Schulte Roth&Zabel

Alert

New Bankruptcy Rule 2019: Mandatory Disclosures for Ad Hoc Committee Members

June 21, 2011

The United States Supreme Court recently submitted to Congress an amendment to Bankruptcy Rule 2019 dealing with disclosure by groups of hedge funds and other distressed investors in reorganization cases. Unless Congress blocks its passage, which is unlikely, the amendment will become effective on Dec. 1, 2011.[1] As shown below, the new rule streamlines and clarifies what had become a frequently litigated disclosure process.

Background
Parties had often used federal Bankruptcy Rule 2019 in the past as a litigation tactic to compel members of ad hoc investor committees (e.g., creditors or shareholders) to disclose the nature of their investments, the prices paid and the timing of their acquisitions. When investors resisted disclosure of this commercially sensitive information, courts differed on whether Rule 2019 even applied to ad hoc committees.[2] As a practical matter, creditors and shareholders form ad hoc committees to advance their common interests and to enhance their leverage in reorganization cases.

The New Rule
A quick summary of the material terms of the amended rule (from the perspective of an investor) are set forth below:

Who Must Disclose?	Members of an informal committee and "*every group* or committee that consists of … multiple creditors or equity security holders that are … acting in concert to advance their common interests." The "committee" label is irrelevant.
Excluded Parties:	Indenture trustees, credit agreement agents and governmental units.

[1] The full text of the amended rule can be viewed at http://www.supremecourt.gov/orders/courtorders/frbk11.pdf.

[2] *Compare In re Philadelphia Newspapers LLC*, 422 B.R. 553, 555 n.1 (Bankr. E.D.Pa. 2010) (rule does not apply to informal groups); *In re Premier Int'l Holdings*, 423 B.R. 58, 60, 65 (Bankr. D.Del. 2010) (same) *with In re Washington Mutual, Inc.*, 419 B.R. 271 (Bankr. D.Del. 2009) (held, ad hoc committee and similar groups are bound by Rule 2019); *In re Northwest Airlines Corp.*, 363 B.R. 701 (Bankr. S.D.N.Y. 2007) (same).

What Must Be Disclosed?	"Pertinent facts and circumstances concerning": (i) the formation of the group, "including the name of each entity at whose instance the group … was formed …" and (ii) the "nature and amount of each *disclosable economic interest* held in relation to the debtor as of the date … the group or committee was formed."[3] The phrase "*disclosable economic interest*" means "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." The disclosure must be made on a member-by-member basis, and not in the aggregate.
When Disclosure Must Be Made:	Whenever a group first appears in the case. The disclosure statement must be later supplemented to disclose material changes whenever the group "takes a position before the court or solicits votes on the confirmation of a plan."
What Need Not Be Disclosed:	Purchase prices paid for each investment; and precise date of acquisition (only the calendar quarter and year are required).
Consequences of Non-Disclosure:	The court may (i) refuse to permit the group to be heard; (ii) invalidate any "authority, acceptance, rejection or objection given, procured or received" by the group; or (iii) grant other appropriate relief.

The Compromise

Opponents of Rule 2019 argued that disclosure would chill the distressed debt market and discourage investors from serving on ad hoc committees, thereby harming the reorganization process. The amended rule, however, purports to strike a balance -- it requires disclosure, but *not* the disclosure of purchase prices.

Potential Litigation

Parties advancing competing strategies may continue to use Bankruptcy Rule 2019 as a weapon against an effective ad hoc committee. They may, for example, challenge the adequacy and timing of any disclosure made by an ad hoc group. More significant, a competing party may still seek disclosure of purchase prices and other trading information by relying on Bankruptcy Rule 2004 or, in appropriate cases, any other applicable discovery rules.[4]

Authored by Michael L. Cook and David M. Hillman.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[3] There are additional disclosure requirements if the group is *representing* other parties in addition to the members of the group or committee.

[4] According to the Advisory Committee note accompanying the new rule, "nothing in this rule precludes either the discovery of that information or its disclosure when ordered by the court pursuant to authority outside this rule."

New York
Schulte Roth & Zabel LLP
919 Third Avenue
New York, NY 10022
+1 212.756.2000
+1 212.593.5955 fax

Washington, DC
Schulte Roth & Zabel LLP
1152 Fifteenth Street, NW, Suite 850
Washington, DC 20005
+1 202.729.7470
+1 202.730.4520 fax

London
Schulte Roth & Zabel International LLP
Heathcoat House, 20 Savile Row
London W1S 3PR
+44 (0) 20 7081 8000
+44 (0) 20 7081 8010 fax

www.srz.com

U.S. Treasury Circular 230 Notice: Any U.S. federal tax advice included in this communication was not intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal tax penalties.