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Impact of Amended Rule 2019: What Bankruptcy Practitioners Should Know

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In April 2011, the Supreme Court of the United States adopted a controversial amendment to Rule 2019 of the Federal Rules of Bankruptcy Procedure. The purpose was to clarify the disclosure required of certain groups consisting of multiple creditors or equity security holders acting in concert in Chapter 9 or Chapter 11 bankruptcy cases. The amendment became effective on Dec. 1, 2011. It governs in all bankruptcy cases commenced after that date as well as "insofar as just and practicable" in all pending proceedings.

Events Leading to the Amendment

Prior to Dec. 1, 2011, Rule 2019 required any "entity or committee" representing more than one creditor or equity security holder to file a verified statement disclosing information that generally included: (1) the nature and amount of the claim or interest held by each such entity or committee; (2) the date the claim or interest was acquired (unless acquired more than one year before the bankruptcy filing); (3) the amount paid for the claim or interest; and (4) "any sales or disposition of the claim or interest."

Over the last several years, Rule 2019 was not uniformly enforced. The inconsistent application of the rule yielded litigation and a split of authority among the courts. Certain courts interpreted Rule 2019 broadly and mandated disclosure by groups of claims that have acted in concert, including ad hoc committees of equity security holders and noteholders. Other courts, however, read Rule 2019 more narrowly and excluded certain claimants, including steering groups and ad hoc committees, from the scope of the rule.

Against this backdrop and the lack of clarity as to the breadth of Rule 2019, an advisory committee comprised of bankruptcy judges and other restructuring experts was formed to propose amendments to the rule. In August 2009, the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States proposed amendments to Rule 2019 for public comment. The initial draft of the amendment eliminated any ambiguity regarding whether it applies to ad hoc committees or groups of creditors. Moreover, the initial draft of the amendment expanded the type of information that must be disclosed.

On Feb. 5, 2010, the Advisory Committee held a public hearing at which witnesses presented testimony on the proposed amendments. Additionally, several individuals and organizations submitted written comments to the Advisory Committee. As evidenced by the commentary, the initial draft of the proposed amendments was controversial. Hedge funds and other distressed debt investors opposed, among other items, the provisions requiring disclosure of proprietary information relating to their trading strategies, including when they acquired their claims and the purchase price. Those parties argued that the disclosure of such information is overly broad, unnecessary and would discourage the participation of distressed debt investors in Chapter 11 cases. Other commentators supported the proposed amendments and the clarity and transparency they offered to the Chapter 11 process.

After considering the public comments and testimony, the Advisory Committee made several substantive modifications to Rule 2019. The proposed amendments

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were approved by the Judicial Conference in September 2010 and promulgated by the Supreme Court in April 2011.

The New Disclosure Requirements

Amended Rule 2019 clarifies and expands the information that must be disclosed by parties that fall within the scope of the rule. The amended rule and the disclosure required thereunder is centered around the new term "disclosable economic interest." This term is broadly 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." Practically speaking, it covers any economic interest that could impact a Chapter 11 case.

The amended rule requires the filing of a verified statement including the following:

• For a group or committee (other than an official committee), the facts and circumstances regarding its formation, 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;

• For an entity representing multiple creditors or equity security holders, the facts and circumstances regarding the employment of the entity, including the name of each creditor or equity security holder at whose instance the employment was arranged;

• For an entity representing multiple creditors or equity security holders, and each member of a group or committee (including official committees), the name and address of the person, and the nature and amount of each disclosable economic interest held (not in the aggregate) in relation to the debtor as of the date the entity was employed or the group or committee was formed;

• For each member of a group or committee (other than an official committee) that claims to represent any entity in addition to the members of the group or committee, the quarter and year in which each disclosable economic interest was acquired by each member of the committee or group, except for disclosable economic interests acquired more than one year prior to the filing of the petition. Also, in such cases, the name and address and nature and amount of disclosable economic interests must be disclosed by those nonmembers who are represented by the group or committee; and

• A copy of the instrument, if any, authorizing the entity, group or committee to act on behalf of creditors or equity security holders.

Parties Impacted by the Amendment

Amended Rule 2019 requires that disclosures be filed by every group or committee that consists of or represents, and by every entity that represents, multiple creditors or equity security holders that are (i) acting in concert to advance their common interests and (ii) not comprised entirely of affiliates or insiders of one another. The amended rule clarifies when an entity "represents" multiple creditors or equity security holders. Under the amended rule, "represent" or "represents" means to take a position before the court to solicit votes regarding the confirmation of a plan. Essentially, active participation in the case is required.

It is now clear that ad hoc committees and other groups of multiple stakeholders (other than official committees) will be required to make the disclosures imposed by Rule 2019. Although the rule excludes official committees from its purview, individual members of official committees are required to disclose their "disclosable economic interests."

Other parties exempted from the disclosure requirements include indenture trustees, agents for one or more entities under an agreement for the extension of credit, class-action representatives and most governmental units. Additionally, the amended rule does not apply to committees or groups of multiple stakeholders consisting of affiliates or insiders of one another.

Impact of the Amended Rule

The amendments to Rule 2019 were enacted to end the conflicting enforcement of disclosure requirements. The exact impact this rule will have on Chapter 11 cases remains to be seen, as the case law interpreting the true scope of the disclosure requirements develops. In the interim, stakeholders and their counsel must carefully consider and understand the modified disclosure requirements of Rule 2019 and their implications before taking an active role in Chapter 11 cases. ■