1126(e).
[3] Proposed Rule 2019(b).

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there is little consensus on the matter.[4] There have been some high profile incidents of creditor misbehavior enabled by claims trading. On the other hand, the vast majority of claims trading is conducted fairly and legitimately. Most claims trading occurs out of view of the public and the courts; it is only the problem cases which receive attention. This situation has contributed to a sometimes unduly negative view of claims trading.

The existence of a robust market in bankruptcy claims provides liquidity that helps bankrupt firms obtain the financing necessary to reorganize. The existence of this market also helps distressed firms obtain the financing to avoid bankruptcy filings. The ability to easily sell or purchase a claim allows creditors with administrative, liquidity, or regulatory concerns to avoid dealing with bankruptcy proceedings, while enabling distressed debt investors with expertise in reorganization to become involved in bankruptcies. These investors are frequently a source for additional financing for the debtor in reorganization and upon exit.

4. Regulation of Claims Trading Markets Is a Policy Decision That Is Properly Reserved for the Regular Legislative Process, Not Rule-Making

Proposed Rule 2019 reasonably requires increased disclosures to ensure the integrity of the reorganization process. Material information—such as whether a party has an economic interest in a reorganization—should be disclosed, lest the court be misled. Requiring the disclosure of claims' purchase date and price, however, goes beyond ensuring the integrity of the reorganization process and becomes a regulation of the claims trading market. While there are legitimate concerns about how claims trading affects the fairness, efficiency, and efficacy of the reorganization process, a determination about whether and how to regulate the claims trading market is a policy judgment on bankruptcy claims trading that is beyond the proper scope of judicial rulemaking, and should instead be enacted through the regular legislative process.

To this end, if the Rules Committee believes that disclosure of purchase price and date are essential to ensuring the fairness of the reorganization process, the requirement should be more narrowly drafted, requiring only disclosure to the court and the United States Trustee, under seal, and not to other creditors or the debtor.

Sincerely,

/s/Adam J. Levitin

[4] *See* Levitin, *Bankruptcy Markets*, *supra* note 1, for a review of the policy arguments for and against claims trading.

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