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OLSHAN GRUNDMAN FROME ROSENZWEIG & WOLOSKY LLP

Client Alert

Bankruptcy Department February 22, 2010

Bankruptcy Courts Split Over Disclosure Required From Ad Hoc Committee Participants Under Rule 2019

The dynamics of Chapter 11 cases have rapidly changed over the last few years. While traditionally a debtor would work with its senior lenders and an official creditors' committee to propel the reorganization process, in the last few years ad hoc committees, generally consisting of investment funds and other distressed investors, have become major players in the Chapter 11 process. Most recently, several judges in the Delaware bankruptcy court have addressed the issue of whether an unofficial group of noteholders is subject to the disclosure requirements set forth in Rule 2019 of the Federal Rules of Bankruptcy Procedure ("Rule 2019").

In a noteworthy opinion by Judge Mary Walrath of the United States Bankruptcy Court for the District of Delaware, *In re Washington Mutual, Inc., et al.*, (the "*Wamu*" case),[1] Judge Walrath held that the members of an ad hoc committee of noteholders were subject to Rule 2019 because the committee was representing more than one creditor. The court reasoned that "collective action by creditors in a class implies some obligation to other members of that class," and that this obligation consists of fiduciary duties, the extent of which the court does not address. Just weeks after Judge Walrath's decision, Judge Christopher Sontchi, also of the Delaware bankruptcy court, in *In re Premier International Holdings, Inc., et al.*, (the "*Six Flags*" case), disagreed.[2] Judge Sontchi held that unless an informal committee represents any persons other than its members, either by consent or operation of law, then it is not a committee under the plain meaning of Rule 2019 and its members are not subject to that rule's disclosure requirements. This January, Judge Brendan L. Shannon, another judge of the Delaware bankruptcy court, issued a brief order directing the ad hoc committee of noteholders in the *In re Accuride Corp.* bankruptcy case (Case No. 09-13449) to comply with Rule 2019.

Thus, the law in Delaware is in flux regarding who is required to make Rule 2019 disclosure. These divergent opinions are of particular importance to institutional investors who should consider the possibility of having to make Rule 2019 disclosure when deciding whether to form ad hoc or informal committees to advance their collective interests.[3]

Bankruptcy Rule 2019

Bankruptcy Rule 2019 provides in relevant part that, "every entity or committee representing more than one creditor or equity security holder . . . shall file a verified statement setting forth . . . the amounts of claims or interests owned by members of the committee, the times when acquired, the amounts paid therefore, and any sales or other disposition thereof." Members of ad hoc committees understandably resist disclosing confidential or proprietary

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[1] 2009 WL 4363539 (Bankr. D. Del. 2009).
[2] 2010 WL 198676 (Bankr. D. Del. Jan. 20, 2010)
[3] Most recently, Chief Judge Stephen Raslavich of the Eastern District of Pennsylvania bankruptcy court (in the same circuit as the Delaware court), agreed with Judge Sontchi, holding that the Steering Group of Pre-petition Lenders in the *In re Philadelphia Newspapers LLC* bankruptcy case (Case No. 09-11204) was not required to make Rule 2019 disclosures.

trading information about their positions and holdings, including the purchase price and timing of the claims they acquired.

Wamu Court's Analysis

In *Wamu*, a group of noteholders which called itself the Washington Mutual Inc. Noteholders Group (the "WMI Noteholder Group") argued that Rule 2019 was inapplicable to it because it was *not* an entity or committee under the Bankruptcy Code, but rather it was merely a "loose affiliation of creditors who, in the interests of efficiency [were] sharing the cost of advisory services in connection with the case." The court rejected this argument and ruled that the WMI Noteholder Group was "in fact acting as an ad hoc committee or entity representing more than one creditor." In its analysis of Rule 2019 and its applicability to the WMI Noteholder Group, the court found that the WMI Noteholder Group "possesses virtually all the characteristics typically found in an ad hoc committee, save the name." The factors cited by the court include (i) multiple creditors; (ii) holding similar claims; (iii) filing pleadings collectively; (iv) appearing in the proceedings collectively; and (v) retaining common counsel.

In perhaps the most controversial part of her decision, Judge Walrath observed that an ad hoc group owes some type of fiduciary duties to other similarly situated creditors, including those outside the group. While Judge Walrath did not delineate the exact fiduciary duties owed, she wrote that "**collective action by creditors in a class implies some obligation to other members of that class**." (emphasis added)

Six Flags Court's Analysis

Contrary to the decision in *Wamu*, Judge Sontchi in *Six Flags* found that under the plain meaning of Rule 2019, a group of noteholders which called itself the "SFO Noteholders Informal Committee" was *not* a "committee representing more than one creditor". Accordingly, Judge Sontchi held that its members need not make the Rule 2019 disclosures, stating that he "respectfully decline[d] to follow the holding in two recent cases addressing the virtually identical question: *In re Washington Mutual, Inc., et al.*, and *In re Northwest Airlines Corp., et al.*" (citations omitted).[4]

In disagreeing with the reasoning applied in the Northwest and Washington Mutual cases, Judge Sontchi held that Rule 2019 does not apply to ad hoc committees because the ordinary meaning of "committee" denotes a subset of a larger group authorized by the larger group to act on its behalf. He reasoned that "a *self-appointed* subset of a larger group — whether it calls itself an informal committee, an ad hoc committee, or by some other name — simply does not constitute a committee under the plain meaning of the word. In order for a group to constitute a committee under Rule 2019 it would need to be formed by a larger group either by consent, contract or applicable law — not by 'self-help.'" Accordingly, the court observed that since the ad hoc committee in *Six Flags* did not represent any persons other than its members, either by consent or operation of law, "it is not a 'committee' under Rule 2019 and, thus, its members need not make the disclosures required under the rule."

Potential Impact

Wamu and *Six Flags* have created a split in authority within the Delaware bankruptcy court with regard to the applicability of Rule 2019 disclosures. In addition, Judge Walrath has raised the possibility that an ad hoc committee and its members hold fiduciary duties to

[4] *Northwest* is a 2007 decision by Judge Gropper in the Southern District of New York (363 B.R. 701), which requires Rule 2019 disclosure by informal committees. To date, *Northwest* is the law applied in the Southern District of New York.

similarly situated creditors and are thereby not free to advance their own interests without the need to represent the interests of non-members. Judge Sontchi's decision, on the other hand, holds to the proposition that not every ad hoc committee of creditors falls within Rule 2019 and, therefore, such creditors may not be bound by the Rule's extensive disclosure requirements. Such reasoning would also likely reject the principal of a fiduciary duty owed by such committees to non-members.

At this time, it remains unclear where the law stands on both the applicability and scope of Rule 2019. With appeals filed by both the WMI Noteholder Group in *Wamu* and the Official Creditors' Committee in *Six Flags*, the final outcome awaits further judicial review and action. However, until the split in Delaware and the uncertainty in other bankruptcy courts is resolved, creditors considering membership in an ad hoc committee or informal group of creditors will face the dilemma of not knowing how much disclosure of their claim is actually necessary.

Please feel free to contact any of the attorneys listed below if you would like to discuss this matter.

Adam H. Friedman
afriedman@olshanlaw.com
212.451.2216

Michael S. Fox
mfox@olshanlaw.com
212.451.2277

Jordanna L. Nadritch
jnadritch@olshanlaw.com
212.451.2209