



Memorandum

June 17, 2010

“The Advisory Committee Report significantly modifies the disclosure requirements [of Rule 2019] by...eliminating... the authorization for the court to order the disclosure of the purchase price...and limiting the requirement to disclose dates of acquisition...”

The Continuing Evolution of Bankruptcy Rule 2019

By Jon Kibbe, Michael Friedman and James A. Bulger

In our Distressed Investor Alert dated December 23, 2009, we wrote that Bankruptcy Rule 2019, an often ignored procedural rule in U.S. bankruptcies, had returned to the public eye in light of the controversial revisions to Rule 2019 (“Revised Rule 2019”)¹ proposed by the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States (the “Rules Committee”).

At a public hearing held in New York City on February 5, 2010, the Advisory Committee on Bankruptcy Rules (the “Advisory Committee”) heard from concerned parties in the bankruptcy field about Revised Rule 2019, including the Loan Syndications and Trading Association (the “LSTA”), Judge Robert Gerber of the Bankruptcy Court for the Southern District of New York and Jon Kibbe and Michael Friedman of RK&O. In our written submission, we noted that if holders would be required to divulge sensitive and proprietary pricing information, distressed investors may be less willing to participate in “*ad hoc* committees” -- increasingly important informal groups or committees that retain common counsel and financial advisors to advocate a restructuring strategy.

On May 27, 2010, the Advisory Committee issued its Report of the Advisory Committee on Bankruptcy Rules (the “Advisory Committee Report”) recommending certain modifications to Revised Rule 2019. We are happy to report that the Advisory Committee recommended significant modifications to Revised Rule 2019 adopting key suggestions from the LSTA and RK&O. A summary of the more significant portions of the Advisory Committee Report follows below.

CURRENT RULE 2019 AND REVISED 2019

Currently, Rule 2019 provides that any “committee” representing creditors in a bankruptcy proceeding must publicly disclose information about (i) the members represented, (ii) the amount and nature of each member’s claims, (iii) the dates the members acquired their claims, and (iv) the amounts paid for the claims.

Revised Rule 2019 would broaden the disclosure requirement to apply to (i) every “entity, group, or committee” that represents or *consists of* more than one creditor and (ii) upon a motion of a party in interest or on the Court’s own motion, to *any entity* that seeks or opposes the granting of any relief. In addition, Revised Rule 2019 broadly defined the “disclosable economic interests” that would be required to be disclosed to include a “participation, derivative instrument, or any other right or derivative right that grants the holder an economic interest that is affected by the

value, acquisition, or disposition of a claim or interest."² Finally, Revised Rule 2019 would require parties to disclose the date a member acquired each disclosable economic interest and, if required by a court, the price paid for such interest.

ADVISORY COMMITTEE REPORT

Disclosure of Time and Purchase Price Limited.

Perhaps the most important recommendation proposed in the Advisory Committee Report is the modification of the requirement in Revised Rule 2019 to disclose the dates of acquisition of disclosable economic interests and, if required by a court, the purchase price paid for such interests. The Advisory Committee Report significantly modifies these disclosure requirements by (i) eliminating from subdivision (c) of Revised Rule 2019 the authorization for the court to order the disclosure of the purchase price paid for any disclosable economic interest, and (ii) limiting the requirement to disclose date of acquisition to rare situations where an unofficial group or committee *claims to represent any entity other than its members*, and then requiring disclosure of the calendar quarter of acquisition.

This result is consistent with testimony demonstrating that disclosure of proprietary and confidential information relating to the acquisition date and price paid would reduce the willingness of hedge funds, institutional investors and other distressed investors to participate (or even appear) in a bankruptcy case. Even though Revised Rule 2019 would not have required disclosure of prices paid absent court order, even requiring a party to disclose dates of claim purchase would result in indirect price disclosure, given the ease of determining the market price of bonds, syndicated loans or securities on any given day. By significantly modifying the requirement to disclose dates of claim acquisition and eliminating the requirement to disclose purchase price, the modifications recommended by the Advisory Committee Report should limit a debtor's ability to use pricing information when negotiating claim recoveries with secondary market debt purchasers.

Entities Required to Disclose. The Advisory Committee Report also includes several changes designed to limit the need for disclosure from certain entities, where additional disclosure and transparency would not be helpful to a court or other parties. Included in these changes are:

- the addition of a definition of "represent" or "represents" that limits the meaning of the terms to taking a position before the court or soliciting votes on a plan. This change removes entities that are only passively involved in a case from coverage under the rule. If a law firm's client remains passive in the case, there is no reason to require the public disclosure of its holdings merely because it retained a firm that happens to represent one or more other creditors or equity security holders;
- the addition of a provision providing that the covered groups, committees, and entities are those that represent or consist of multiple creditors or equity security holders that act in concert to advance their common interests and are not composed entirely of affiliates or insiders of one another; and
- the elimination of the provision that authorized the court to require disclosure by an entity that does not represent anyone else.

NEXT STEPS IN ENACTMENT OF REVISED RULE 2019

Although the issuance of the Advisory Committee Report is a significant step, enactment of amendments to Rule 2019 is not likely to occur prior to December 1, 2011. The next step in the process of enacting Revised Rule 2019 is for the Advisory Committee to submit the Advisory Committee Report to the Standing Committee on Rules of Practice and Procedure (the "Standing Committee") for approval which we understand is likely to occur this week. The Standing Committee may accept, reject, or modify the Advisory Committee's final recommendations. If the Standing Committee approves the recommendations, it will transmit the proposed amendments to the Judicial Conference of the United States (the "Judicial Conference") with a

² See Revised Rule 2019.

recommendation for approval. If the Standing Committee rejects or significantly modifies to the proposal, the proposal will likely be returned to the Advisory Committee with appropriate instructions. Any revised proposal from the Advisory Committee may be subject to an additional public notice period before re-submitting the proposal to the Standing Committee.

To the extent the proposed amendments to Rule 2019 are transmitted to the Judicial Conference, the Judicial Conference will consider the proposed amendments in September 2010. If approved by the Judicial Conference, the amendments would then be transmitted to the Supreme Court. The Supreme Court would be required to transmit the proposed amendments to Congress by May 1, 2011. Finally, Congress would have 7 months to act on any rules prescribed by the Supreme Court. If Congress does not enact legislation to reject, modify, or defer the rules, the proposed amendments would take effect as a matter of law on December 1, 2011.

To the extent the proposed changes recommended by the Advisory Committee Report are ultimately enacted, we believe that Revised Rule 2019 would: (i) promote the twin goals of disclosure and transparency by creditors participating in the bankruptcy process, (ii) respect the bedrock principle of distressed investing – that a claim in the hands of a secondary purchaser is just as good as it was in the hands of the original claimant, (iii) insure that debtors did not have unfair negotiating leverage through the disclosure of the price paid for a distressed claim and (iv) promote efficiency in complex bankruptcy proceedings by encouraging stakeholders (including distressed investors) to join *ad hoc* committees and otherwise participate fully in the bankruptcy process.

QUESTIONS

If you have questions regarding the matters discussed in this memorandum, please call your usual contact at Richards Kibbe & Orbe LLP or one of the persons listed below.

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