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Bankruptcy Law

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Rule 2019 - It's As Plain As The Nose On An Elephant's Face

Article contributed by: Robin Phelan, Autumn Highsmith and Kendra Mayer of Haynes and Boone, LLP

The Forgotten Rule

Federal Rule of Bankruptcy Procedure [2019](#) requires every committee in a chapter 9 or chapter 11 bankruptcy case “representing” more than one creditor or equity security holder to file a verified statement containing certain disclosures, such as the amount of claims held by members of the committee, the dates the members acquired their claims and the amounts paid for the claims.¹ In the event the court determines that there has been a failure to make the required disclosures, the court may refuse to permit the committee to be heard further or to intervene in the case, and may hold invalid actions taken by the committee.² In practice, committees largely ignored or only partially complied with Rule 2019. More recently, however, Rule 2019 has been used as a litigation tactic and has attracted much attention from judges and distressed debt traders.³ Even more controversial are proposed changes to Rule 2019 that are currently contemplated and may become effective at the end of 2011.

To date, only a handful of bankruptcy courts have considered the application and scope of Rule 2019 and they have been unable to agree upon the “plain meaning” of the rule and whether groups of creditors who act in concert constitute a Rule 2019 “committee.”

Cases Examining the Rule

Rule 2019 popped onto the radar screens of participants in reorganization cases when the court in *In re Northwest Airlines Corp.* issued two opinions.⁴ In the first, the court required members of an *ad hoc* committee of equity security holders to disclose the information required by Rule 2019, including the dates of acquisition of the interests and the price paid.⁵ The court focused on the actions and representations of the *ad hoc* committee, as well as the legislative history of Rule 2019. The court found that the actions and representations of the committee demonstrated that it represented one entity for purposes of the Rule 2019, because the committee members elected

to consolidate their collection efforts, appeared in the case as one, retained counsel collectively, compensated counsel on a *pro rata* basis, and gave counsel instructions based on the decision of the members as a whole.⁶ The court, therefore, compelled the committee to comply with Rule 2019's disclosure requirements.⁷

In a second opinion in *In re Northwest Airlines Corp.*, the judge refused to allow the committee to file Rule 2019 disclosures under seal.⁸ The court explained that it is a "basic tenet of our jurisprudence that court records are public and 'open to examination by an entity at reasonable times without charge.'"⁹ In addition, the court noted that the committee's concern that disclosing Rule 2019 information would allow competitors to discern certain investment strategies was "improbable" and any interest individual committee members had in keeping information confidential was overridden by the interests that Rule 2019 seeks to protect.¹⁰ Accordingly, the court concluded the committee had no basis for protection pursuant to [11 U.S.C. § 107\(b\)](#).¹¹

In *In re Scotia Dev. LLC*, the *ad hoc* noteholder group provided certain disclosures in the bankruptcy case, but the debtors filed a motion to compel the noteholder group to comply with Rule 2019, specifically seeking disclosures related to prices paid and received for the debt and individual trading histories of each member.¹² Without providing any elaboration, the court denied the motion in its entirety. The court declared that the noteholder group was not a "committee" within the meaning of Rule 2019, and the noteholder group was not subject to the disclosure requirements under Rule 2019.¹³ Given that the court's opinion sets forth only the court's conclusion and does not provide any supporting authority or legal reasoning, this case provides little guidance for other courts considering the issue.

In *In re Washington Mutual Inc.*, 23 entities, constituting the Washington Mutual Inc. noteholders group, argued that Rule 2019 did not apply because the noteholders group was merely a loose affiliation of creditors who, in the interests of efficiency, decided to share the cost of advisory services.¹⁴ After reviewing the plain language of the statute, the court held that the noteholders group was an *ad hoc* committee subject to Rule 2019, since a loose affiliation of creditors is a defining characteristic of an *ad hoc* committee.¹⁵ As further support, the court stated that the noteholders group possessed virtually all the characteristics typically found in an *ad hoc* committee, including appearing in the case collectively and retaining counsel as a group.¹⁶ Because the noteholders group fell within the ambit of Rule 2019, it was compelled to provide certain disclosures.¹⁷ In addition, Judge Walrath noted that the noteholders group's argument that Rule 2019 was only intended to apply to a body purporting to speak on behalf of an entire group in a fiduciary capacity was based on an erroneous assumption that the noteholders group owed no fiduciary duty to similarly situated creditors inside or

outside the noteholders group.¹⁸ Judge Walrath went on to say that members of a class of creditors may, in fact, owe fiduciary duties to other members of the class.¹⁹ Needless to say, this suggestion was not well received by distressed debt traders.

The court in *In re Accuride Corp.* granted a motion to compel compliance with Rule 2019 "for the reasons stated in [o]pen [c]ourt."²⁰ The order provided no other support for the court's decision; however, the court in *Philadelphia Newspapers*²¹ reviewed the restricted transcript of the hearing and reported that the transcript revealed that Judge Shannon concurred with the conclusions reached in the *Northwest* and *Washington Mutual* cases, but did not concur with the *Washington Mutual* court's suggestion that fiduciary obligations may arise in the context of multiple representation.

A different conclusion was reached in *In re Premier International Holdings, Inc.*, commonly known as the Six Flags case, where Judge Sonchi considered whether an informal committee holding notes issued by one of the debtor's subsidiaries was a "committee" within the context of Rule 2019.²² The court examined the plain meaning of Rule 2019 and concluded that a committee consists of a "group representing the interests of a larger group with that larger group's consent or by operation of law."²³ Since the informal committee did not meet this definition, Rule 2019 did not apply.²⁴ In reaching its decision, the court declined to follow the holdings in *In re Northwest Airlines Corp.* and *In re Washington Mutual*.²⁵ The *Premier* court noted that those courts misread the plain meaning of the language of Rule 2019, failed to adequately interpret the legislative history, placed an inappropriate emphasis on roles *ad hoc* committees play, and ignored that a legitimate committee requires formal formation.²⁶ The court also stated that a thorough review of the legislative history was unnecessary (although the court provided a comprehensive background of events that prompted the passage of Rule 2019), because legislative history should not be taken into account when the plain meaning of a statute is unambiguous.²⁷ In effect, the court held that a Rule 2019 committee must be appointed to act in a representative capacity and be delegated some duty by those it represents.²⁸ In contrast, the "committee" in *Premier* was self appointed and had no authority to speak for the other note holders.²⁹

A similar conclusion was reached in *In re Philadelphia Newspapers, LLC*, where a self-styled steering group of prepetition lenders consisted of lenders holding a majority of the debtors' outstanding secured debt.³⁰ The court determined that the plain meaning of Rule 2019's text rendered it inapplicable to the steering group.³¹ The court found that "committee," within its ordinary meaning or the common usage of the term, is a body appointed by a larger body for some specific purpose.³² Thus, since the steering group formed itself, the court held it was not a "committee"

within the meaning of Rule 2019.³³ In addition, after examining the legislative history, the court pointed out that if Rule 2019 already covered the steering group, there would be no need for the proposed amendments.³⁴

Do I Have to Disclose My Grandmother's Holdings?

Significantly, the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States ("Rules Committee") has proposed a complete rewrite of Rule 2019 ("Proposed Rule 2019"), including a change in title to reflect the broadened focus of the required disclosures.

Proposed Rule 2019(a) contains the definition of "disclosable economic interest" that is used throughout the remainder of Proposed Rule 2019. "Disclosable economic interest" is 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." In their notes, the Rules Committee explains that this definition is "intended to be sufficiently broad to cover any economic interest that could affect the legal and strategic positions a stakeholder takes in a chapter 9 or chapter 11 case." This broad language will likely lead to litigation since it could be read to cover indirect economic interests such as a significant debt or equity position in a major competitor of the debtor or a short position in a non debtor company that is dependent upon its continuing relationships with the debtor as a supplier or customer.

Proposed Rule 2019(b) continues to require disclosures by an entity or unofficial committee that *represents* more than one creditor or equity security holder, while extending the rule's reach to unofficial committees *consisting of* more than one creditor or equity security holder and to groups of creditors or equity security holders *acting in concert* to advance common interests, even in cases where a group of creditors does not call itself a committee. Additionally, Proposed Rule 2019(b) gives a bankruptcy court, *sua sponte* or on motion of a party in interest, the authority to require disclosures from any entity that seeks or opposes the granting of relief in a bankruptcy case. This portion of Proposed Rule 2019 allows a court to order disclosure, even from a single creditor, anytime the court determines that knowledge of a party's economic stake in the debtor could assist the court in evaluating that party's position or motivation.

Proposed Rule 2019(b) requires that every entity, group, or unofficial committee that consists of or represents more than one creditor or equity security holder file, with respect to each member of the group or committee, a verified statement which must include: (1) name and address; (2) the nature and amount of each disclosable economic interest held in relation to the debtor as of the date the entity was employed or the group or unofficial

committee was formed; and (3) the acquisition date of any disclosable economic interest acquired within the year before the bankruptcy petition was filed. Proposed Rule 2019(c)(2)(B) gives the bankruptcy court discretion to require the disclosure of the amount paid for each disclosable economic interest, but does not automatically require such disclosure. Similar information is required of creditors or equity security holders represented by an unofficial committee. Proposed Rule 2019(c)(1) requires disclosure of the facts and circumstances surrounding the employment of an entity or indenture trustee and the formation of a group or unofficial committee, including the name of each entity directing the employment of an entity or formation of an unofficial committee, and the names of each entity for whom a group or unofficial committee has agreed to act. Monthly updates are required. Although the disclosure of the price paid is not mandatory, debt traders argue that disclosure of the acquisition or sale date will reveal the price since pricing information is readily available.

Proposed Rule 2019(e) gives a bankruptcy court the power to determine whether there has been a violation of Proposed Rule 2019, [11 U.S.C. § 1125\(b\)](#), or other applicable law, and the power to impose appropriate sanctions for any violation. If a group or committee violates the Proposed Rule 2019, the court can prevent it from being heard or intervening in the bankruptcy case, invalidate actions taken by the group or committee and grant other sanctions as determined by the court.

The Debate

Proponents of the Proposed Rule 2019 contend that the judge in a chapter 11 case needs to know the agenda of parties advocating positions before the court since the parties may have short positions in the securities of the debtor or are holders of credit default swaps, or other derivatives, that dictate an economic interest that is counter to the best interest of the debtor and other creditors. Creditors who purchase debt at substantial discounts may be more interested in the short term return on their investment than the long term stability of the reorganized debtor. Transparency must be maintained to allow all parties to participate in the case and to permit judges to maximize value and protect the interests of all stakeholders. Some judges believe that they need to know where the party is coming from if someone is trying to influence a court.

Opponents have focused on the requirements to disclose the dates of purchase and the ability of the court to require disclosure of the price paid. They point out that the agent for a syndicate of lenders may be required to disclose the amount, price and acquisition date for all members of the syndicate. The disclosure of this proprietary information, they contend, will discourage the debt traders and syndicate members from participating in the bankruptcy and that such disclosure will

change the negotiating position of participants in the market. Discouraging the formation of informal committees will just add more lawyers in the courtroom as individual creditors each retain counsel and act independently. The ability of creditors to sell their claims may also be negatively affected. Opponents fear that the Proposed Rule 2019 will increase its use by parties as a litigation tactic. It has even been suggested that Rule 2019 be repealed in its entirety since relevant information can be obtained through the discovery process and other means.

While both sides of the debate raise good points, substantially absent has been an examination of what is the role of the court and what will the court do with the information covered by the Proposed Rule 2019. If a party takes a position in a hearing should the court rule on the substantive facts and the law, or should the court alter its ruling because of the motivations of the parties? If the legal position of a claimant is correct, is it really relevant that the claimant (or possibly an affiliate of the claimant) holds a short position or contract at another level of the debtor's capital structure? Is the price paid by a claimant who bought a claim any more relevant than the margin of a trade creditor on its trade claim, or the fact that a creditor holds a guaranty, which is effectively the same as a credit default swap? Is a trade creditor with a 30 percent net margin entitled to a different ruling from the court than a distressed debt creditor who bought at 70 cents on the dollar? Is the bank in a lender syndicate which loaned 100 cents on the dollar entitled to a different ruling from the court than another member of the syndicate that bought the claim for 20 cents on the dollar? Unless it is determined that creditors who purchased below par, or who hold short positions, or who have guarantees, or hold other economic positions that are different from the garden variety creditor are not entitled to equal treatment by the court, the wisdom of Proposed Rule 2019 can be questioned. Of course, the debtor and other parties in interest would *like* to know this information. The real question is whether they are *entitled* to that information and whether it is appropriate for the bankruptcy court to evaluate the motivations of those who advocate positions in a chapter 11 proceeding. Before price and other additional disclosures are required, these questions should be addressed.

Robin Phelan is a partner in the Dallas office of Haynes and Boone, LLP. His practice is exclusively devoted to insolvency, reorganization and related areas, including extensive litigation in the bankruptcy court and other federal courts. He works with other Haynes and Boone attorneys to analyze the effect of bankruptcy on corporate and financial transactions.

Autumn Highsmith is a Dallas Haynes and Boone, LLP associate focused in the areas of business reorganization and bankruptcy and related litigation, including representation of chapter 11 debtors, secured and unsecured creditors, and parties looking to acquire assets out of bankruptcy.

Kendra Mayer is a Dallas associate in the Haynes and Boone, LLP Bankruptcy and Business Restructuring Practice Group. Her practice is focused on the representation of chapter 11 debtors, secured and unsecured creditors, as well as other parties-in-interest in business reorganization and bankruptcy situations.

¹ Fed. R. Bankr. P. [2019\(a\)](#).

² Fed. R. Bankr. P. [2019\(b\)](#).

³ Debtors and others appear to have filed motions to compel compliance with Rule 2019 in order to achieve leverage over opponents since traders do not want to reveal the timing and pricing of their positions.

⁴ *In re Northwest Airlines Corp.*, [363 B.R. 701](#) (Bankr. S.D.N.Y. 2007); *In re Northwest Airlines Corp.*, [363 B.R. 704](#) (Bankr. S.D.N.Y. 2007) (where the debtor filed a motion to compel compliance with Rule 2019 by an *ad hoc* committee of equity security holders).

⁵ *In re Northwest Airlines Corp.*, 363 B.R. 701.

⁶ *Id.* at 703.

⁷ *Id.* at 704.

⁸ 363 B.R. 704.

⁹ *Id.* at 706.

¹⁰ *Id.* at 707.

¹¹ *Id.* at 709.

¹² Case [No. 07-20027](#) (Bankr. S.D. Tex. Apr. 18, 2007) (Schmidt, R.).

¹³ *Id.*

¹⁴ [419 B.R. 271](#) (Bankr. D. Del. 2009).

¹⁵ *Id.* at 274.

¹⁶ *Id.* at 275.

¹⁷ *Id.*

¹⁸ *Id.* at 278.

¹⁹ *Id.* at 279.

²⁰ Case [No. 09-13449](#) (Bankr. D. Del. January 20, 2010) (Shannon, J.).

²¹ *Discussed below.*

²² [423 B.R. 58](#) (Bankr. D. Del. Jan. 20, 2010).

²³ *Id.* at 65.

²⁴ *Id.*

²⁵ *Id.* at 74–76.

²⁶ *Id.*

²⁷ *Id.* at 65.

²⁸ *Id.* at 65.

²⁹ *Id.* at 65, 75.

³⁰ [2010 BL 23870](#) (Bankr. E.D. Pa. Feb. 4, 2010).

³¹ *Id.* at 28.

³² *Id.* at 24.

³³ *Id.*

³⁴ *Id.* at 27.

District Court Affirms Bankruptcy Court's Ruling that Case Should Be Consolidated with Claims Sharing Common Issues and Questions of Fact

[Quillen v. Guttman, No. 06-15938, 2010 BL 74876 \(D. Md. Apr. 5, 2010\)](#)

On April 5, 2010, the United States District Court for the District of Maryland affirmed the bankruptcy court's ruling that: (1) the appellant's case should be consolidated with