

Insolvency and Restructuring Update

Standing Committee Approves Major Changes to Bankruptcy Disclosure Rule

On June 15, 2010, significant amendments to Bankruptcy Rule 2019, which governs the disclosure of claims and interests held by members of certain representative entities and the parties they represent in Chapter 11 cases, cleared an important hurdle when the amendments were approved by the Committee on Rules of Practice and Procedure of the Judicial Conference, commonly known as the Standing Committee. The proposed changes to Rule 2019 ("Proposed Rule 2019") considerably expand the scope of disclosure required, broaden the types of economic interests that must be disclosed (to include, among other things, derivatives) and clarify which groups, committees and other entities must publicly disclose those economic interests in order to actively participate in a bankruptcy case.

The Standing Committee will present Proposed Rule 2019 to the full Judicial Conference for consideration at its September 2010 meeting. If the Judicial Conference approves the changes, it will then present Proposed Rule 2019 to the Supreme Court, which will meet in April 2011 to consider the amendments, and finally, absent a Congressional veto, the proposed changes will become effective on December 1, 2011.

Background

Current Bankruptcy Rule 2019 requires committees and other entities that represent more than one creditor or equity holder, other than official committees under Sections 1102 and 1114 of the Bankruptcy Code, to file a verified statement disclosing: (i) the name and address of the creditor or equity holder; (ii) the nature and amount of the claim or interest held by the creditor or equity holder and the time of acquisition thereof; (iii) the pertinent facts and circumstances in connection with the employment of the representative entity; (iv) the amounts of claims and interests owned by the representative entity or the members of the committee, the times when acquired, the amounts paid therefor, and any sales or other dispositions thereof; (v) a copy of the instrument empowering the entity to act in a representative capacity; and (vi) in promptly filed supplemental statements, material changes that have occurred to the information previously disclosed.

Historically, Rule 2019's requirements have been inconsistently applied such that many purportedly covered entities typically have not submitted detailed disclosure of their economic interests with respect to the debtor. Recently, several bankruptcy courts have sparred over the meaning of the language in Rule 2019 and the scope of its application (particularly over the issue of whether members of unofficial or "ad hoc" committees are required to comply with the rule). This judicial divergence as well as concerns over potential conflicting economic interests held by some creditors and investors have generated the necessary momentum for the expansion and revision of Rule 2019.

In August of 2009, in an effort to revise Rule 2019 so that it would better reflect the dynamic nature of modern restructuring cases, the Bankruptcy Rules Advisory Committee published a dramatically revised Rule 2019 ("Original Proposed Rule 2019") and invited comments by interested members of the public. Original Proposed Rule 2019 introduced the term "disclosable economic interest", which detailed numerous broad categories of information that covered parties must disclose. A specific provision also allowed the court, on motion of any party in interest or its own motion, to require disclosure by any entity that seeks or opposes the granting of relief. Representative and represented entities, except for those represented by official committees, were also required to disclose, with respect to each disclosable economic interest: (i) the nature of holdings; (ii) the amount held; (iii) the date acquired; and (iv) if ordered

by the court, the prices paid therefor. Original Proposed Rule 2019 also required monthly supplemental statements advising as to material changes in the disclosable economic interests held.

After a comment period and public hearing in which numerous individuals and organizations commented on Original Proposed Rule 2019, the Bankruptcy Rules Advisory Committee, which drafts and proposes bankruptcy rules amendments to the Standing Committee, made several substantive modifications to Original Proposed Rule 2019 and presented a revised Proposed Rule 2019 to the Standing Committee for approval at its meeting held on June 14-15, 2010. As noted above, the Standing Committee approved Proposed Rule 2019 for presentation to the full Judicial Conference. A link to a marked version showing the differences between Original Proposed Rule 2019 and Proposed Rule 2019 (as approved by the Standing Committee) can be found [here](#).

Proposed Rule 2019

Proposed Rule 2019 expands the types of economic interests required to be disclosed by utilizing the term “disclosable economic interest,” broadly defined as “any claim, interest, pledge, lien, option, 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.” These interests include short positions, credit default swaps and total return swaps.

Both the members of, and parties represented by, every committee, group and entity that “consists of or represents” multiple creditors or equity holders that act in concert to advance common interests (but are not merely affiliates or insiders of one another) must disclose: (i) their name and address; (ii) the nature and amount of each disclosable economic interest held with respect to the debtor; (iii) for members of a group or committee that claim to represent any entity other than the members of such group or committee, but not for official committees, the quarter and year the disclosable economic interest was acquired; and (iv) a copy of the instrument authorizing the entity to act in a representative capacity. Proposed Rule 2019 defines “represent” as taking a position before the court or soliciting votes on a plan on behalf of another, thus clarifying that an entity more passively representing multiple parties does not subject the entity or parties to the disclosure requirements. The Committee Note states that although precise acquisition date and price paid for a disclosable economic interest need not be disclosed, Proposed Rule 2019 does not preclude the discovery of such information when relevant or when ordered by the court pursuant to its authority outside of the rule.

Administrative agents and indenture trustees are specifically excluded from the disclosure requirements of Proposed Rule 2019 (unless the court orders otherwise) while members of official committees (but not the parties represented by an official committee) are required to make certain of the required disclosures. If material changes to the previously disclosed information arise after the initial filing, covered parties must file a supplemental statement when they further take a position before the court or solicit votes on a plan. Finally, if the court determines that a party has failed to comply with Proposed Rule 2019, the court may refuse to permit the entity to be heard or to intervene in the case, or it may hold invalid any authority, acceptance, rejection or objection made by the entity.

Conclusion

Through elaboration and clarification of what information must be disclosed and by which parties, Proposed Rule 2019 resolves many of the issues that have led to confusion, inconsistent application and recent contentious bankruptcy litigation under the current Rule 2019. Proposed Rule 2019 aims to balance the important competing policies of providing debtors, creditors, courts and other interested parties with accurate information regarding a party’s economic interests in order to decipher its motivations, on the one hand, with creditors’ and investors’ business interest in keeping proprietary trading and investment information confidential, on the other hand. This policy compromise was particularly reflected in the revisions to Original Proposed Rule 2019, which removed the requirement that

covered parties must disclose the price paid for their disclosable economic interests and greatly limited the requirement that they reveal the date such interests were acquired. While Proposed Rule 2019's disclosure requirements certainly mandate more detailed disclosures by covered parties, the extent to which these enhanced disclosure requirements will discourage active participation by certain creditors in Chapter 11 cases remains to be seen.

A link to the Proposed Rule 2019 (as approved by the Standing Committee) can be found [here](#).

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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