Expert Q&A on Bankruptcy Rule 2019 Amendments

PLC Finance

Rule 2019 of the Federal Rules of Bankruptcy Procedure (Rule 2019) governs disclosure of certain information by groups, committees and entities that consist of or represent more than one creditor in a bankruptcy case. Significant amendments to Rule 2019 were recently approved by the US Supreme Court, substantially expanding the types of economic interests that must be disclosed under the rule. The amendments apply to all future Chapter 11 cases and, to the extent "just and practicable," to all pending Chapter 11 cases. Practical Law Company asked Abid Qureshi of Akin Gump Strauss Hauer & Feld LLP to explain the scope of revised Rule 2019 and assess the impact on distressed investors, lenders and other creditors.

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Abid focuses his practice on financial restructuring litigation. He represents creditors, bondholders, hedge funds, institutional investors and creditor committees in the full range of complex litigation matters arising in the course of Chapter 11 restructurings and other bankruptcy contexts.

What has been your experience with revised Rule 2019 in practice? Do you think the new rule is an improvement over the old version?

In assessing the impact of revised Rule 2019, one must consider the text of the old rule versus the actual practice that developed under that rule. In practice, under the old regime, notwithstanding the text of the rule and certain case law, ad hoc groups typically disclosed only the aggregate face amount of holdings of the group as a whole with respect to the claims for which they served on an ad hoc committee. They did not disclose all economic interests or holdings by institution. Revised Rule 2019 makes clear that members of a group must individually make public each "disclosable economic interest." From that perspective, the new rule is much more burdensome in its disclosure requirements than what in practice occurred under the old rule.

One significant reason why representatives of the distressed investment community that testified before the Rules Committee were ultimately supportive of the final version of revised Rule 2019 was that the new rule was much clearer in setting forth both what must be disclosed and what will remain confidential. In particular, the new rule, unlike its predecessor, makes clear that the price paid for a debt purchase will generally not need to be disclosed. Though we are still in the very early days of practice under the new rule, in terms of clarity, it appears that the new rule is an improvement over the old version.

What issues, if any, do you expect to be litigated with respect to revised Rule 2019?

In the final years under the previous rule, there was a marked increase in "strategic" litigation, where efforts to enforce compliance with the rule were often motivated by a desire to gain a litigation advantage, rather than any interest in disclosures to protect the integrity of the process. Because the new rule appears on its face to be easier to apply than the old rule, the hope is that such litigation will be dramatically reduced.

The most likely area of litigation under the new rule relates to the "acting in concert" language. The Advisory Committee memorandum that accompanied the new rule explains that the defined term "represent" was designed to exempt from the application of the rule those entities that are only passively involved in a case. That comment, however, does not square entirely with the triggering of the disclosure requirement by interest holders "acting in concert to advance their common interests." Given the room for interpretation in this language, this could well be an area for future litigation.

Given the ambiguity of the acting in concert language, are courts likely to apply revised Rule 2019 to other types of groups, such as parties to joint defense agreements or lending groups seeking to credit bid for a debtor's assets?

For a lending group seeking to credit bid, it is typically the indenture trustee that is the entity authorized to submit a credit bid, at the direction of the requisite percentage of lenders. Indenture trustees acting in that capacity are specifically exempted from the application of revised Rule 2019. However, a group of lenders that joins forces and hires counsel to, for example, enforce their ability to credit bid at a bankruptcy auction, would appear to be "acting in concert" and would be subject to the rule.

It is not the intent of the rule that separately-represented creditors be required to comply with the disclosure requirements. Therefore, if multiple separately-represented creditors enter into a joint defense agreement to protect their otherwise privileged communications in respect of litigation within a Chapter 11 case, and each creditor files its own pleading on the issue, it is not the intent of the rule to require these creditors to comply with the disclosure requirements.

Has revised Rule 2019 affected the claims trading market?

The obligation under revised Rule 2019 to make public all "disclosable economic interests" carries with it an obligation to update the disclosure throughout the course of a Chapter 11 case. It is too early to tell whether these disclosure obligations will make distressed investors who are on ad hoc groups less likely to trade during the pendency of a case.

Likewise, we will have to take a wait-and-see approach to understand what impact, if any, the new rule might have on the claims trading market generally, and on the claims trading of individual creditors who are not part of a group.

Has revised Rule 2019 encouraged the formation of ad hoc committees?

While in each case there are a multitude of reasons why creditors will join together to form ad hoc groups, the disclosure requirements under revised Rule 2019 certainly do not provide a positive impetus for creditors to join forces. The real question is whether the new disclosure requirements create a meaningful disincentive for creditors to join ad hoc groups — a question which it is still too early to answer.

In light of revised Rule 2019, what factors would you advise creditors to consider before joining an ad hoc or official committee?

Creditors should be aware of the very broad definition of "disclosable economic interest" under revised Rule 2019 and that, unlike the practice under the old rule, holdings will need to be disclosed by institution rather than in the aggregate for the group. In addition, creditors should be mindful of the fact that the disclosure requirement is ongoing and must be updated in the event of any material change.

How has revised Rule 2019 affected the behavior of creditors?

The broad scope of disclosure required under revised Rule 2019 has clearly discouraged some creditors from participating in ad hoc groups, but it remains to be seen if this becomes a widespread phenomenon. It would certainly be a negative development for all interested parties in large and complex Chapter 11 proceedings if there were to be a decline in ad hoc groups, replaced instead by a proliferation of separately-represented creditors.

>> For a Practice Note providing an overview of revised Rule 2019, including the parties it covers, its initial and supplemental disclosure requirements, consequences of noncompliance and its practical implications, search Disclosure under Bankruptcy Rule 2019 on our website.

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