BANKRUPTCY ALERT

AMENDED BANKRUPTCY RULE 2019

On April 26, 2011, the United States Supreme Court adopted several amendments to the Federal Rules of Bankruptcy Procedure, including amendments to Rule 2019 – a rule of particular interest to bankruptcy participants in the lending, hedge fund and private equity communities. The amended Rule 2019 expands both the applicability and the scope of the disclosure requirements on parties who work together in a bankruptcy case. Whether parties collaborate to further some shared interest, to create sufficient leverage to participate more meaningfully, or simply to defray costs, the new Rule carries important and potentially prejudicial disclosure requirements.

The Amendments will become effective December 1, 2011, absent Congressional action to block them.

Rule 2019 – Currently

In general, Rule 2019 concerns the disclosure requirements imposed on creditors and equity security holders in cases brought under chapters 9 or 11 of the Bankruptcy Code. As currently written, Rule 2019 applies to "every entity or committee representing more than one creditor or equity security holder," and requires the disclosure of, among other things, "the nature and amount of the claim or interest and the time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition," by each such entity or committee member. The exact scope of the Rule, and the information required to be disclosed, has been the subject of several high profile cases recently, and has created a split among jurisdictions (and, in Delaware, has actually created a split within the court).

Rule 2019 – As Amended

Amended Rule 2019 modifies the applicability and the scope of the Rule, presumably in response to the recent case law that created the conflicting precedent.

Who Must Disclose: As amended, Rule 2019 will impose disclosure requirements on "every group or committee that consists of or represents, and every entity that represents, multiple creditors or equity security holders that are (A) acting in concert to advance their common interests, and (B) not composed entirely of affiliates or insiders of one another." Among other things, the new language now specifically requires disclosure by informal or "ad hoc" groups of creditors, each of which under current rules may not be required to disclose. Notably, indenture trustees and agents under credit agreements (in addition to committees appointed under Sections 1102 or 1114 of the Bankruptcy Code) are explicitly excepted from this disclosure requirement.

What Must Be Disclosed: As amended, new subdivision (c) of Rule 2019 would require, *inter alia*, the disclosure of:

- "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 committee was formed," and as of the date of the statement; and

- with respect to each member of a group or committee that claims to represent any entity in addition to the members of the group or committee, the date of acquisition by quarter and year of each disclosable economic interest, unless acquired more than one year before the petition was filed.

In this context, "disclosable economic interest" means "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."

Takeaways

In short, this amendment makes two important changes (in addition to a few more nuanced changes). First, the rule requires the disclosure of all "disclosable economic interests," not just claims against the estate. Second, it only requires that members of a group or committee disclose "the date of acquisition by quarter and year of each disclosable economic interest" if the relevant group or committee claims to represent parties that are not a member of the group or committee.

The real impact of these changes will develop over time as parties (and courts) consider the nuances of "disclosable economic interests," "nature and amount," and what interests are "held in relation to the debtor" (i.e., does a material interest in a debtor's primary competitor "relate to the debtor"?). However, while those and other issues play out in the courts and courtrooms, certain things are clear. **First**, derivatives and other "economic interests" are now clearly considered relevant to bankruptcy proceedings. Congress and the courts continue to express concern about the potentially contradictory economic incentives that swaps and other risk-averting products create in the bankruptcy context, and courts may now have the ammunition by which they can require full disclosure of those competing interests. **Second**, careful planning – at the very earliest stages of any case – can be critical. The more onerous (and potentially prejudicial) disclosure regarding the timing of the acquisition can be avoided through careful wording of the ad hoc committee's mandate and pleadings. Moreover, most (if not all) of these disclosure requirements may be avoidable through separate representation – parties with separate legal counsel, even those acting in a coordinated manner and subject to joint defense or similar doctrines, do not have disclosure obligations under amended Rule 2019 (although the traditional litigation discovery and disclosure obligations remain).

Questions?

If you have any questions regarding the information in this bulletin, please contact:

- Henry P. Baer, Jr., 203-325-5083, HBaer@fdh.com

- Tony Miodonka, 203-325-5034, TMiodonka@fdh.com

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