O L S H A N
O L S H A N G R U N D M A N F R O M E R O S E N Z W E I G & W O L O S K Y L L P

Client Alert

Business Restructuring & Bankruptcy Department May 2011

Revised Bankruptcy Rule 2019:
New Disclosure Rules Approved

On April 26, 2011, the Supreme Court of the United States adopted an amendment to Rule 2019 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). The proposed amendments to Bankruptcy Rule 2019 expand public disclosure requirements and attempt to provide greater clarity to a rule that has been subject to much debate among both practitioners and courts, many of which interpreted the existing rule in different and conflicting ways.

Background

Bankruptcy Rule 2019 currently requires all entities and committees representing more than one creditor or equity security holder to disclose certain information about itself, its claims, the circumstances surrounding the formation of the entity or committee, the members of the committee, and information regarding the acquisition of the claims, including the amounts paid.

Over the last few years, with the increased roles and active participation of "*ad hoc*" or "informal committees" in bankruptcy cases, litigation has arisen regarding the true economic position of creditors acting in concert. *Ad hoc* groups have been applauded when they contribute to the orderly administration of a case, and vilified when they are seen as antagonistic or overly aggressive. In some cases, Bankruptcy Rule 2019 has become a weapon for parties trying to silence vocal creditors by forcing disclosure of trading prices and other sensitive trading information. The underlying premise for seeking to compel disclosure of proprietary trading information is that transparency, including a full understanding of the "true economic position" of creditors, is essential to the bankruptcy process (*i.e.*, did the creditor buy the debt for cents on the dollar? does the creditor have a derivative claim or hedging position which might render that creditor an "empty creditor" with goals differing from other creditors and the estate?).

The proliferation of litigation involving the scope and application of Bankruptcy Rule 2019 resulted in a series of contradictory bankruptcy court rulings, even within the same court. For a prior Olshan Alert on this issue, click here. Those decisions focused on two core issues: whether the creditors involved constituted an *ad hoc* committee, and whether they should disclose how much they paid for their respective holdings. These conflicting rulings, in turn, gave rise to proposed, clarifying revisions to Bankruptcy Rule 2019.

Revised Bankruptcy Rule 2019

A summary of the requirements of amended Bankruptcy Rule 2019 follows:

- Parties Subject to the Rule. In a chapter 9 or 11 bankruptcy case, every group or committee that consists of or represents multiple creditors or equity security holders that are acting in concert to advance their common interests is subject to the rule. Only those groups and committees that actually take a position before the bankruptcy court (*i.e.*, through filings

with the bankruptcy court) or solicit votes regarding the confirmation of a plan on behalf of another are required to comply with the rule.

- Parties Not Subject to the Rule. Excluded from compliance with revised Bankruptcy Rule 2019 are groups or committees composed entirely of affiliates or insiders of one another and, unless otherwise ordered by the bankruptcy court, indenture trustees, an agent for one or more entities under an agreement for the extension of credit, a class action representative, and certain governmental units. In addition, those groups and committees that do not actually take a position before the bankruptcy court nor solicit votes regarding the confirmation of a plan on behalf of another are not required to comply with the rule.
- What Must Be Disclosed. Parties subject to the rule must file with the bankruptcy court a verified statement that includes:
    - The pertinent facts and circumstances concerning (a) with respect to a group or committee (other than an official committee appointed under the Bankruptcy 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; and (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.
    - With respect to an entity and each member of a group or committee, the following must be disclosed:
        - the name and address of such parties,
        - the nature and amount of the "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
        - a copy of the instrument (if any) authorizing the entity, group or committee to act on behalf of creditors or equity security holders.
    - With respect to each member of a group or committee (other than an official committee appointed under the Bankruptcy Code), **the date of acquisition by quarter and year of each "disclosable economic interest"**, unless acquired more than one year before the bankruptcy petition was filed.
    - The defined term "disclosable economic interest" has been added to the amended rule to encompass **any economic interest that could affect the legal and strategic positions of creditors**. The term is defined to mean "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."
    - As originally drafted, the amendment required disclosure of the date when each disclosable economic interest was acquired and, if directed by the court, the amount paid for such disclosable economic interest. In response to opposition from various industry groups and distressed investors, **the amendment was revised to limit the disclosure to the quarter and year in which each disclosable economic interest was acquired**.

  - Although the proposed amendment does not require the disclosure of the price paid for a disclosable economic interest, the rule does not affect the right of any party to obtain information by means of discovery or as otherwise ordered by the bankruptcy court.

- Failure to Comply with Rule. Upon motion, or on its own motion, the bankruptcy court may refuse to permit the entity, group or committee to be heard or to intervene in the case, hold invalid any authority, acceptance, rejection, or objection given, procured, or received by the entity, group or committee, or grant other appropriate relief.

Conclusion

Creditors seeking to join forces to advance their common interests must understand the new disclosure requirements of Bankruptcy Rule 2019. Accordingly, prior to joining any such group or committee, creditors are advised to be informed regarding the scope of revised Bankruptcy Rule 2019 and to make an independent determination whether the benefits of such joint representation outweigh the harms of Bankruptcy Rule 2019 disclosure. With respect to the latter, two factors must be considered. First, although the proposed amendment does not require disclosure of the price paid for a disclosable economic interest nor the disclosure of the date on which such disclosable economic interest was acquired, the rule does require disclosure of the date of acquisition by quarter and year of each disclosable economic interest, unless acquired more than one year before the bankruptcy petition was filed. Creditors must make a determination whether such disclosure could lead to the dissemination of otherwise proprietary trading information. Creditors must also keep in mind that additional disclosure may be sought by parties-in-interest through discovery. Second, although it is undisputed that claim purchasers have a legal entitlement to seek a recovery of their claims based on the face amount thereof, such creditors must also be aware that public Bankruptcy Rule 2019 disclosure may provide an undue advantage to other parties negotiating with such creditors by providing parties with information relating to what amount such creditors may be willing to settle. Although impossible to quantify, creditors must also consider the potential for bias if profit margins are made public.

The proposed amendment to Bankruptcy Rule 2019 is scheduled to take effect on December 1, 2011, unless Congress makes changes to the rule that affects this timing. Please feel free to contact the attorneys listed below if you would like to discuss the proposed amendment or its potential effect on the bankruptcy process.

Michael S. Fox
mfox@olshanlaw.com
212.451.2277

Adam H. Friedman
afriedman@olshanlaw.com
212.451.2216

Fredrick J. Levy
flevy@olshanlaw.com
212.451.2218

David Y. Wolnerman
dwolnerman@olshanlaw.com
212.451.2265