

Investors Alarmed As Rule 2019 Uncertainty Persists

By **Jacqueline Bell**

Law360, New York (January 28, 2010) -- The controversy over whether distressed debt investors should be forced to disclose how much they paid for their bankruptcy claims is growing, with contradictory court opinions and contentious amendment proposals only adding more fuel to the Rule 2019 debate.

With roots in the 1930s, Bankruptcy Rule 2019 was initially crafted to help boost transparency in bankruptcy cases, but the crux of the current fight is over just how much data informal groups of creditors, often made up of distressed debt investors, should be forced to hand over.

The current rule requires any committee representing creditors to make public disclosures about their claims that include the dates when group members acquired those claims and the amount they paid for them.

But hedge funds and other distressed debt investors carefully guard their trading data, and argue that being forced to disclose the price at which they purchased a claim, or the date on which they purchased the claim, only complicates restructuring negotiations and serves no relevant purpose.

The custom for informal groups has long been to make Rule 2019 disclosures that simply leave out information about the prices they paid for bankruptcy claims, or the dates they acquired them, in the absence of a court order requiring them to do otherwise.

Even disclosing the date a bankruptcy claim was purchased can present problems, because anyone can determine the price paid for a claim once the date of purchase is known, distressed investors argue.

While some informal groups have made the case that Bankruptcy Rule 2019 does not apply to them, two recent contradictory rulings from the same bankruptcy court highlight the growing uncertainty regarding the rule's application.

Earlier in January, the judge overseeing the bankruptcy of Six Flags Inc. struck down an attempt to force an informal committee of noteholders to reveal trading details about their investments.

Citing the Oxford Shorter English Dictionary as a reference, Judge Christopher S. Sontchi of the U.S. Bankruptcy Court for the District of Delaware found that the plain meaning of Bankruptcy Rule 2019 did not include self-appointed groups of stakeholders in bankruptcy cases, a conclusion similar to a 2007 ruling from the U.S. Bankruptcy Court for the Southern District of Texas in the bankruptcy of Scotia Pacific Co. LLC.

Judge Sontchi's ruling was an about-face from a December decision by a fellow Delaware bankruptcy court judge in the Washington Mutual Inc. case.

In that ruling, Judge Mary F. Walrath compelled an informal group of noteholders to disclose trading details, finding that the group generally represented itself in a manner befitting a committee, making it subject to the Rule 2019 disclosure requirements.

Judge Walrath's ruling was in some ways an echo of a similar 2007 decision in the U.S. Bankruptcy Court for the Southern District of New York in the Northwest Airlines Corp. Chapter 11 case.

The conflicting rulings on the issue, however, have not stopped debtors and creditors from increasingly using Bankruptcy Rule 2019 as a weapon against informal or ad hoc groups in contentious bankruptcy proceedings.

“For some reason, it's spreading like the swine flu,” said Kurt Mayr, a partner at Bracewell & Giuliani LLP. “And all it's really fostering is a more litigious dynamic that is burdening the estates and providing legally irrelevant information that may only serve to protract the case.”

With uncertainty growing over the potential outcome of those battles, distressed debt investors now must do a cost-benefit analysis of participation in an ad hoc group, said Brian S. Hermann, a partner at Paul Weiss Rifkind Wharton & Garrison LLP

“You should assume someone's going to push the issue,” Hermann said. “Each investor will have to weigh the pros and cons, and ultimately, I think it could have a dampening effect on people's willingness to participate in these groups.”

Further complicating the questions facing distressed debt investors are controversial proposed amendments to Rule 2019 currently being considered by the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States.

The proposals would ensure that the disclosure requirements apply to all types of creditor groups, and would also give bankruptcy courts the power to order group members to disclose the prices they paid for a particular economic interest.

Jon Kibbe, founding partner of Richards Kibbe & Orbe LLP, is set to testify at a Feb. 5 hearing in New York on the proposed amendments to Bankruptcy Rule 2019, and has already indicated that he can't support required disclosure of trading details.

Kibbe maintains that such a requirement runs counter to the basic bankruptcy law principals that demand that similarly situated creditors be treated the same, and that a claim in the hands of a secondary market purchaser be enforced to the same extent as a claim in the hands of an original holder.

“Requiring this disclosure would really just further arguments from the debtor and other creditors groups that people should take a haircut because they purchased the claim on the secondary market,” Kibbe said.

“Everyone is in favor of more transparency. Judges should never be misled,” he said. “But, you can get there, satisfy all of those needs, without requiring price to be disclosed, or date of purchase. That just leads to mischief and is only used against the person who disclosed that information.”

If members of informal groups are pressured to disclose trading data under Bankruptcy Rule 2019, some may eventually just choose not to participate in bankruptcy cases, decreasing efficiency and potentially forcing debtors to negotiate one-on-one with these creditors.

“If the rule is rigidly enforced, the bankruptcy process will lose out,” said Bennett Murphy, a partner at Hennigan Bennett & Dorman LLP. “Cases do need collective representation of actively traded securities. It’s not a bad thing.”

For now, participants in ad hoc committees are clearly concerned by the possibility of being forced to disclose trading details by bankruptcy courts, but so far they seem to be trying to navigate the uncertainty, rather than dropping out of the process, said Robert Eisenbach, a partner at Cooley Godward Kronish LLP.

But if courts start to lean more toward requiring those disclosures, or the proposed amendments to Bankruptcy Rule 2019 are approved, distressed debt investors may have to make some tough choices.

“I think if the Northwest Airlines-Washington Mutual position prevailed throughout, or this proposed rule were adopted, then it would be front and center, and these groups would really have to decide what they are going to do,” Eisenbach said.

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