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WHAT'S INSIDE

COMMENTARY

Full disclosure? Bankruptcy Rule 2019 and unofficial creditor groups

Jonathan Covin of Wick Phillips Gould & Martin discusses recent developments regarding whether Bankruptcy Rule 2019, which requires official committees and other entities to disclose certain details of members' interests, applies to informal committees or creditors' groups.

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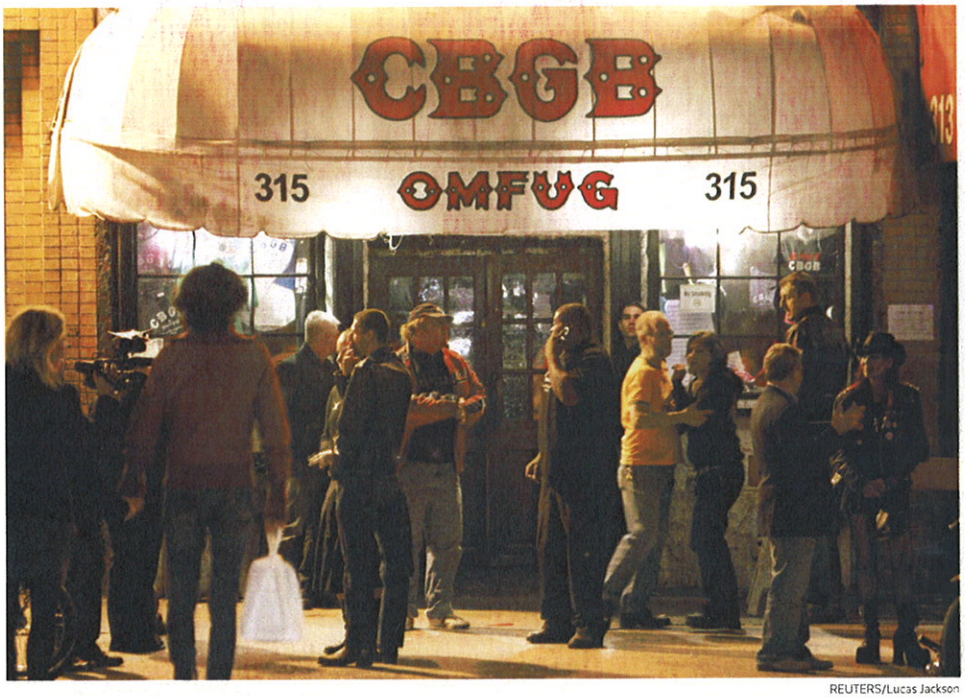

REUTERS/Lucas Jackson

ASSETS (INTELLECTUAL PROPERTY)

CBGB founder's estate wins trademark battle with bankrupt firm

The trademarks and other property connected to the legendary CBGB music club belong to the estate of the New York City landmark's late founder Hillel "Hilly" Kristal, not bankrupt CBGB Holdings, a federal judge has ruled.

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Full disclosure? Bankruptcy Rule 2019 and unofficial creditor groups

By Jonathan Covin, Esq.

Distressed-debt investors and hedge funds play a significant role in many Chapter 11 bankruptcy cases. They sometimes provide debtor-in-possession financing to companies when more conventional financing sources are not available, participate actively in cases and purchase debtors' assets. In certain cases, distressed-debt investors purchase a company's debt at a deep discount, in hopes that they will be able to profit through a later sale of the debt at a higher price.

In recent years, debtors and other constituencies have sought to require distressed-debt investors and other creditors that form ad hoc committees in bankruptcy cases to comply with Bankruptcy Rule 2019.

Rule 2019 requires every "entity or committee representing more than one creditor or equity security holder," and every indenture trustee, to file a statement. The statement must include information about the amounts of claims or interests owned by each member of the committee, the dates such claims or interests were acquired, the amounts paid for them, and any sales or dispositions of them.

Proponents of such disclosure argue that ad hoc committees often have an influential role in Chapter 11 proceedings, and it is important for courts and other parties to understand their true economic motives. This is especially true, proponents argue, because distressed-debt investors sometimes seek to put other creditors at a disadvantage in a proceeding designed for rehabilitation and restructuring of a company, and a bankruptcy judge needs to be able to guide the outcome.

Critics of such disclosure, including many distressed-debt investors, contend that it is unfair for them to be required to disclose their proprietary trading strategies. They say such disclosure will undermine their ability to obtain a higher sales price for their claims and disadvantage them in negotiations with other parties in interest. They also argue that it will decrease the purchasing of distressed debt.

Regardless of the wisdom of the disclosure requirements, courts deciding whether to require ad hoc committees or "groups" of creditors to comply with Rule 2019 and disclose sensitive trading data have often focused on the rule's "plain meaning" to determine whether it applies to members of ad hoc committees or creditor groups.

As discussed below, a number of recent court decisions have produced a split in authority. A proposed amendment to Rule 2019, however, clearly applies to ad hoc committees or "groups" of creditors and expands the scope of disclosure requirements.

Debtors and other constituencies have sought to require distressed-debt investors and other creditors that form ad hoc committees in bankruptcy cases to comply with Rule 2019.

NORTHWEST AIRLINES

In the case of *In re Northwest Airlines Corp.*, 363 B.R. 701 (Bankr. S.D.N.Y. 2007), the debtors moved the court to require an ad hoc committee of equity security holders to supplement a Rule 2019 disclosure statement.[1]

The statement identified 11 members of the ad hoc committee and disclosed that "[t]he members of the ad hoc equity committee own, in the aggregate, 16,195,200 shares of common stock of Northwest and claims against the debtors in the aggregate amount of $164.7 million" and that "[s]ome of the shares of common stock and some of the claims were acquired by members of the ad hoc equity committee after the commencement of the cases."[2]

The debtors argued that the Rule 2019 statement was inadequate because it failed to disclose "the amounts of claims or interests owned by the members of the committee, the times when acquired, the amounts paid therefore, and any sales or other disposition thereof."[3]

The ad hoc committee contended, however, that it did not have to comply with Rule 2019.[4] The lynchpin of this argument was the text of the rule: It applies to "every entity or committee representing more than one creditor or equity security holder."[5] The ad hoc committee claimed that no member represented any party other than itself, and Rule 2019 was therefore inapplicable.[6]

The U.S. Bankruptcy Court for the Southern District of New York rejected the committee's position and said "the rule cannot be so blithely avoided."[7] In reaching this conclusion, the court noted that the ad hoc committee had appeared as a "committee," had actively litigated issues as the "committee" and had retained counsel compensated by the "committee" on the basis of work performed for the "committee."[8]

The court held, in effect, that all ad hoc committees must comply with Rule 2019.

"Where an ad hoc committee has appeared as such, the committee is required to provide the information plainly required by Rule 2019 on behalf of each of its members," the court said.[9]

The *Northwest* decision is the first of the modern reported cases addressing whether an ad hoc committee had to comply with Rule 2019. Many bankruptcy attorneys believed that the decision would hamper the formation of ad hoc committees by distressed-debt investors and hedge funds that did not wish to disclose the details of their trades in a debtor's claims and stock to other parties in interest in bankruptcy cases.

SCOTIA PACIFIC

On April 18, 2007, shortly after the decision in *Northwest*, the U.S. Bankruptcy Court for the Southern District of Texas considered whether Rule 2019 applied to an ad hoc committee of noteholders. *In re Scotia Dev. LLC*, No. 07-20027-C-11, *order entered* (Bankr. S.D. Tex. Apr. 18, 2007).

In this case debtor Scotia Pacific Co. filed a motion to compel an ad hoc group of timber noteholders to amend its Rule 2019 statement to require each member of the noteholder group to disclose its trading history, including prices paid for claims and stock and prices received for any sales of claims and stock.[10]

Proponents of disclosure argue that ad hoc committees often have an influential role in Chapter 11 proceedings and that it is important for courts and other parties to understand their true economic motives.

The noteholder group objected to the motion and argued that it was merely a group of noteholders and not a "committee" as that term is used in Rule 2019.[11] Like the ad hoc committee in *Northwest*, the noteholder group claimed that it did not represent or purport to represent any noteholders that were not members of the group.

Moreover, the noteholder group contended that, even if it were a "committee" falling within the ambit of Rule 2019, the purpose of the rule was to protect others in the class represented by the committee, and in this case any non-member in the class could join the noteholder group directly.

In a two-page order, U.S. Judge Richard Schmidt o denied Scotia Pacific's motion to compel the noteholder group to make Rule 2019 disclosures.[12] He concluded that the group was not a "committee" within the meaning of Rule 2019 and therefore not subject to the disclosure requirements under the rule.[13]

WASHINGTON MUTUAL

Over two years after the decisions in *Northwest* and *Scotia*, on Dec. 2, 2009, a Delaware bankruptcy judge stepped into the fray. In *In re Washington Mutual Inc.*, 419 B.R. 271 (Bankr. D. Del. 2009), U.S. Bankruptcy Judge Mary Walrath required a "group" of noteholders to comply with Rule 2019.

In *WaMu* a creditor filed a motion to compel the noteholder group to comply with Rule 2019.[14]

The group argued that Rule 2019 was inapplicable because it was not "an entity or committee representing more than one creditor."[15] Instead, the group contended that it was:

> simply a loose affiliation of WMI creditors who, in the interest of efficiency are sharing the cost of advisory services in connection with the case. The noteholders do not speak for, have no ability to bind and owe no duties to anyone who is not a noteholder. Perhaps as importantly, the noteholders don't even have the right to speak for or bind individual noteholders absent their individual consent. Each noteholder acts in its own right and on its own behalf; issues are discussed and negotiated among the individual noteholders, who often hold competing views about certain issues, and ultimately agreed to before a position is formally taken by the noteholders.[16]

Judge Walrath concluded, however, that the noteholders' argument "proves too much; the above statement applies with equal force to ad hoc committees as well as to the [noteholder group]."[17]

The judge reasoned that the noteholder group "possesses virtually all the characteristics typically found in an ad hoc committee, save the name."[18] Ad hoc committees, like the noteholder group, are a "loose affiliation" of creditors that cannot bind their members without consent.[19]

Further, like the noteholder group, ad hoc committee members must generally all agree on any position that the committee takes.[20] Having decided that the noteholder group was in fact acting as an ad hoc committee, the judge concluded that the plain language of Rule 2019 applied to the group.

"Under the plain language of Rule 2019, therefore, the court finds that although the [noteholder group] call themselves a group, they are in fact acting as an ad hoc committee or entity representing more than one creditor," Judge Walrath said. "The WMI noteholders group, therefore, must comply with Rule 2019."[21]

In addition to its holding concerning the Rule 2019 disclosure obligations of the ad hoc committee, the *WaMu* decision is especially noteworthy because of its discussion of Rule 2019's legislative history and its suggestion that ad hoc committees may have a fiduciary obligation to act in the interests of similarly situated creditors not part of that group.

The noteholder group contended that Rule 2019 was only intended to apply to "a body that purports to speak on behalf of an entire class or broader group of stakeholders in a fiduciary capacity with the power to bind the stakeholders that are members of such a committee."[22]

Judge Walrath noted, however, that this argument "is premised on the erroneous assumption that the group owes no fiduciary duties to other similarly situated creditors, either in or outside the group."[23] According to the judge, however, the case law "suggests that members of a class of creditors may, in fact, owe fiduciary duties to other members of the class."[24]

Judge Walrath went on to conclude that "[i]t is not necessary, at this stage, to determine the precise extent of fiduciary duties owed but only to recognize that collective action by creditors in a class implies some obligation to other members of that class."[25]

The holding in *WaMu* should cause creditors to choose carefully before deciding to join an ad hoc committee or group of creditors. In addition to the possibility that a court may require disclosure of sensitive data regarding

Critics of disclosure, including many distressed-debt investors, contend that it is unfair for them to be required to disclose their proprietary trading strategies.

the purchase and sale of claims or equity interests, the decision raises the possibility that members of an ad hoc committee or group of creditors may owe fiduciary duties to similarly situated creditors not part of the committee or group.

Such fiduciary duties, if imposed by a court, might restrict each member's ability to act in its self-interest and also expose the member to potential liability for breach of fiduciary duty.

PREMIER INTERNATIONAL HOLDINGS INC. ('SIX FLAGS')

A bankruptcy judge in Delaware again considered whether Rule 2019 applied to an informal committee of noteholders in *In re Premier International Holdings*, 423 B.R. 58 (Bankr. D. Del. Jan. 20, 2010) ("*Six Flags*"). In *Six Flags* the Judge Christopher S. Sontchi ruled that Rule 2019 did not apply to an informal noteholder committee.[26]

Judge Sontchi began his analysis with the text of Rule 2019: "The question here is whether the [informal noteholder committee] is 'a committee representing more than one creditor.' If so, its members are subject to Rule 2019."[27]

ACCURIDE CORP.

The Delaware bankruptcy court again considered whether Rule 2019 applied to an ad hoc noteholder group in *In re Accuride Corp.*, No. 09-13449 (Bankr. D. Del. Jan. 25, 2010). In *Accuride*, Judge Brendan L. Shannon entered a two-page order granting a motion by the official committee of equity holders to compel an ad hoc noteholder group to comply with Rule 2019.

PHILADELPHIA NEWSPAPERS

In the case of *In re Philadelphia Newspapers LLC*, No. 09-11204 (Bankr. E.D. Pa. Feb. 4, 2010), the court, relying heavily on the reasoning in *Six Flags*, concluded that Rule 2019 did not apply to a self-styled "steering group of pre-petition lenders."

PROPOSED AMENDMENT OF RULE 2019

The Advisory Committee on Bankruptcy Rules has announced proposed amendments to Rule 2019 that, among other things, would eliminate any ambiguity regarding whether it applies to ad hoc committees or groups of creditors. The proposed amended rule applies to "groups" of creditors and equity

> In the Northwest Airlines case, the court rejected the ad hoc committee's position and said Rule 2019 "cannot be so blithely avoided."

The judge first considered whether an ad hoc committee was a "committee" within the meaning of Rule 2019.[28] He concluded that a self-appointed subset of a larger group of creditors — whether it calls itself a group or an informal committee — "simply does not constitute a committee under the plain meaning of the word."[29] Thus, the judge held that the informal noteholder committee was not a "committee" within the meaning of Rule 2019.[30]

The judge also concluded that the noteholder committee did not represent anyone other than its members and that Rule 2019 did not apply for this additional reason.[31] Although he viewed its determination of the plain meaning of Rule 2019 as dispositive, he also discussed the legislative history of Rule 2019 at length and concluded that it supported his interpretation of the rule.[32]

interest holders, and it expands the type of information that must be disclosed.

According to the Advisory Committee's report, Rule 2019 was "amended to expand the scope of the rule's coverage and the content of its disclosure requirements."[33]

The amended Rule 2019 requires disclosures in Chapter 9 and Chapter 11 cases by committees, groups or entities that consist of or represent more than one creditor or equity security holder.[34] Further, the amended Rule 2019 expands the type of financial information that must be disclosed to include "disclosable economic interests," a term broadly defined to include not just claims and interests, but "all economic rights that could affect the legal and strategic positions that a stakeholder takes in a case."[35]

According to the Advisory Committee, a disclosable economic interest "extends beyond claims and interests owned by a stakeholder and includes, among other types of holdings, short positions, credit default swaps and total return swaps."[36]

While the proposed amended Rule 2019 expands the required disclosure to include

> The court in Scotia Development's case concluded that a noteholder group was not a "committee" within the meaning of Rule 2019 and therefore not subject to its disclosure requirements.

disclosable economic interests, the current version of the amended rule no longer requires the disclosure of the precise date of acquisition or the amount paid for disclosable economic interests.[37] The Advisory Committee notes, however, that "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."[38]

Proposed Rule 2019 further provides that "[i]f any fact disclosed in its most recently filed statement has changed materially, an entity, group or committee shall file a verified supplemental statement whenever it takes a position before the court or solicits votes on the confirmation of a plan."[39]

In its report, the Advisory Committee forwarded a revised version of Rule 2019 (which contained the provisions discussed above) to the Standing Committee on Rules of Practice and Procedure and recommended that the Standing Committee approve its recommendations.

Under the Rules Enabling Act, the proposed amended Rule 2019 would become effective Dec. 1, 2011, if ultimately approved by the Standing Committee, the Judicial Conference and the U.S. Supreme Court and not otherwise disapproved or delayed by Congress. WJ

NOTES

[1] *In re Northwest Airlines Corp.*, 363 B.R. 701 (Bankr. S.D.N.Y. 2007).

[2] *Id.* at 702.

[3] *Id.* at 701.

[4] *Id.* at 703.

[5] *Id.* at 702.

[6] *Id.* at 703.

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *In re Scotia Dev. LLC*, No. 07-20027-C-11 (Bankr. S.D. Tex. Apr. 18, 2007).

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] *Id.* at 272

[15] *Id.* at 274.

[16] *Id.*

[17] *Id.*

[18] *Id.* at 275.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id.* at 278.

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *Id.*

[27] *Id.* at 563

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *Id.* at 566

[32] *Id.* at 568

[33] Report of the Advisory Committee on Bankruptcy Rules 3 (May 27, 2010, revised June 14, 2010).

[34] *Id.*

[35] *Id.*

[36] *Id.* at Appendix B-30.

[37] *Id.* at Appendix B-32.

[38] *Id.*

[39] *Id.* at Appendix B-28-29.

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PLAN VIOLATIONS

Citadel Broadcasting accused of violating reorganization plan

Citadel Broadcasting Corp. has been accused in a federal bankruptcy court filing of violating the terms of its reorganization plan by awarding millions of shares of stock to several managers and directors.

In re Citadel Broadcasting Corp., No. 09-17442, motion to direct reorganized debtors to comply with plan filed (Bankr. S.D.N.Y. Oct. 6, 2010).

Creditor R² Investments LDC filed a motion to compel the return of those shares, alleging the country's third-largest radio broadcaster has engaged in "one of the most egregious frauds by a company emerging from bankruptcy under Chapter 11."

Citadel filed for Chapter 11 protection Dec. 20, 2009, in the U.S. Bankruptcy Court for the Southern District of New York.

The company's reorganization plan and disclosure statement provide that managers would receive stock options with a designated strike price and a three-year vesting period, according to the motion.

But on Aug. 19 Citadel allegedly awarded certain managers and directors millions of

shares of stock that vest in less than three years.

R² claims the award violates the reorganization plan at the expense of Citadel's creditors.

It further asserts that the award is "fraudulent" because Citadel's representatives allegedly told the court that they would not receive the type of securities they eventually awarded themselves.

> "Despite having just emerged from bankruptcy, Citadel now has the highest-paid management in the terrestrial radio broadcasting industry," the motion says.

"Despite having just emerged from bankruptcy, Citadel now has the highest-paid management in the terrestrial radio broadcasting industry," the motion says.

Management's compensation was "a hotly contested topic" during the bankruptcy proceedings, according to the motion.

R² seeks a court order directing Citadel to comply with the reorganization plan by revoking the stock award and issuing stock options instead.

A hearing on the motion is scheduled for Nov. 3 before Judge Burton R. Lifland. WJ

Attorneys:
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Related Court Document:
Motion: 2010 WL 4097925

See Document Section B (P. 24) for the motion.