WHO IS AT THE TABLE?
INTERPRETING DISCLOSURE REQUIREMENTS
FOR AD HOC GROUPS OF INSTITUTIONAL
INVESTORS UNDER FEDERAL RULE OF
BANKRUPTCY PROCEDURE 2019

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This Note explores Federal Rule of Bankruptcy Procedure 2019’s disclosure requirements when hedge funds and other institutional investors appear as groups in Chapter 11 cases. In particular, this Note traces the history of Rule 2019 and the various corporate reorganization mechanisms to explain the split between two bankruptcy courts on whether these groups constitute “committees” under Rule 2019. This Note cites the fundamental differences between these groups and protective committees—the committees charged with representing security holders under federal equity receiverships. Hence, ad hoc groups do not have to make detailed disclosures of each individual transaction, disclosure that would be required if the groups were considered “committees.” However, the current industry practice insufficiently discloses the economic interests at stake. This Note advocates renewed emphasis on individual fund holdings and revision of Rule 2019 to require disclosure of positions at other areas of the capital structure.

INTRODUCTION

When Adelphia Communications Corp. agreed to a sale of substantially all of its assets to Time Warner Cable and Comcast Cable in 2005,¹ it set off a lengthy battle among a number of noteholder groups in the U.S. Bankruptcy Court for the Southern District of New York: how would $17 billion be divided among thousands of creditors, each jockeying to secure the largest piece of the pie? Adelphia and several hundred of its operating and holding company subsidiaries filed for Chapter 11 protection under the

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Bankruptcy Code in 2002.² Adelphia was riddled with problems, both legal and financial, following criminal misconduct on the part of its founders and certain company insiders.³ At last, the creditors, waiting for years, began to see the light at the end of the tunnel following Adelphia’s settlement with the Securities and Exchange Commission (SEC) and the Department of Justice.⁴ But to resolve the bankruptcy case—and receive payment on their notes—the groups had to litigate a number of issues critical to the confirmation of a plan of reorganization by July 31, 2006, or risk losing the Time Warner and Comcast deals.⁵

Given Adelphia’s complex corporate structure,⁶ its prepetition practices of issuing subordinated unsecured notes from its subsidiaries,⁷ and its internal accounting practices,⁸ holders of unsecured claims against some subsidiary debtors stood to receive drastically different distributions under any proposed plan.⁹ Critical to the finalization of any plan was the determination of certain issues related to interdebtor (and consequently intercreditor) transactions.¹⁰ The groups that actively litigated these intercreditor issues were the noteholders, primarily institutional investors whose business involves the high-risk, high-reward practice of distressed

² See Adelphia, 368 B.R. at 148–49.
⁴ See Peter Grant & Deborah Solomon, Adelphia to Pay $715 Million in 3-Way Settlement, Wall St. J., Apr. 26, 2005, at A3 (discussing Adelphia’s agreement with the federal government to resolve claims of looting and accounting fraud that led the company into Chapter 11).
⁵ See Adelphia, 368 B.R. at 154; Adelphia Disclosure Statement, supra note 3, at 188; see also Peter Grant, Adelphia’s Sale Plan Suffers a Blow: Major Creditor Group Vows to Reject Proposed Payout, Saying It Favors Subsidiary, Wall St. J., Apr. 19, 2006, at C5 (discussing the risk to the Adelphia sale posed by noteholder group litigation).
⁶ See Adelphia, 368 B.R. at 146, 156 (confirming the reorganization plan for “230-odd Debtors” described as a “rather complex parent-subsidiary structure”).
⁷ See generally Adelphia, 368 B.R. at 156 (discussing the various noteholder constituencies); Adelphia Disclosure Statement, supra note 3, at 67–72.
⁸ See Adelphia, 368 B.R. at 150–53 (discussing the “Bank of Adelphia paradigm” and Adelphia’s extensive restatement of its prepetition books).
⁹ See id. at 162 n.35 (noting the “significant detriment” that would occur to some creditors depending on how certain intercreditor issues were resolved); Gregory Zuckerman & Peter Grant, Adelphia Debt Stings Investors: Prices Fall Amid Assets Dispute and Doubts over Cable’s Future in Face of Telecoms’ Competition, Wall St. J., Dec. 23, 2005, at C1 (explaining how the uncertainty of Adelphia’s bankruptcy led to depressed prices on the company’s debt in 2005).
¹⁰ See Adelphia, 368 B.R. at 152–53 & n.12 (describing the “waterfall” analysis leading to the dispute over the accounting and legal implications of the company’s book restatements and noting that certain bondholder groups could be significantly affected by the proposed resolutions to the intercreditor dispute); Zuckerman & Grant, supra note 9 (summarizing the intercompany claim dispute between parent company noteholders and subsidiary noteholders).
Like other creditors, noteholders of Adelphia companies were creditors of the individual companies that issued their notes. Consequently, the noteholders organized themselves into groups to litigate these issues, with holders of notes issued by the Adelphia parent company banding together because of their similar interests and holders of notes issued by the various subsidiary companies banding together into groups by subsidiary issuer. In order to efficiently and systematically resolve these various intercreditor issues, the court approved the debtors’ motion in aid of confirmation, which established discovery and trial procedures for each of the intercreditor issues.

The motion in aid proceedings began discovery in the fall of 2005 and contemplated a series of six one-week trials on the various issues to be held in February and March 2006. By the time the second trial had reached the middle of March, it became clear that the motion in aid proceedings would not be resolved before the July 31, 2006, deadline. Eventually, the companies’ assets were sold and a plan was confirmed, but only after the noteholder groups, the creditors’ committee, and the debtors reached a settlement.

Adelphia’s story illustrates the incredible power and influence that security holders can have in modern Chapter 11 corporate reorganizations. For complex, public companies like Adelphia, reorganization is a multibillion-dollar puzzle, and few unsecured creditors or shareholders have the resources to vindicate their claims and interests against bankrupt companies. Even institutional investors would be unable to individually bear the costs of protecting their rights under the Bankruptcy Code.

11. See Zuckerman & Grant, supra note 9; see also Adelphia, 368 B.R. at 156–57, 159–61 (discussing the litigation and involvement of the ad hoc investor groups in the Adelphia reorganization); Peter Grant, Adelphia Gains Some Ground in $17 Billion Reorganization, Wall St. J., July 25, 2006, at B6.
12. See Adelphia, 368 B.R. at 156 (identifying noteholders’ status as creditors).
13. See Zuckerman & Grant, supra note 9 (reporting on the litigation between noteholders of the parent company and noteholders of its subsidiary, Arahova Communications, over “how billions of dollars of claims are treated in Chapter 11 of the U.S. Bankruptcy Code”).
14. See Adelphia, 368 B.R. at 157–58 (confirming a Chapter 11 plan and discussing the lengthy case history, including the motion in aid proceedings); Adelphia Disclosure Statement, supra note 3, at 190.
16. See id. at 162, 165 (discussing the length of the proceedings and the importance of the sale closing before July 31, 2006); Grant, supra note 5.
17. The sale of most of the assets was accomplished pursuant to section 363 of the Bankruptcy Code instead of through a plan of reorganization. See Adelphia, 368 B.R. at 169–70. However, Adelphia had to rush through a plan of reorganization for its joint venture debtors to Comcast Cable, further delaying the motion in aid proceedings. Id. at 169.
18. See id. at 238–44.
19. See Grant, supra note 11 (reporting that noteholder litigation in Adelphia posed a serious threat to the closing of sale transactions).
However, when they pool their resources, hire a single law firm to represent them, and speak with a collective voice, they can be successful in maximizing recoveries under a plan of reorganization by securing “a seat at the table.”

Consequently, the appearance of so many ad hoc groups can make it difficult to tell who is really at the negotiating table in a bankruptcy reorganization. One major way that parties in bankruptcy and the court are advised of the interests at play is through the filing of verified statements made by counsel to ad hoc groups pursuant to Federal Rule of Bankruptcy Procedure 2019. As David M. Friedman, counsel to the official committee of unsecured creditors of Adelphia, has stated, “2019 is a provision that requires public disclosure of what people hold for obvious reasons. It is appropriate to know when somebody stands up in court, somebody takes a position, somebody . . . files pleadings, it’s appropriate to know who their clients are and what their positions are.”

Increasingly, the people at the negotiating table in bankruptcy reorganizations are distressed investors, including many sophisticated institutional investors and hedge funds. Alternately praised and vilified, these distressed investors hold corporate securities, including debt and equity securities, which offer high rates of interest outside of bankruptcy in exchange for high risk. Therefore, when an issuer files for bankruptcy, these security holders band together to form ad hoc informal groups to represent their similar interests in the issuer’s bankruptcy. Yet, these

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22. Transcript of Motions at 66, Adelphia, 368 B.R. 140 (No. 02-41729) [hereinafter Adelphia, Sept. 11, 2006, Hearing Transcript]. Counsel to a group of noteholders, however, argued that the group’s Rule 2019 statement was both adequate and the same as everyone else’s: “I would also mention . . . that we have done what each of the other litigants, attorneys in this case have done in 2019s, and said that the debt was acquired at various times . . . [I]t’s not a matter of a new group coming in that suddenly made acquisitions.” Id. at 125.
23. Marie Beaudette, Dry Spell in Bankruptcy Filings Is Expected to End in 2007: Risks Rise for Homebuilders, Hospitals, Daily Bankr. Rev., Jan. 2, 2007, at 1, 9–10 (stating that hedge fund creditors are already a “major presence in Chapter 11 cases” and that experts predict hedge funds and other distressed investors, including private equity firms, will grow in influence in corporate restructurings in the future); Nurnberg & Rosenblat, supra note 21 (describing the hedge fund tactic of investing at multiple layers of a company’s capital structure).
24. See infra note 181 and accompanying text.
25. See infra Part I.B.2.b.ii; see also Peter Lattman & Karen Richardson, Hedge Funds Play Hardball with Firms Filing Late Financials, Wall St. J., Aug. 29, 2006, at A1 (discussing the role of hedge funds as bondholders for certain debt issuances).
26. See Mayr, supra note 20, at 7 (“Distressed investors often form unofficial or ad hoc committees/groups in connection with Chapter 11 cases. These informal arrangements permit parties with similar interests to coordinate action and speak with one voice . . . .”).
securities continue to trade during the bankruptcy case, and group membership can, and frequently does, change.27 When these distressed investors appear in bankruptcy cases as part of an ad hoc group, their counsel will file the required Rule 2019 statement.28 Since these statements disclose an attorney-client relationship between a law firm and a number of client creditors or shareholders, Rule 2019 requires disclosure of the nature and amount of the clients’ claims or equity interests and the time of acquisition thereof.29 However, if the group represented by that attorney is considered a “committee” under Rule 2019, additional disclosures must be made—disclosures that point directly to the buying and selling of securities, and the prices paid for those securities.30 Complicating this distinction is that the groups often call themselves ad hoc committees.31 However, for hedge funds and some other institutional investors, the distinction is critical because hedge funds go to great lengths to keep their investment strategies a secret. As a result, ad hoc groups disclose the group’s aggregate holdings instead of each holder’s relative stake.32

Recently, Judge Allan Gropper of the U.S. Bankruptcy Court for the Southern District of New York in In re Northwest Airlines Corp. ordered a group of equity holders to disclose their trading and investment history under the more stringent standard of Rule 2019(a)(4), concluding that the concerted efforts of the group of equity holders qualified them as a committee under Rule 2019.33 After the decision in Northwest,34 the

27. See Zuckerman & Grant, supra note 9 (discussing a decline in the price of one Adelphia bond during 2005, which was probably attributable to the uncertainty of the Adelphia outcome).
28. See Mayr, supra note 20, at 7 (noting that counsel to ad hoc committees voluntarily file Rule 2019 statements “disclosing the existence of the group, its members’ names and the group’s aggregate holdings”).
29. Id.; see Fed. R. Bankr. P. 2019(a)(2). The time of acquisition that must be disclosed, however, can be quite vague. See Adelphia, Sept. 11, 2006, Hearing Transcript, supra note 22, at 125 (noting that counsel stated that his disclosure that claims were acquired at various times satisfied Rule 2019).
30. See Fed. R. Bankr. P. 2019(a)(4) (requiring members of a committee other than an official committee to disclose the time of acquisition of claims, the amounts paid for the claims, and any buying or selling of claims); see also Marc Abrams et al., Intersection Between Bankruptcy and Securities Law: Outline of Topics/Issues to be Addressed at 9th Annual N.Y.C. Bankruptcy Conference by Panelists on Bankruptcy/Securities Law Intersection § I.B.1 (2007). The distinction between committee disclosures and disclosures for multiple creditors represented by a single attorney is not readily apparent in the rule and has caused some confusion. See In re CF Holding Corp., 145 B.R. 124, 126–27 (Bankr. D. Conn. 1992) (stating that counsel “misread” the requirements of Rule 2019, confusing the standards under Rules 2019(a)(2) and 2019(a)(4), which only applies to “the entity filing the Rule 2019 statement”).
31. See Mayr, supra note 20, at 7.
32. See Nurnberg & Rosenblat, supra note 21.
34. The Northwest decision also spurred motions in several other bankruptcy cases, namely, In re Le-Nature’s, Inc., No. 06-25454 (Bankr. W.D. Pa. 2007), In re Musicland
debtors in *In re Scotia Development, LLC* filed a similar motion seeking an order compelling an ad hoc group of bondholders to comply strictly with Rule 2019, but the motion was rejected by Judge Richard Schmidt of the U.S. Bankruptcy Court for the Southern District of Texas because the group did not constitute a committee under Rule 2019.35 Judge Schmidt expressly rejected the *Northwest* decision and chose to follow what he called “a practical approach” based on bankruptcy practices commonly followed in large Chapter 11 cases.36

Many in the distressed investing community are interested in the resolution of this split. The participation of hedge funds in today’s bankruptcy cases places key bankruptcy interests, such as open and public reorganization, in conflict with the secretive business models and practices that make hedge funds successful business ventures. With many insolvency experts predicting the next big wave of Chapter 11 filings, and so many hedge funds entrenched in large holdings of corporate securities, figuring out what disclosures must be made by investors appearing in bankruptcy

*Holding Corp*, No. 06-10064 (Bankr. S.D.N.Y. 2007), and *In re Dura Automotive Systems, Inc.*, No. 06-11202 (Bankr. D. Del. 2007). However, these controversies were settled before any decisions interpreting the application of Rule 2019 to ad hoc investor groups were made. See Letter from Loan Syndications & Trading Ass’n and the Sec. Indus. & Fin. Mkts. Ass’n to Peter G. McCabe, Sec’y, Comm. on Rules of Practice & Procedure of the Judicial Conference of the United States 6 (Nov. 30, 2007) [hereinafter LSTA/SIFMA Comment Letter], available at http://www.sifma.org/regulatory/pdf/BankruptcyRule2019Letter.pdf; see also Motion to Compel Counsel for Certain 9% Subordinated Noteholders to Comply with Bankruptcy Rule 2019 Disclosure Requirements, *Dura Automotive*, No. 06-11202 (Bankr. D. Del. Nov. 2, 2007); Memorandum of Law in Support of Motion by Wachovia Bank, National Ass’n, for an Order Compelling the Informal Committee of Secured Trade Vendors to File a Verified Statement Pursuant to Bankruptcy Rule 2019(A), *Muscleland*, No. 06-10064 (Bankr. S.D.N.Y. July 31, 2007); Motion of Wachovia Bank, National Ass’n for Order Compelling Ad Hoc Committees to Fully Comply with Bankruptcy Rule 2019, *Le-Nature’s*, No. 06-25454 (Bankr. W.D. Penn. May 9, 2007); Posting of Ben Feder to Overheded, http://overheded.blogspot.com/2007/11/dura-automotive-seeks-disclosure-under.html (Nov. 6, 2007, 10:00 EST). Despite a formal objection from the subordinated noteholders in *Dura Automotive*, the parties represented to the court that the matter was settled, and shortly after the filing of the Rule 2019 motion, counsel to the noteholders filed a detailed Rule 2019 statement, including the date of acquisition of, and price paid for, the holders’ notes. See Transcript of Motions on Shortened Notice Hearing at 4, *Dura Automotive*, No. 06-11202 (Bankr. D. Del. Nov. 8, 2007) (withdrawing motion from hearing when debtors’ counsel stated that it was their “expectation that [the Rule 2019 motion] should be resolved without the need for further intervention by the Court” because counsel to the noteholders had agreed to file an amended Rule 2019 statement); Supplemental Verified Statement of Ballard Spahr Andrews & Ingersoll, LLP Pursuant to Federal Rule of Bankruptcy Procedure 2019 at ex. A, *Dura Automotive*, No. 06-11202 (Bankr. D. Del. Nov. 7, 2007) (setting forth the “Name and Address,” “Face Value of Bonds,” “Dates of Acquisition,” “Amount Paid,” and “Sale or Disposition” for each holder and his or her bonds).


cases is a critical question in Chapter 11 practice. The Loan Syndications and Trading Association (LSTA) and the Securities Industry and Financial Markets Association (SIFMA), the leading trade associations of distressed investors, have predicted that distressed investors will no longer participate in the bankruptcy process should the Northwest classification of ad hoc groups as committees prevail. Because very few cases have addressed how Rule 2019 applies to ad hoc groups, the distressed investor community is keenly interested in resolution of this problem. In fact, LSTA and SIFMA submitted a letter to the Judicial Conference Committee on Rules of Practice, Procedure, and Evidence seeking the repeal of Rule 2019, calling it “obsolete” and arguing that it adversely affects the interests of key participants in the Chapter 11 process.

Over the past century, corporate reorganization in the federal courts has morphed from a general equitable principle into the complex and highly structured Chapter 11 bankruptcy proceedings employed by companies like

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37. See Henry T.C. Hu & Jay Lawrence Westbrook, Abolition of the Corporate Duty to Creditors, 107 Colum. L. Rev. 1321, 1375 n.193 (2007) (highlighting the importance of the “roaring controversy over [hedge fund] disclosure obligations under [Rule 2019]”); The Vultures Take Wing, Economist, Mar. 31, 2007, at 77, 77 (noting the role that banks and hedge funds plan to play in what many predict to be an active distressed and bankruptcy market); cf. Erika Lovley, How Troubled Firms Skip Bankruptcy Court, Wall St. J., Feb. 7, 2007, at B5B (describing the increasing role of hedge funds and distressed investors in out-of-court restructurings, but noting that these out-of-court restructurings are the last chance to avoid bankruptcy court); see also Henry T.C. Wu & Bernard Black, Equity and Debt Decoupling and Empty Voting II: Importance and Extensions, 156 U. Pa. L. Rev. 625, 732–33 (2008) (describing how courts have disagreed on how Rule 2019 applies to distressed “vulture” investors who “often accumulate large stakes in a debt class that are likely to be pivotal in the expected restructuring”). Although Professors Wu and Black conclude that the debate is not that controversial since, “[i]n any case, creditors can avoid this rule in a number of ways, including not serving on ad hoc committees and, oddly, gaining membership on an official creditor committee,” which are exempt from Rule 2019, id. at 733, these solutions are not as easy as they sound. For one, the cost is sometimes too great for any single security holder to take on the cause by itself. See supra notes 20–21 and accompanying text. Furthermore, official committees are kept small to allow them to act as negotiating bodies. See infra Part I.B.2. With only a handful of seats on an official committee, and a number of different creditor groups in a complex reorganization, every creditor cannot get a seat at the table by becoming a member of an official committee. In Adelphia, for instance, there were approximately eight seats on the official committee of unsecured creditors, see Adelphia Disclosure Statement, supra note 3, at 412, while there were at least sixty different classes of creditors entitled to vote under the proposed plan, Id. at 2–4. Consequently, participation in an ad hoc group remains the most viable way for many institutional investors to actively appear in a Chapter 11 case.

38. See infra Part II.B.2.a.


40. LSTA/SIFMA Comment Letter, supra note 34.
Adelphia, Northwest Airlines, and Scotia Development. This Note explores the various ways in which equitable principles and federal statutes have governed reorganizations and the ways in which security holders have participated in each of these different mechanisms. In particular, this Note looks at a report issued by the SEC that laid the framework for Congress’s first significant foray into legislating a federal mechanism for corporate reorganization during the 1930s and at the many changes that followed. This report is the genesis for the predecessors to the modern Rule 2019, and understanding the report is a crucial step in interpreting Rule 2019 today.

Part II of this Note discusses the recent *Northwest* and *Scotia* decisions interpreting the application of disclosure rules to informal groups of investors. In particular, Part II contrasts the “plain meaning” of Rule 2019 to require disclosure by committee members under Rule 2019(a)(4) in *Northwest* with the “practical approach” requiring disclosure only from the group’s attorney in *Scotia*. Part II also discusses the positions advanced by LSTA and SIFMA in calling for the revision of disclosure requirements under Rule 2019.

After analyzing the conflict, Part III of this Note explains why ad hoc groups of institutional investors are not committees under Rule 2019. Judge Gropper’s position is understandable in light of a plain meaning reading of the rule. Yet, Rule 2019’s use of the word “committee” has a more specific meaning historically—and the meaning of “committee” in place at the time of drafting is more appropriate. Nevertheless, disclosure of some sort is required by the rule because the policy goals inherent in Rule 2019 are necessary checks on abuse of the reorganization process. Thus, Part III of this Note proposes a compromise that will ensure investor participation while still achieving the necessary policy goals of open and honest reorganizations and full disclosure of the true economic interests at stake in reorganizations. Finally, given the current hedge fund practice of holding multiple positions across a debtor’s capital structure, Part III suggests that Rule 2019 be revised to require disclosure of these cross-structure holdings in order to achieve the goal of revealing the true economic interests at stake in reorganization.

I. FROM EQUITY TO STATUTE: A HISTORY OF INVESTOR PARTICIPATION IN CORPORATE REORGANIZATION

Until recently, Rule 2019 acted mainly as a guideline for ad hoc groups. They have filed statements that disclose some information about their economic interests, but have not included all of the disclosures required in Rule 2019. However, in 2007, courts began to develop more fully the ways in which the rule applies to ad hoc investor groups. Rule 2019’s history and the various statutory and equitable processes under which it developed influence the meaning of the word “committee.” Part I.A begins with a brief history of corporate reorganizations in federal courts over the past hundred years. Specifically, Part I.A looks at a report of the SEC on committee involvement in equity receivership and the resulting statutory
changes Congress has enacted. In addition, Part I.A describes the shifts in reorganization theory enacted as part of the 1978 Bankruptcy Code. Part I.B then describes the various ways in which committees and groups of investors have participated in reorganizations in the various reorganization processes. Finally, Part I.C describes the disclosure requirements of Rule 2019 and the limited jurisprudence interpreting the Rule.

A. Receiverships, the SEC, and Congress: The Road to Modern Reorganizations

1. Federal Equity Receiverships

Corporate reorganization began in the federal courts under a system known as equity receivership. Reorganization, as a practical matter, was unavailable under the Bankruptcy Act of 1898, which provided mainly for the liquidation of legally insolvent corporations, defined as those companies whose liabilities exceeded their assets. No remedies were provided for those companies that were equitably insolvent or “unable to pay their debts as they mature[d].”

Absent a viable statutory procedure, federal courts, lawyers, and creditors “made up the rules as they played the game, which they called the ‘federal equity receivership.’” First, a creditor from a state other than the debtor’s would file a bill in equity against the troubled company. Federal courts, lawyers, and creditors were then able to invoke federal jurisdiction by diversity, thus removing the reorganization of debt from state courts. The creditor would...
seek the appointment of a receiver “of the debtor’s liking” on the grounds of the “debtor’s equitable insolvency,” and the debtor would consent to the receiver’s appointment.47

Under equity receiverships, a corporation’s management or the underwriter of a class of its securities would form protective committees for each of the different public classes of securities.48 These committees are intimately involved with the reorganization and are responsible for formulating plans of reorganization, which, after negotiations among the various committees, would ultimately be approved by the court.49

2. Section 77B

In 1934, Congress passed section 77B,50 which was the first “statutory reorganization process for non-railroad corporations.”51 This section, in essence, was a codification of the procedures of federal equity receiverships.52 Congress included certain provisions designed to ensure that plans were fair and equitable, nondiscriminatory, and economically feasible.53 Section 77B also sought to protect investors by requiring greater judicial scrutiny of protective committees.54

to obtain jurisdiction in the federal courts). As Tracy wrote, federal courts were preferable because “federal judges are usually abler men, because they have had more experience, particularly in equity matters, because their powers are broad and are generally exercised in a broad manner,” and because federal reported decisions provide a “wealth of precedent at the command of counsel.” Id. § 29.

47. See Bussel, supra note 41, at 1553.
48. See Tracy, supra note 46, § 10.
49. See Dean, supra note 44, at 538.
51. Bussel, supra note 41, at 1555.
52. See id.; Dean, supra note 44, at 546 (describing section 77B as “largely a codification of equity receivership procedure with particular attention to the more glaring defects of that method”).

53. See Bussel, supra note 41, at 1555; Dean, supra note 44, at 1555. Furthermore, section 77B was adopted in reaction to dicta contained in Northern Pacific Railway Co. v. Boyd, 228 U.S. 482 (1913), in which the U.S. Supreme Court questioned, but did not decide, whether the federal courts had jurisdiction to hear equity receiverships absent statutory authority. See Bussel, supra note 41, at 1555 (discussing Boyd’s holding as the genesis of the absolute priority rule, which requires that dissenting creditors be afforded a fair opportunity to participate in the reorganization if prereceivership shareholders received any distribution in the receivership sale). By the late 1920s and early 1930s, several Supreme Court cases seemed to cast doubt on the use of equity receiverships in the federal courts, suggesting perhaps that the province of the federal courts could be limited to railroads and other public utility company reorganizations. See First Nat’l Bank of Cincinnati v. Flershem, 290 U.S. 504, 515 n.7 (1934) (“All of the cases in which this Court appears to have exercised this power in aid of reorganization . . . dealt with railroads or other public utilities where continued operation . . . seemed to be required in the public interest.” (citations omitted)); Harkin v. Brundage, 276 U.S. 36, 52 (1928) (“We do not wish what we have said to be taken as a general approval of the appointment of a receiver under the prayer of a bill brought by a simple contract creditor simply because it is consented to at the time by a defendant corporation.”). For competing views of the jurisdiction of federal courts in equity receiverships following Boyd, see generally James N. Rosenberg, Reorganization—The Next
3. The SEC Report and the Chandler Act

In 1938, the statutory regime for corporate reorganizations changed again. Congress passed the Chandler Act, creating Chapter X, following an extensive eight-volume report by the SEC on “the strategy and techniques of reorganization committees.” The SEC report was written under the guidance of then–SEC Commissioner William O. Douglas and addressed the severe shortcomings in the corporate reorganization mechanisms then available to struggling corporations. It paved the way for the Chandler Act in 1938, which allowed corporations a better process of reorganizing in federal courts under the auspices of federal statutory law. Part I.A.3.a discusses the SEC report, the abuses it sought to eradicate, and Congress’s reaction in passing the 1938 Chandler Act.

a. The SEC Report on Protective and Reorganization Committees

Pursuant to its investigative powers authorized by the Securities Exchange Act of 1934, the SEC studied the work, activities, personnel and functions of protective and reorganization committees. The SEC report strongly criticized then-existing means of reorganization—namely, receivership, foreclosure, bankruptcy, and voluntary reorganizations—for failing in practice to carry out their theoretical goals. Reorganization, was, theoretically, an integral part of corporate law because it allowed for the systematic distribution of assets to creditors following business failure. In practice, though, these systems “conformed by and large to the...
requirements and objectives of the reorganizers”—those parties in positions of power, particularly management and the banks.61 These groups took control of reorganizations and used the process to their benefit and to the detriment of investors.62 For investors, reorganizations needed to be “expeditious, economical, fair, and honest.”63 Reorganization fell short of these ends because “[t]he systems of reorganization, the legal techniques, the protective committee system, have all been shaped to conform with the requirements of reorganizers.”64 Thus, these processes were “incompatible” with investors’ interests and “too often caused perversion of the functions of reorganization.”65

Corporate insiders were not the only ones causing perversion of the reorganization process. The SEC report pointed out that the “emolument[] of control” was equally attractive to outside groups.66 Because protective committees were also able to use the reorganization process to take control
of the company, “the efforts of the parties [were] in the main spent in a fierce struggle for control.”67

i. Perceived Abuses in the SEC Report

The SEC report strongly criticized the workings of protective committees, particularly those consisting of, or created by, company insiders.68 “By virtue of advance knowledge of the debtor’s affairs and practically exclusive possession of the indispensable bondholders lists” these “hand-picked” insider protective committees could have considerable, if not total, control over the reorganization process,69 largely to the detriment of individual security holders.70 Equally troubling was the fact that members of these insider committees also stood to gain financially from their participation in reorganizations.71 Such abuses prevented companies from achieving the theoretical goals of reorganization and needed to be eliminated.

Groups outside of the management’s direction were also frequently a part of the struggle for control of a reorganization,72 often “able to win a variety of victories and to make various profits,” despite often being unsuccessful in taking control of the company.73 The SEC report recognized, though,

67. Id. However, often the success of protective committees in taking control of the company depended on the “power, ability and prestige of those who presume to challenge the existing management and bankers.” Id. This fight for control remains, to some extent, a very hot issue in modern corporate reorganizations. For an example of noteholders challenging management, bankers, and one of the world’s wealthiest men for control of a multimillion-dollar steel company, and winning, see generally Order Confirming Consensual Modified Plan of Reorganization, In re WCI Steel, Inc., No. 05-81439 (Bankr. N.D. Ohio Mar. 30, 2006).
68. See Comment, supra note 54, at 230.
69. Id.
70. See id. (“Uninformed and helpless, the great majority of security-holders generally deposited their claims with such committees under agreements which bound depositors to any plan their representatives might adopt . . . .”).
71. See id. at 231 (noting that the use of protective committees also offered reorganizers “lucrative emoluments in the form of fees and patronage” and that this opportunity was therefore a “powerful incentive for a protective committee sponsorship by inside as well as other groups”; see also SEC, supra note 56, at 136 (detailing cases to provide “evidence of how rich the spoils of reorganization may be”). Further, the SEC report noted that “[b]ankers in control of the reorganization will be in a key position to obtain any underwriting . . . . [T]he history of reorganizations reveals that bankers controlling or in a position of influence . . . . will commonly obtain those contracts if the plan provides for an underwriting of the new securities.” Id. at 137.
72. See id. at 671 (noting that committees seemed to appear in all types of reorganizations, but were more prevalent in large corporate reorganizations because “the reorganization [was] likely to attract more attention” since “the stakes [were] higher,” but noting that “size alone [was] not controlling” since “outside interests may be galvanized into action where there has been gross mismanagement”).
73. Id. at 672 (observing, once again, that outside groups may be able to get themselves representation on the “dominant protective committees and reap the profits incident thereto” or “win representation on the board of directors of the reorganized company”). Management seemed to describe any outside group as “strikers,” a term used to describe those “with no status in the situation, either because they have no substantial financial interest at stake or
that these disruptive outsiders challenging management and the banks for control were actual security holders,\(^{74}\) and even security holders posed a threat to successful reorganization.\(^{75}\) At the same time, though, despite the significant challenges faced by outside groups in dealing with management, outside group participation could vastly improve the results of a reorganization from a security holder’s perspective.\(^{76}\)

In the reorganization of R. Hoe & Co., for example, an independent group developed consisting of security holders and their representatives.\(^{77}\) While counsel to the independent group of security holders had taken aggressive tactics in the reorganization, some of which were seen as distasteful and disparaging,\(^{78}\) the SEC report nonetheless recognized that counsel to the independent group “had a direct financial interest in Hoe which he was protecting and also represented other persons who were financially interested in the company.”\(^{79}\) Although criticizing his “objectives and tactics” of using “direct, forceful and . . . ‘vituperative’”

because they are motivated solely by the desire for personal profit.” \(^{Id.}\) at 673. The term often “connote[d] a species of blackmail.” \(^{Id.}\) The SEC expressed concern that dominant groups may simply pay off outsiders since they usually hold the outsiders in such low esteem. \(^{Id.}\) at 675. Nevertheless, the SEC pointed out that “there is also no doubt . . . that insiders sometimes seek to buy off a bona fide opposition group which is seeking not merely its own profit, but benefit to the class of security holders which it represents.” \(^{Id.}\) In the Baldwin Locomotive Works reorganization, for instance, noted in the SEC report, the independent bondholder committee had a serious interest in the reorganization, it consisted almost exclusively of security holders. \(^{Id.}\) at 677. Often, management would try to “test the integrity of the opposition” by putting out certain “feelers” to determine the motives of the independent committee. \(^{Id.}\) at 676. In the Baldwin Locomotive Works reorganization, this took the form of the inside protective committee making an offer to pay a commission to the independent committee if it sold some of the company’s real estate in order to raise new capital. \(^{Id.}\) at 677. The chairman of the independent committee acknowledged that this offer was an attempt by the inside committee to find out “whether I was the type of fellow that would take a price.” \(^{Id.}\) The SEC report concluded that the “attitude of regarding all outsiders as ‘strikers’ is serious. It tends to make opposition onerous, distasteful, and, even in the most necessitous situations, somewhat disgraceful in the eyes of a large segment of the public.” \(^{Id.}\) at 678.

74. See \(^{id.}\) at 677 (citing the reorganization of Baldwin Locomotive Works and its outside committee consisting almost exclusively of security holders).
75. \(^{Id.}\) at 797–98.
76. \(^{Id.}\)
77. \(^{Id.}\) at 678.
78. See \(^{id.}\) at 679 (mentioning that counsel to the independent committee had made a “disparaging” motion to disqualify counsel to the receiver on the grounds that their representation of the receiver was in conflict with their former representation of the corporation). Interestingly, a similar motion was made by counsel to the Arahova noteholders in In re Adelphia Communications Corp., 336 B.R. 610, 654 (Bankr. S.D.N.Y.), aff’d, 342 B.R. 122 (S.D.N.Y. 2006) (denying noteholders’ motion to disqualify debtors’ counsel because it was “a tactical measure, to secure greater recoveries”).
79. SEC, supra note 56, at 679–80 (footnote omitted) (reporting that the committee represented people holding over ten percent of the issuance of notes and holders of about 2700 shares of class A stock).
language in attacking the dominant groups, the SEC noted that his actions substantially benefited the security holders.

In the reorganization of Union Power Corp., threats to institute fraud proceedings against several underwriters of the bonds helped give the outsiders enough power to block management control of the reorganization process. The SEC concluded that the outsiders’ presence in the case was the main reason security holders were able to recover in the reorganization because an inside committee would have been unlikely to threaten fraud proceedings against inside directors.

Even the independent committee in R. Hoe & Co.’s reorganization was lauded by the SEC report because the committee was able to “wrest control of the company from the bankers” by making “vigorous attack[s]” upon banker management. Further, they became very active in negotiating the plan of reorganization and in “securing changes which they believed to be in the interests of security holders.”

Simultaneously, the SEC confronted the difficulty of appraising the value added to reorganizations by independent committees, primarily because most outside committees were unsuccessful in wrestling control away from management. Even if an outside committee achieved some level of success, the desire to profit from reorganization, rather than to achieve a successful reorganization, may have motivated the committee.

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80. Id. at 680.
81. Id. at 680–81 (“[F]rom the point of view of the interests of Hoe security holders, charges that [he] was not properly qualified to appear in the reorganization, and attacks upon his program by the inside group, were hardly tenable.”). The SEC report also points out that the formation of the independent bondholder committee of Union Power Corp. was shown “to have been bona fide and to have proceeded from the desire of a security holder to protect his interests.” Id. at 681–82. The SEC, however, notes that the committee took “vigorous action,” id. at 682, but that these actions were “an example of the benefits that can flow to security holders from the activities of outsiders,” id. at 798.
82. See SEC, supra note 56, at 681–83, and supra note 81.
83. See SEC, supra note 56, at 798–803.
84. Id. at 802–03 (“[I]f it had not been for the appearance of this independent committee on the scene, the bondholders would not have received either the recognition worked out for them or its equivalent. . . . [E]ven if the insiders had formed a committee, it seems reasonable to suppose that this would not have improved the bondholders’ lot. It is hardly conceivable that a protective committee organized or controlled by the insiders would have favored assertion of a claim founded upon the alleged misconduct of its sponsors.”).
85. Id. at 803, 805. The committee was eventually able to secure appointment of five members to the corporation’s board of directors, in the face of what the SEC described as “great obstacles.” Id. at 805–06.
86. Id. at 808 (noting, however, that the district court refused the independent committee’s request for allowance of fees and expenses from the estate because the judge could not see “that anything ha[d] been brought into the estate as a result of [their] efforts, or that the reorganization ha[d] been materially aided or advanced by what [they had] done” (internal quotation marks omitted)).
87. See id. at 809 (“At times the results of an independent group’s activities are difficult to appraise. Frequently, the group is entirely unsuccessful.”).
88. Id. at 809. The SEC wrote,
Consequently, the SEC hesitated to encourage unfettered outside group participation in reorganizations so as not to encourage the very kind of abuse of reorganization it sought to eradicate.

ii. Fundamental Policies of Reform

The SEC report concluded that its “survey supplies ample evidence of the necessity of refashioning the process of reorganization to the end that primary emphasis be given to the protection of the interests of investors.”

The SEC identified three essential policies and fourteen suggestions to effectuate these policies.

Primarily, the SEC encouraged placing control of reorganizations with “bona fide security holders and their direct representatives.” To do this, holders of securities had to be given the right to be heard on all matters and to be active participants in the formulation of reorganization plans. In particular, independent groups of security holders, outside the control of management, should be encouraged to take part in reorganizations because they were the parties whose interests were directly at stake. However, the SEC was concerned that some groups would try to take advantage of the reorganization process by buying securities at distressed and default prices. Consequently, any reform that would encourage bona fide security holder participation had to provide some sort of check on these distressed investors.

Second, because the SEC was concerned with protective committees whose organizers and members sought to use reorganization to make a profit, the SEC concluded that “renewed emphasis [must] be given to the

But frequently the outside group will pool its forces with the insiders before or after formulation of the final plan of reorganization. This alliance of two warring forces may be variously motivated. . . . What appears to be a desertion of announced principles for an ostensibly profitable settlement may be merely a wise move, prudently shaped to meet practical exigencies. Conversely, what appears to be a victory for security holders, may be merely a battle in which the entrepreneurs of the independent group carry off the spoils. . . . [W]hat appears to be a search for the dollar may be a genuine endeavor to perform a necessary service.

Id.

89. Id. at 897.
90. Id.
91. Id. (“The right to be heard in all matters arising in a reorganization proceeding, and the privilege of submitting plans and suggestions for plans should be freely accorded them.”).
92. Id. (“[I]ndependent groups who represent bona fide interests should be encouraged” because “[i]t is their investment which is at stake in any reorganization.”). The SEC also noted that participation should be denied to those “whose sole claim is derived from a position in the management of the corporation or from banking associations with it.” Id.
93. Id. (“[M]easures should be adopted to deal with those who acquire securities or claims at default prices and either capitalize on their nuisance position or endeavor to effectuate settlements or plans favorable to those who bought at depressed prices but disadvantageous to those who purchased at pre-default prices.”).
94. Id.
fact that representatives of security holders in reorganization occupy a fiduciary position.”95 Committee members (and their lawyers) ought not to possess “dual or multiple interests.”96

Finally, the SEC noted that it was essential that the abuses “which have characterized the strategy and techniques of reorganization should be eliminated.”97 In particular, the SEC noted that the use of deposit agreements should be prohibited,98 control of the essential bondholder lists must be taken away from management and bankers,99 and “misrepresentation and non-disclosure in solicitation methods must be controlled.”100

iii. Fundamental Methods of Reform101

First, the SEC recommended that independent, disinterested trustees should be appointed to administer insolvent estates.102 The SEC suggested that the trustee would act as a “clearing house” for proposed plans, which would “result [in] (or greater opportunity will be provided for) a larger measure of participation in these activities by bona fide creditors and stockholders.”103

The SEC also recommended that “[t]he right of bona fide creditors or stockholders to be heard on all matters arising in a reorganization proceeding should not be restricted.”104 Further, indenture trustees should be given the power to “be heard on all matters, to file proofs of claim (but not to vote) on behalf of holders of securities outstanding under the indentures.”105

The SEC also proposed prohibiting compensation or reimbursement of expenses for those “who have purchased or sold securities in contemplation or after commencement of the proceedings.”106 However, the SEC did not limit checks against distressed investors to the denial of fees. The SEC advocated preventing investors who acquired securities at distressed prices

95. Id.
96. Id. Similarly, committees and counsel should not solely determine their own fees. 
97. Id.
98. Id. For a discussion of proxy deposit agreements, see infra notes 133–40 and accompanying text.
99. Id. at 897–98.
100. Id. at 898.
101. The SEC report identified fourteen methods of reforming reorganizations in the federal courts. This section discusses only those reform proposals addressing creditor and equity holder involvement in reorganization proceedings. For a full discussion of the SEC report recommendations, see SEC, supra note 56, at 897–907.
102. Id. at 899.
103. Id. at 899–900.
104. Id. at 901.
105. Id.
106. Id.
from voting on plans at all.\textsuperscript{107} In the opinion of the SEC, such a practice amounted to bad faith participation in reorganizations.\textsuperscript{108}

These policies were to be enacted and enforced through disclosures in reorganization cases. The SEC recommended requiring any person who represented more than twelve creditors or stockholders to file a sworn statement setting forth the amount of securities or claims he owned, the date he acquired them, the amount he paid, and any sale or dispositions he made.\textsuperscript{109} This rule was to apply to any person acting in a representative capacity, including committee members and indenture trustees.\textsuperscript{110} The SEC also advocated requiring similar disclosures by attorneys with respect to their clients’ holdings.\textsuperscript{111} Such disclosure would allow for “a routine method of advising the court and all parties in interest of the actual economic interest of all persons participating in the proceedings.”\textsuperscript{112}

\textbf{b. Provisions of the Chandler Act}

Congress enacted many of the SEC’s recommendations through the 1938 Chandler Act. The Chandler Act allowed public corporations to reorganize under the new Chapter X.\textsuperscript{113} Congress implemented many of the SEC’s suggestions, creating a process in which insider control was prevented by mandatory appointment of disinterested trustees and the involvement of the SEC in reviewing all reorganization plans.\textsuperscript{114}

Similarly, the Chandler Act largely codified the disclosure requirements advocated by the SEC report.\textsuperscript{115} A party purporting to represent others that

\begin{itemize}
  \item \textsuperscript{107} \textit{Id.} at 902 (arguing that the “court should be empowered to provide that a claim or share of stock . . . should not be included within the class of those entitled to accept a plan, if the acceptance of or the failure to accept any plan is not in good faith”).
  \item \textsuperscript{108} \textit{Id.} at 902.
  \item \textsuperscript{109} \textit{Id.}
  \item \textsuperscript{110} \textit{Id.}
  \item \textsuperscript{111} \textit{Id.}
  \item \textsuperscript{112} \textit{Id.}
  \item \textsuperscript{113} See Bussel, supra note 41, at 1557; \textit{see also} Chandler Act, Pub. L. No. 75-696, ch. X, 52 Stat. 840, 905 (1938) (repealed 1978). There was an alternative form of reorganization under the Chandler Act, Chapter XI, which was designed for small businesses and allowed for the restructuring of unsecured debts under a plan of arrangement, but did not allow for restructuring of secured debt or equity interests. \textit{Id.} at 1558. The different options for reorganization under the Chandler Act, and abuses of the choices, eventually led Congress to reject a dual system in favor of one reorganization chapter. \textit{See} H.R. Rep. No. 95-595, at 223 (1977), \textit{reprinted in} 1978 U.S.C.C.A.N. 5963, 6182–83.
  \item \textsuperscript{114} Bussel, \textit{supra} note 41, at 1557.
  \item \textsuperscript{115} Chandler Act § 211, 52 Stat. 840, 895 (repealed 1978) (“Every person or committee, representing more than twelve creditors or stockholders, and every indenture trustee, who appears in the proceeding” must file a “statement, under oath.”). The statement was to include “a copy of the instrument, if any, whereby such person, committee, or indenture trustee is empowered to act on behalf of creditors or stockholders,” \textit{id.} § 211(1), and “in the case of a committee, the name or names of the person or persons at whose instance, directly or indirectly, such employment was arranged or the committee was organized or formed or agreed to act,” \textit{id.} § 211(2). The statements also were to include “a showing of the claims or
failed to make adequate disclosures would be denied the right to be heard until it complied with disclosure rules.\(^{116}\) Chapter X thus provided for the protection of public investors, the main suggestion of the SEC report, by giving courts greater control over reorganization cases.\(^{117}\)

### 4. Reorganization Under the Bankruptcy Code

In 1978, Congress dramatically altered the federal laws of reorganization, enacting the Bankruptcy Code and specifically Chapter 11.\(^{118}\) In enacting Chapter 11 reorganization, Congress recognized the severe shortcomings of the previous bankruptcy system, particularly the lack of protection of public investors.\(^{119}\) The enactment of the Bankruptcy Code represented a fundamental shift in the nation’s approach towards business reorganization. The House Report accompanying the Bankruptcy Code underscored this realignment, noting that the provisions of the Bankruptcy Act “were written in the 1930[s], at a time when the law of commercial reorganization was little developed.”\(^{120}\) In contrast, the House of Representatives noted that stock represented by such person or committee and the respective amounts thereof . . . with a showing of the times of acquisition thereof.” \(^{138}\) Section 213 further provided that “an agent, indenture trustee, or committee, purporting to represent creditors or stockholders, shall not be heard or allowed to intervene in a proceeding . . . until such person or persons shall have satisfied the court that they have complied with all applicable laws regulating the activities and personnel of such persons.” \(^{140}\) Furthermore, judges were given the ability to “examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney . . . or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder.” \(^{142}\)

\(^{116}\) Chandler Act § 213.


\(^{119}\) S. Rep. No. 95-989, at 9 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5796 (“Reorganization, in its fundamental aspects, involves the thankless task of determining who should share the losses incurred by an unsuccessful business and how the values of the estate should be apportioned among creditors and stockholders. In a large public company, whose interests are diverse and complex, the most vulnerable today are public investors who own subordinated debt or equity securities. The bill, like Chapter X, is designed to counteract the natural tendency of a debtor in distress to pacify large creditors, with whom the debtor would expect to do business, at the expense of small and scattered public investors.”).

“[c]ommercial financing ha[d] undergone significant changes since the nearly universal adoption of the Uniform Commercial Code in the 1960’s. The Bankruptcy Act ha[d] not yet been revised to account for the change in the industry.”121 Thus, the Bankruptcy Code was designed to “modernize[] bankruptcy law in its interaction with commercial financing.”122 In essence, the Bankruptcy Code reflected Congress’s attempt to fashion a practical system reflective of actual market dynamics.123

Unlike reorganizations under the Bankruptcy Act,124 Chapter 11 debtors largely remain in control of their affairs.125 Chapter 11 also expanded the debtor’s administrative powers126 and gave the debtor an exclusive period in which to file a proposed plan of reorganization and to solicit acceptance or rejection of such a plan.127 Such an arrangement reflects Congress’s desire that a reorganization embrace an additional purpose—the rehabilitation of debtors—which provides economic benefits to multiple constituencies.128

121. Id.
122. Id.
123. See id. at 3–4, reprinted in 1978 U.S.C.C.A.N. at 5964–65 (recounting that the Bankruptcy Act was “designed in 1898, in the horse and buggy era of consumer and commercial credit, and was last overhauled in 1938,” and setting forth the market developments since then that had caused the bankruptcy system to “fall[] into disrepair”).
124. See supra notes 101–12 and accompanying text (discussing the SEC’s recommendations for shifting control of reorganization from management and bankers to an independent trustee).
125. See Elizabeth Warren, Business Bankruptcy 17–19 (1993) (opining that control by debtors maximizes the value of a business because the debtor possesses superior information on its operation); Harvey R. Miller & Shai Y. Waisman, Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-first Century?, 78 Am. Bankr. L.J. 153, 176 (2004) (concluding that the most significant aspects of Chapter 11 were that “the debtor’s management remained in control during the restructuring process” and that “[t]rustees and examiners were only to be appointed for cause, and receivers were prohibited”). Absent cause for the appointment of a trustee or examiner, debtors in Chapter 11 act as debtors in possession. See 11 U.S.C. § 1107 (2000). A debtor in possession is given virtually the same rights and responsibilities as a trustee and thus acts as a fiduciary of the estate. See id. § 323(a) (“The trustee in a case under this title is the representative of the estate.”). In the case of a debtor in possession, the debtor in possession in Chapter 11 has “all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under” Chapter 11. Id. § 1107(a).
127. Id. § 1121.
128. H.R. Rep. No. 95-585, at 220 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6179 (identifying benefits to employees, creditors, and stockholders that are “more economically efficient” because reorganization “preserves jobs and assets”). Control by debtors, as opposed to uninformed trustees, was thought to maximize the going concern value of businesses, thereby increasing recoveries for investors. See id. at 220, reprinted in 1978 U.S.C.C.A.N. at 6179–80 (“The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.”); Warren, supra note 125, at 8 (“The Chapter 11 reorganization alternative . . . attempt[s] to capture the going-concern value of a business that would likely be lost in liquidation and to pass that benefit on to those who would be injured by a business collapse.”).
However, Congress attempted to “balance the interests of all parties involved in the Chapter 11 reorganization” by providing various safeguards for the protection of creditor and public investor interests. Importantly, protection of public investors was even more crucial because the securities held by the public were different—when the Chandler Act was passed, public securities were typically senior bonds and companies were largely privately held corporations. By the 1970s, when the Bankruptcy Code was enacted, public classes of securities were often subordinated debentures and equity securities—the claims and interests at the lowest priority of Chapter X’s repayment scheme. To provide more for recovery by public investors, Chapter 11 had to focus on both rehabilitation of debtors and repayment of creditors and shareholders. Consequently, the Bankruptcy Code reflects a preference for the protection of a distinct set of economic interests—namely, the interests of subordinated debenture holders and equity holders. Such a preference is evident when exploring the various ways in which security holders and committees have participated in reorganizations in the past.

B. Committees and Groups: Investor Involvement in Corporate Reorganization

Under each of the corporate reorganization mechanisms discussed, committees of creditors and equity security holders have played vital roles in reorganizing the companies. Under each system, the duties and roles of committees have varied, but in essence the main purpose of committees has been the same: committees represent creditors in either leading or assisting in the development of a plan of reorganization that rehabilitates the corporation and pays the outstanding debts of the corporation. To understand the role of committees, Part I.B explores the functions, duties, and roles of committees under the various reorganization mechanisms available in the last hundred years.

129. See Miller & Waisman, supra note 125, at 177 (pointing to adequate protection rights for secured creditors, requirements that reorganization plans be accompanied by a disclosure statement approved by the court, and due process for creditors in the form of notice and hearing before obtaining entry of orders and judgments).


131. See id.

1. The Protective Committee in Receiverships and Chapter X

Under equity receiverships, “protective” committees “representing each class of public debt would form.”133 Usually, these committees were organized by company management or the security underwriters and were intimately involved in the reorganization.134 Protective committees did not have standing to appear on their own.135 However, courts would grant them permission to intervene in a reorganization.136 Protective committees then began soliciting irrevocable proxies for the securities, or sometimes even the securities themselves, of the class the committee purported to represent.137 Through these proxies or security deposits, the various protective committees then had the power to negotiate plans on behalf of their constituencies to reorganize the corporation, producing a plan negotiated by all of the various classes of debt and equity.138 In essence, “the bondholders irrevocably agree[d] to be bound thereby by depositing their bonds” and thus ceded power to the committee to perform its “principal work of the committee under the deposit agreement”—formulation of a plan of reorganization.139 In exchange, the duties of the committee were “in the highest degree fiduciary.”140

133. Bussel, supra note 41, at 1553. These committees often consisted of large holders of the security, but also often included “men of experience and prestige so that their names [would] serve to create confidence in the committee.” Chester Rohrlich, Protective Committees, 80 U. Pa. L. Rev. 670, 675 (1932). Traditionally, “[t]he banking house which sold the bonds to the public [would] take the initial step by selecting certain men to act as a committee.” Churchill Rodgers, Rights and Duties of the Committee in Bondholders’ Reorganizations, 42 Harv. L. Rev. 899, 900 (1929); see also Tracy, supra note 46, § 10 (detailing steps for the formation of a protective committee, including initiation by underwriting banks).

134. Dean, supra note 44, at 538; Rohrlich, supra note 133, at 675 (noting that the protective committee was “self-constituted, willing itself into being.”).

135. See Bussel, supra note 41, at 1558.

136. Id.

137. Id. at 1553. These deposit agreements “would give the protective committee broad discretion to negotiate a plan of arrangement that would modify the rights of the securityholders it represented.” Id. Furthermore, these deposit agreements were standardized form contracts. Bondholders exchanged their bonds for certificates of deposit, and they agreed to appoint the committee to represent their interests. See Rodgers, supra note 133, at 900, 904.

138. Bussel, supra note 41, at 1553. In general, each class of debt was represented by a different protective committee. See Tracy, supra note 46, § 18 (stating that “the negotiations as to [a] plan should be carried on by separate committees, each representing a separate class of security holders”).

139. Rodgers, supra note 133, at 907. The various protective committees “would negotiate with each other and the debtor management over a plan.” Bussel, supra note 41, at 1553. Under the proposed plan, existing securities would be surrendered for new securities that would be allocated among creditors and shareholders. Id. When a plan was agreed to, a new reorganization committee would emerge, consisting of the protective committees and debtor management. Id. The court would then set rules for a foreclosure sale of the debtor’s property, at which the reorganization committee would be the only bidder. Id. “[T]he reorganization committee had the full cooperation of management and could use the securities controlled by the protective committees to ‘credit bid’ for the firm’s assets.” Id. at 1553–54. Upon presentation to the court, the debtor’s property would be sold to the
Under section 77B and Chapter X, protective committees were given broad opportunity to intervene in cases. Although neither statute conferred official standing on protective committees, Chapter X “anticipated that committees would continue to form and represent creditors in the proceeding.” Consequently, under both section 77B and Chapter X, committees could request payment of their fees from the estate.

The two essential characteristics of protective committees under equity receiverships (and carried over to section 77B and Chapter X reorganizations under subsequent federal statutes) were the representation of individual security holders, and the fiduciary relationship that extended to individual security holders. Protective committees were required to be “reasonably representative” of security holders’ interests. In fact, one court noted the “well-settled principle that: [a] bondholders (creditors) committee is a fiduciary for all bondholders and as such owes undivided loyalty and allegiance to the bondholders.”

Furthermore, protective committees “directly represented” security holders and “act[ed] in their behalf” and therefore “must be free of conflicting interest . . . [and] give loyal and disinterested service.” Committees thus represented individual security holders when they did not appear formally in their individual capacities.

reorganization committee and nonconsenting creditors would receive their pro rata share in cash in accordance with the priority of their legal rights. See id. at 1554. Some sixty years following the height of equity receiverships, Professor Bussel called the process an “odd little dance, a negotiated restructuring masquerading as a receivership and foreclosure.” Id. at 1555.

140. Rodgers, supra note 133, at 905.

141. See Bussel, supra note 41, at 1558.

142. Id.


144. See Bussel, supra note 41, at 1558 (discussing the carryover of the committee role from equity receiverships into Chapter X).

145. Steere v. Baldwin Locomotive Works, 98 F.2d 889, 892 (3d Cir. 1938) (discussing the role of protective committees in reorganization proceedings in evaluating claims for payment of attorneys’ fees from debtor’s estate).

146. In re Realty Assocs. Sec. Corp., 61 F. Supp. 574, 576 (E.D.N.Y. 1945) (citations and internal quotation marks omitted) (denying the motion of certain bondholders to disqualify a bondholder committee for breach of its fiduciary duties to the bondholders).

147. In re Int’l Ry. Co., 86 F. Supp. 546, 546–47 (W.D.N.Y. 1949) (citation and internal quotation marks omitted); see also Tracy, supra note 46, § 16 (“The duties of the committee will be to represent the depositing bondholders in all matters requiring bondholders’ action and for all such purposes they are the owners of the bonds.”).

148. See In re Flour Mills of Am., Inc., 27 F. Supp. 559, 561 (W.D. Mo. 1939) (highlighting the fact that section 211 of the Chandler Act “assume[s] that creditors and stockholders may be represented by committees, or groups of creditors and stockholders may be represented by a person” while section 209 affords “any creditor or stockholder the right to appear in person, by an attorney at law, by duly authorized agent, or by a committee”). The Chandler Act granted creditors and stockholders the right to be heard and the freedom to decide how they wished to appear. See id. (“[E]very person [has] the right to be heard in a way that he may select. The judge must hear him in his own proper person, or by an attorney, or by an agent, or through a committee. . . . [I]t is not the function nor the power of
2. Committees Under the Bankruptcy Code

Today, representation of security holders is divided between two different types of groups—official committees and ad hoc groups. Unlike protective committees, ad hoc groups are individual security holders voluntarily appearing to enforce their rights rather than leaving representation up to the official committees appointed pursuant to section 1102 of the Bankruptcy Code. Often, individual creditors find official committee representation insufficient or wish to take more aggressive positions than those advocated by official committees. Consequently, they band together and form ad hoc groups. As a result, two different groups, the official committees and the ad hoc informal groups, play active roles in today’s bankruptcy reorganizations.

a. Section 1102 Official Committees

The Bankruptcy Code contemplated the protection of creditor interests through the formation of official committees. Section 1102 of the Code called for the U.S. trustee to appoint a committee of creditors holding unsecured claims and delegated power to the U.S. trustee to appoint additional committees of creditors or of equity security holders as the trustee deemed appropriate. A committee appointed under section 1102 is required to act “in the interest of those represented.”

i. Roles of the Official Committees

The official committees represent various classes of debt and committee members and “are commonly thought of as representatives of all unsecured creditors.” Section 1102 of the Code requires that the committee structure contain “adequate representation of creditors.” As fiduciaries, committee members have obligations to represent creditors through duties of loyalty and care.

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149. The U.S. trustee is appointed by the U.S. attorney general who may appear and be heard in any matter in a bankruptcy case. 11 U.S.C. § 307 (2000); 28 U.S.C. §§ 581–589 (2000). The primary function of the U.S. trustee at the commencement of a case is to call a meeting of creditors. 11 U.S.C. § 341. If the debtor has filed under Chapter 11, the U.S. trustee appoints a committee of unsecured creditors of the debtor at this meeting. Id. § 1102.


151. Id. § 1103(c)(5).

152. Bussel, supra note 41, at 1569–61 (comparing protective committees with Bankruptcy Code official committees, noting that the protective committee structure was designed to “reduce[] the risk of insider abuse”); see 11 U.S.C. § 1103(c)(5) (stating that the committee appointed under section 1102 is required to act “in the interest of those represented”).


154. See Bussel, supra note 41, at 1562–66; Carren Shulman & Timothy Mehok, Membership Has Its Privileges, or Does It?, Financier Worldwide (Heller Ehrman LLP,
ii. Functions in the Chapter 11 Process

Official committees serve various functions in the reorganization process. In particular, official committees may take part in the administration of a case;\textsuperscript{155} investigate causes of action against the debtor, its management, or insiders of the corporation;\textsuperscript{156} participate fully in the negotiation and solicitation of plans of reorganization;\textsuperscript{157} and generally monitor all proceedings related to the bankruptcy case. The official committee is given the statutory authority to “perform such other services as are in the interest of those represented.”\textsuperscript{158} In addition, the official committee is a “party in interest” and “may raise and may appear and be heard on any issue in a case.”\textsuperscript{159} The committee is also entitled to service of process of any motion, pleading, objection, or other paper filed with the court in the case.\textsuperscript{160}

b. The Ad Hoc Informal Groups

Ad hoc informal groups form mainly from creditor frustration with the committee process. Official committees represent every class of creditors in an attempt to consolidate all creditor interests into one negotiating body.\textsuperscript{161} Individual creditors, particularly hedge fund creditors looking to control their own representation, wish to be heard individually, a right afforded all creditors and equity security holders under the Bankruptcy Code.\textsuperscript{162} Creditor unhappiness with the committee system may stem from the need to control their own representation, wish to be heard individually, a right afforded all creditors and equity security holders under the Bankruptcy Code.\textsuperscript{162}

New York, N.Y.), n.d., at 1 (noting the fiduciary duty to maximize recoveries for the estate and its creditors). Professor Bussel notes that the leading case on committees’ fiduciary obligations is Woods v. City National Bank & Trust Co., 312 U.S. 262 (1941). Bussel, supra note 41, at 1562. Although this case arose in the context of the protective committee system, at the time of Bussel’s publication, Woods had been cited in 136 judicial opinions in bankruptcy cases under the Bankruptcy Code. Id. at 1562 n.55.

156. Id. § 1103(c)(2).
157. Id. § 1103(c)(3) (stating that committees may “participate in the formulation of a plan, advise those represented by such committee of such committee’s determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan”).
158. Id. § 1103(c)(5).
159. Id. § 1109(b).
161. See Bussel, supra note 41, at 1560. This negotiating body needs to be consolidated because, according to Professor Bussel, “[o]ne striking finding from the study of the history of reorganization law . . . is that, somehow, if we do place people in a room together and make them discuss a problem, usually, but not always, bargains will be struck.” Id. at 1609. As a result, at least as far as official committees go, the overwhelming trend is to appoint a single creditors’ committee, regardless of the size of the debtor or its capital structure. Id.; see also In re Hill Stores Co., 137 B.R. 4, 5–6 (Bankr. S.D.N.Y. 1992) (holding that the bankruptcy court has discretion to appoint multiple official committees because sometimes a case is “sufficiently large and complex” enough to overcome the general “reluctan[ce]” to appoint multiple committees, but declining to do so in the instant case).
162. 11 U.S.C. § 1109(b) (granting every creditor and equity security holder the status of “party in interest” and giving creditors, including bondholders, the right to raise any issue in a case and to “appear and be heard on any issue in a case”); In re Adelphia Commc’ns Corp.,
the failure to appoint multiple creditor groups, as contemplated in the 1978 Bankruptcy Code, which is rarely done. To represent actively their interests, similarly situated security holders band together and form ad hoc groups (sometimes referred to colloquially as “ad hoc committees”) to appear in Chapter 11 cases.

In these cases, these ad hoc committees consist of institutional investors, such as hedge funds and investment firms, whose businesses often involve the buying and selling of distressed debt, which includes risky noninvestment grade publicly traded debentures (known in the financial industry as high yield or junk bonds) and equity securities of bankruptcy (or near-bankrupt) companies. It is helpful to understand how these markets work in order to see how holders of these debt securities end up as players in Chapter 11 cases.

359 B.R. 54, 64 (Bankr. S.D.N.Y. 2006) (“[T]he law has long upheld creditors’ efforts to maximize their individual recoveries in their self-interest as creditors under a plan.”).

163. See H.R. Rep. No. 95-595, at 104 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6065 (noting that the Bankruptcy Code permits more than one committee in a case and that creditor “committees” will be the primary “negotiating bodies for the classes of creditors that they represent”).

164. See Bussel, supra note 41, at 1574 & n.112 (noting litigation over the structure of committees, but admitting that such litigation may have been the result of “economic issues” and not the “appointment process”). Nevertheless, it is often extremely difficult to construct a committee that can adequately represent the different interests of various classes of creditors. For a discussion of the challenges faced by the U.S. trustee in composing creditors’ committees in the Maxicare Health Plans, Inc., bankruptcy case of the late 1980s, see id.

165. See Mayr, supra note 20, at 7 (discussing the creation of “informal arrangements” of ad hoc groups); Shulman & Mehok, supra note 154, at 2 (citing the various reasons for the formation of ad hoc groups, principally, “to remedy the official committee’s failure to adequately address the concerns of a particular group of creditors” and “to avoid the burden of having fiduciary duties imposed by membership on an official committee”). The appearance of ad hoc groups in bankruptcy can best be seen in the Adelphia Communications Corp. bankruptcy case. See Adelphia, 359 B.R. at 56 (describing the Adelphia reorganization as one in which “investors in distressed debt” were involved in a protracted litigation represented by separate counsel). For a more detailed discussion of the various developments in the Adelphia case, see generally In re Adelphia Communications Corp., 368 B.R. 140 (Bankr. S.D.N.Y.), appeal dismissed as moot, 371 B.R. 660 (S.D.N.Y. 2007) (confirming the Adelphia Chapter 11 plan, in which the official committee of unsecured creditors consisted of approximately 7 members, despite representing almost 300 debtors’ estates eventually valued at almost $18 billion).

166. See Edward I. Altman & Scott A. Nammacher, Investing in Junk Bonds 2–5 (Beard Books 2003) (1987); Nurnberg & Rosenblat, supra note 21 (arguing that hedge funds “bring liquidity to the market” and can “bring substantial value to the restructuring process because they have the sophistication to formulate the right business plan and ‘deep pockets’ that allow for additional investment if the ‘right’ business fix requires it”); Serena Ng, Junk Turns Golden, But May Be Laced with Tinsel, Wall St. J., Jan. 4, 2007, at C1.

167. See, e.g., In re Northwest Airlines Corp. (Northwest I), 363 B.R. 701, 702 (Bankr. S.D.N.Y. 2007) (discussing the appearance of an ad hoc group of equity security holders); see also infra note 182.
i. The Emergence of the Secondary Distressed Debt Market

Junk bonds have become a common means of financing for corporations. High yield or junk bonds are publicly traded debt obligations rated by one of the independent agencies as noninvestment grade. Debt of this grade is highly speculative and consequently carries high risk and a correspondingly high level of interest. Public debt, including these high yield debt offerings, represents substantial portions of the unsecured debt of most large corporate Chapter 11 debtors. In addition, a large secondary market exists for these (and more traditional) debts.

Historically, noninvestment grade debt had been limited to “fallen angels,” debt of investment grade that had, due to poor company performance, been downgraded into the noninvestment grade ratings categories. However, with the rise of interest rates in the late 1970s, traditional investments became much less attractive to investors, who decided to switch to the rapidly expanding supply of high yield corporate debt. The high yield market offered investors an opportunity to achieve superior yields, increased liquidity, and diversification potentials unmatched in other markets. For companies, high yield debt offers significant advantages—principally, the availability of credit that it would otherwise be unable to secure.

168. As noted by Professor William A. Klein, “[T]echnically these debt instruments are generally debentures rather than bonds—if we take bonds to mean secured obligations.” William A. Klein, High-Yield (“Junk”) Bonds as Investments and as Financial Tools, 19 Cardozo L. Rev. 505, 505 (1997).


170. See Altman & Nammacher, supra note 166, at 1; Raviv, supra note 169, at 14 (“The issuer of these bonds would never deny that they were risky, because the principal—the face value—might never be repaid, but the high interest being offered was sufficiently seductive to make up for the risk.”).


172. Id. at 16 (highlighting that in 2006, $39.9 billion of distressed debt was traded; whereas, in 1991, the volume was only $4.4 billion); see also Raviv, supra note 169, at 14 (describing high yield bonds as “so popular that they were traded from one investor to the next, in a ‘secondary market’ that added to the impression that they always had some definable value,” and further highlighting the fact that “[b]y the time the maturity date [comes] around” the holders of high yield bonds are rarely the same people who initially bought them).

173. See Altman & Nammacher, supra note 166, at 3–4 (describing the origins of the term “junk” in the mid-1970s to define corporate securities that deteriorated in quality to such an extent that “the default probability was considered sufficiently high so as to drop the bonds from the list of investment grade securities”).

174. See id. at 5.

175. Id.; Ng, supra note 166.

176. See generally Klein, supra note 168. However, companies sometimes favor issuing debt over equity given its tax benefits. See Ng, supra note 166.
Today, distressed debt often contains both the “fallen angels” and high yield debt instruments. In either case, the term distressed debt refers to the debt of a company once its operations become financially troubled. While not exactly debt that is in default, distressed debt is debt viewed by analysts as heading towards default, and consequently distressed securities often trade at prices below their face value. Holders of these debt securities become involved in bankruptcy when the issuer files for Chapter 11 protection.

ii. Distressed Investors in Chapter 11 Proceedings

Within the context of bankruptcy reorganizations, distressed trading is having significant impact on the reorganization process because the liquidity of distressed securities—even after the issuer files for Chapter 11—allows distressed investors entry into many Chapter 11 cases. Investors holding debt securities generally rely on the principle that “a claim or interest in the hands of a purchaser has the same rights and disabilities as it did in the hands of the original claimant or shareholder.” Thus, there is no disability attached to a claim (including a debt security) purchased after the commencement of a case. Therefore, distressed traders are appearing more and more frequently in Chapter 11 cases, a phenomenon that has been both lauded as providing rehabilitation for distressed

177. See Paul M. Goldschmid, Note, More Phoenix Than Vulture: The Case for Distressed Investor Presence in the Bankruptcy Reorganization Process, 2005 Colum. Bus. L. Rev. 191, 193 n.6 (noting that the term “distressed-debt investors . . . refers to a class of investors who purchase the assets or claims of firms once their debt or operations become ‘distressed’”).


179. Miller & Waisman, supra note 125, at 181 (“Distressed debt trading and changing relationships as a result of globalization and technology have upset the symbiotic relationship of a debtor and its creditors. Traders purchase debt claims at a substantial discount, as they are concerned solely with the return on their investment.”).

180. Chaim J. Fortgang & Thomas Moers Mayer, Trading Claims and Taking Control of Corporations in Chapter 11, 12 Cardozo L. Rev. 1, 13 (1990); Mayr, supra note 20, at 7 (“It is well settled that a Chapter 11 debtor cannot treat its similarly situated creditors differently based upon the price that they paid for their claims.”); see also In re Pittsburgh Rys. Co., 159 F.2d 630, 632 (3d Cir. 1946) (“In the absence of fraud, the prices which security holders pay for their securities do not affect the measure of their participation under the plan of reorganization.” (internal quotation marks omitted)); In re Fairfield Exec. Assocs., 161 B.R. 595, 602–03 (D.N.J. 1993) (holding that a creditor’s motivation for investing is irrelevant in determining its classification); In re Executive Office Ctrs., Inc., 96 B.R. 642, 649 (Bankr. E.D. La. 1988) (concluding that purchasers of bankruptcy claims at discounts succeed to the rights of the sellers); Robert D. Drain & Elizabeth J. Schwartz, Are Bankruptcy Claims Subject to the Federal Securities Laws?, 10 Am. Bankr. Inst. L. Rev. 569, 576 (2002) (describing the market for distressed debt, particularly trade debt, but noting the liquidity of debentures and bonds).
companies and criticized as a mechanism for achieving a high return on investment.181

Distressed investors participate in Chapter 11 reorganizations in several ways, in both debt and equity positions. Hedge funds, in particular, often invest in first- or second-lien secured debt and join lender groups; frequently they invest in unsecured subordinated notes, bonds and other debentures, and equity securities.182 Once issuers enter bankruptcy, hedge funds play active roles—either in lender groups, or even on official committees.183 However, more frequently, these investors favor forming ad hoc groups in an effort to “secure a seat at the table” with the debtors, its lenders, and the official committees in the case without the stringent fiduciary standards imposed upon members of official committees.184 Increasingly, institutional investors are using bankruptcy to maximize recoveries by holding positions across capital structures.185 In addition, some investors are known to practice “short selling” across a corporation’s capital structure, which allows them to buy securities in another area of the capital structure and sell them quickly to make a gain in a short amount of time.186 Throughout their involvement in Chapter 11 cases, institutional
investors must comply with Rule 2019 when they appear and participate through ad hoc groups.

C. Openness and Honesty Through Disclosure: Rule 2019 in Practice

Under the Bankruptcy Code, Rule 2019 plays an important role in the appearance and participation of ad hoc groups in Chapter 11 cases. Rule 2019, specifically, is carried over from the disclosures originally promulgated by the SEC report. The U.S. Supreme Court has the power to promulgate rules governing the forms, practice, and procedure in bankruptcy cases. Like the Federal Rules of Civil Procedure, the Bankruptcy Rules must “be consistent with Acts of Congress.” Furthermore, the Bankruptcy Rules “shall be construed to secure the just, speedy, and inexpensive determination of every case and proceeding.”

1. Provisions of Rule 2019

Bankruptcy Rule 2019, “Representation of Creditors and Equity Security Holders in Chapter 9 Municipality and Chapter 11 Reorganization Cases,” requires certain disclosures in reorganization cases. In particular, Rule 2019(a) sets forth various disclosure requirements for certain parties and entities (other than official committees appointed by the U.S. trustee and committees appointed to represent workers and retirees pursuant to section 1114) and applies only to cases under Chapter 9 or Chapter 11.

Generally, Rule 2019 applies to “every entity or committee representing more than one creditor or equity security holder.” Each of these

Kahan & Rock, supra, at 1080.
187. Fed. R. Bankr. P. 2019 advisory committee’s note (stating that the rule “is derived from §§ 209–213 of the [1938 Chandler] Act and former Chapter X Rule 10-211”). Section 209 of the Chandler Act gave creditors or stockholders the right to proceed “in person, by an attorney at law, or by a duly authorized agent or committee.” Chandler Act § 209, 52 Stat. 840, 895 (repealed 1978). Section 210 required that attorneys file a statement “setting forth the names and addresses” of their client creditors or stockholders, “the nature and amounts of their claims or stock, and the time of acquisition thereof, except as to claims or stock alleged to have been acquired more than one year prior to the filing of the petition. Id. § 210.
192. Id.; see also Resnick & Sommer, supra note 39, ¶ 2019.01 (explaining the application of the Rule to only Chapters 9 and 11 to be the result of greater participation in cases by creditors and equity holders).
193. Fed. R. Bankr. P. 2019. Under the Chandler Act, attorneys needed to file disclosure statements, as did every “person or committee” representing more than twelve creditors and every indenture trustee. See Chandler Act §§ 210–211, 52 Stat 840, 895 (repealed 1978). The word “entity” thus seems to have replaced both the words “attorney” and “person” in the Chandler Act. Under Rule 2019, an indenture trustee must also make similar disclosures, but the rule specifically allows the court to order otherwise. See Fed. R. Bankr. P. 2019(a); Resnick & Sommers, supra note 39, ¶ 2019.02 (concluding that applying Rule 2019 to indenture trustees is consistent with their fiduciary status and that indenture trustees must comply if they wish to appear on behalf of the beneficiaries of their indentures).
representing bodies must file a verified statement setting forth the names and addresses of the represented creditors or equity security holders, the nature and amount of their claims or equity interests, and the time those claims or interests were acquired. The statements must also explain the circumstances and facts that gave rise to the employment of the representing entity. If the representing entity is a committee, the committee should disclose who organized the committee and who agreed to act and appear in the bankruptcy case.

Finally, disclosure statements must say whether or not the representing entity has any claims or interests itself. This disclosure must be made as of the time the entity was employed as a representative, the time the committee was organized or formed, or the time when the indenture trustee appears in the case. If the representing entity itself holds claims or equity interests (e.g., an attorney representing multiple creditors has its own claims), then it must disclose the amount of claims or interests it owns, the times when those claims or interests were acquired, and the amounts paid for those claims or interests. In addition, it must disclose any sales or dispositions of claims or interests. Similarly, disclosure of this information is required by an indenture trustee and by every member of an unofficial committee. A party governed by Rule 2019 who fails to file such a disclosure statement may be denied the right to be “heard further or to intervene in the case” or have “any authority, acceptance, rejection, or objection given” voided.

2. Interpretations of Rule 2019

These disclosure requirements were rarely interpreted by the bankruptcy courts with respect to ad hoc groups until the Northwest and Scotia cases in 2007. Previously, it was generally understood that Rule 2019 applied to those acting in a representative capacity—to both attorneys and other

195. Fed. R. Bankr. P. 2019(a)(2). If creditors or equity holders acquired their claims more than one year before the date of the petition, though, the statements need not contain the time of acquisition. Id.
197. Id. (“[I]n the case of a committee, [statements must include] the name or names of the entity or entities at whose instance, directly or indirectly, the employment was arranged or the committee was organized or agreed to act . . . .”).
199. Id.
200. Id. (“[W]ith reference to the time of the employment of the entity, the organization or formation of the committee, or the appearance in the case of any indenture trustee, [disclosure must include] the amounts of claims or interests owned by the entity, the members of the committees or the indenture trustee, the times when acquired, the amounts paid therefor, and any sale or other disposition thereof.”). The statement must also include a copy of the instrument giving the representing entity the power to represent creditors or equity security holders. Id.
202. See supra note 39 and accompanying text.
entities and committees representing others’ interests. However, courts generally agreed that the rule required different disclosures for different representations. For instance, the most typical representation is the attorney-client representation. When an attorney represents multiple clients in the Chapter 11 case, he or she must file a verified statement in accordance with Rule 2019(a)(2) and disclose the nature and amount of the client creditors’ claims and the times of acquisition thereof. However, when another representative relationship exists—such as an unofficial committee representing the interests of other creditors—the members of the committee must also give additional disclosures under Rule 2019(a)(3)–(4). Specifically, committees must disclose the name of the person or group organizing the committee, the amount of claims owned by the committee members, the times when these claims were acquired, the amounts paid for the claims, and any sales of claims by committee members.

a. Disclosures by Attorneys Representing Multiple Creditors or Equity Security Holders

There is almost universal agreement that Rule 2019 requires an attorney or law firm to file a verified statement when it represents more than one creditor or equity security holder. The representing entity, the law firm and/or lawyer, must disclose the represented parties’ claims and the times those claims were acquired. In addition, the representing entity must disclose its holdings, if any, under Rule 2019(a)(4).

203. See Resnick & Sommer, supra note 39, ¶ 2019.02. Rule 2019 “covers entities which act in a fiduciary capacity that are not otherwise subject to the control of the court. . . . Entities . . . that assume the representation of a group must be subject to some court control because they are fiduciaries to those they purport to represent. It is through Rule 2019 that the court monitors such entities.” Id.

204. See supra note 30 (discussing In re CF Holding Corp., 145 B.R. 124 (Bankr. D. Conn. 1992) and its distinction between disclosure of creditors’ interests and representing entity’s interests).


207. See, e.g., In re Muralo Co., 295 B.R. 512, 524 (Bankr. D.N.J. 2003) (deciding that Rule 2019 requirements apply to counsel); In re Okla. P.A.C. First Ltd. P’ship, 122 B.R. 387, 390–91 (Bankr. D. Ariz. 1990) (noting that a fiduciary relationship between attorney and clients brings attorneys into disclosure requirements of Rule 2019); Resnick & Sommer, supra note 39, ¶ 2019.02. But see Flaschen & Mayr, supra note 39, at 991 (arguing that the application of Rule 2019 to mandate disclosure by attorneys is incorrect because Rule 2019 is “aimed at persons having the delegated authority to act on behalf of a larger group” and not at “‘attorneys-at-law’ . . . [who] advocate their clients’ positions but . . . do not make their clients’ decisions unless they have an express power of attorney to do so”).

208. See CF Holding, 145 B.R. at 127 (explaining that Rule 2019(a)(2) applies to claims held by represented parties, i.e., the individual creditors or equity security holders, in the bankruptcy case); see also Muralo, 295 B.R. at 525 n.10 (“A properly filed statement . . . should indicate the relationship between the filing entity and the creditors named in the submission.”); Resnick & Sommer, supra note 39, ¶ 2019.04[1]–[2].

209. Fed. R. Bankr. P. 2019; Resnick & Sommer, supra note 39, ¶ 2019.04[1] (“In addition, the statement must include, with respect to the representative filing it or the
b. Disclosures by Other Representative Entities

However, entities other than attorneys must also file statements under Rule 2019 if they are involved in a consensual agency relationship. In *In re Ionosphere Clubs, Inc.*, for instance, Consumers Union, a nonprofit organization, appeared in the airline reorganization case and moved to compel the debtor to adopt refund procedures for prepetition ticket holders. Consumers Union filed a statement listing eight individuals who had completed disclosure under Rule 2019. The organization claimed that it acted on behalf of these eight individuals, its members and subscribers, and all other individuals who held prepaid tickets. After determining that the organization was not a party in interest entitled to be heard in the bankruptcy case, the bankruptcy court held that Consumers Union did not fulfill the requirements of Rule 2019 because it had failed to follow the necessary steps “to be an authorized agent of a multiple grouping.” Consumers Union had received specific authorization from only 8 of over 100,000 ticket holders. This did not meet Rule 2019’s requirements because the ticket holders had not all given their “express authorization” that Consumers Union represent their interests. Consumers Union failed to show that “this general agency relationship is consensual in nature.” Thus, Rule 2019’s purpose, according to the court, is to regulate those in consensual positions of agency.
c. Exceptions to Rule 2019

However, not all those parties in consensual agency relationships must file Rule 2019 statements; rather, Rule 2019 applies to those in fiduciary/agency relationships who are not otherwise under the supervision of the court. For instance, in the case of attorneys or law firms representing a class of plaintiffs properly certified as a class for class action purposes, the law firm need not disclose the underlying holdings of each member of the class.\(^{219}\) In the Kaiser Aluminum Corp. reorganization, the U.S. District Court for the District of Delaware ruled that the law firms that represented thousands of asbestos personal injury claimants were not required to file every document by which they became official representatives of the individual claimants.\(^{220}\) Reasoning that such a requirement would be too onerous, the court determined that “[i]t has been recognized that Rule 2019 need not always be strictly applied” and approved the bankruptcy court’s remedy of filing exemplars of the agreements instead because they could fulfill the main purpose of Rule 2019: verifying representation.\(^{221}\) This purpose must be balanced against another important consideration: ensuring that any information filed with the court is not misused.\(^{222}\)

In addition, an entity who, although representing others, obtains a money judgment in its favor directly need not file a Rule 2019 statement.\(^{223}\) Such rulings comport with the premise of Rule 2019 that it be a mechanism for the court to monitor those groups acting in a fiduciary capacity who are not governed by any other regulations.\(^{224}\) Because these groups are already subject to his control, and consent by the other so to act.” Restatement (Second) of Agency § 1 (1958); see also Restatement (Third) of Agency § 1.01 (Tentative Draft No. 2, 2001).


\(^{220}\) Kaiser, 327 B.R. at 559.

\(^{221}\) Id. at 559–60.

\(^{222}\) See id. at 560 (noting that the bankruptcy court’s order requiring Rule 2019 information to be filed under seal with the Clerk of the Court and allowing parties in interest to move the court for access to the information “strike[s] the appropriate balance between maintaining the public’s right to access the Rule 2019 information and ensuring that the information is not misused”).

\(^{223}\) See In re MJ Metal Prods., 292 B.R. 702, 704 (Bankr. D. Wyo. 2003) (noting that the National Labor Relations Board did not have to file a Rule 2019 statement because it obtained a money judgment, rather than the individual wage earners whose interests it represented in the suit); Resnick & Sommers, supra note 39, ¶ 2019.02.

\(^{224}\) See In re Okla. P.A.C. First Ltd. P’ship, 122 B.R. 387, 390 (Bankr. D. Ariz. 1990) (“Rule 2019 covers entities which act in a fiduciary capacity but which are not otherwise subject to the control of the court.”); Rapisardi, supra note 39 (“At its core, Rule 2019 uses disclosure to regulate ad hoc committees and other representative entities . . . over which the bankruptcy court holds no other statutory oversight.”); Resnick & Sommers, supra note 39, ¶ 2019.02.
regulated by other more specific regulations, the catch-all provision of Rule 2019 is not needed to regulate them.

Further, at least one court has taken the position that Rule 2019 disclosures are required, although the public filing of them is sometimes inappropriate. In an order applying to all asbestos-related Chapter 11 cases pending before her in the U.S. Bankruptcy Court for the District of Delaware, Judge Judith K. Fitzgerald entered an order requiring all Rule 2019 disclosures to be made under seal with the clerk of the bankruptcy court. Judge Fitzgerald reasoned that the advent of electronic case filing in federal bankruptcy cases allows parties’ information to “get[] spread on the public docket and that is not appropriate.” The order required a party seeking Rule 2019 disclosures to make a motion before the bankruptcy court stating the reasons it needed the information before it would be released. Such a ruling reflected the realities that electronic filing makes Rule 2019 disclosures easily accessible to the public, and that a compromise must be reached between the theoretical goal of open and honest reorganization and the practical interest in protecting parties’ relevant information. Hedge funds and other institutional investors take this into account when trying to comply with Rule 2019.

3. Rule 2019 and Ad Hoc Groups

In Chapter 11 cases, ad hoc investor groups frequently file statements pursuant to Rule 2019 that, on their face, fail to satisfy the requirements of Rule 2019. These statements, filed as statements of the law firm representing the ad hoc groups, attempt to satisfy the disclosure requirements of Rule 2019(a)(2); however, they often do not fully disclose the information sought by Rule 2019. In Adelphia, for example, a


226. But see Rapisardi, supra note 39 (“Courts uniformly agree the degree to which a bankruptcy court decides to enforce or interpret Rule 2019’s requirements is within the bankruptcy court’s discretion.”).


229. Id.

number of ad hoc groups appearing in the motion in aid process filed Rule 2019 statements. One group of noteholders, holders of subordinated notes issued by the Adelphia parent company, appeared through counsel as “certain holders, or investment advisors to certain holders” of senior notes issued by Adelphia Communications Corp., the parent company in Adelphia’s corporate structure. The Rule 2019 statement filed by Weil Gotshal & Manges LLP, their counsel, identified each client it represented in the firm’s contact information located directly above the case caption. Weil stated that it represented “certain holders, or investment advisors to certain holders . . . of the following notes and debentures,” and abbreviated the group, for purposes of the Rule 2019 statement, as the “ACC Senior Noteholders.” The names and addresses of the noteholders were set forth on schedule A to the Weil Rule 2019 statement. The Rule 2019 statement also asserted that “[i]he ACC Senior Noteholders have advised [Weil] that, as of September 8, 2006, they are the beneficial owners of, or the holders of the investment authority, contractual authority, or voting authority with respect to, more than $1.03 billion face amount of the Senior Notes. The Senior Notes held by the ACC Senior Noteholders were acquired on a number of dates.” At no time in its notice of appearance or in its Rule 2019 statement did Weil refer to the group as a “committee,” but both the notice of appearance and the Weil Rule 2019 statement fail to identify the holdings of individual noteholders.

On the other hand, the Rule 2019 statement filed by Brown Rudnick Berlack Israels LLP stated that the firm appeared in the case “on behalf of the Ad Hoc Adelphia Trade Claims Committee” and then listed the names and addresses of the committee “members” on an attached schedule. Brown Rudnick asserted that the “members of the Committee” held claims “arising as the holder of trade claims . . . against Adelphia . . . and its debtor subsidiaries” but that the members’ claims were not limited to just these holdings. Furthermore, the firm claimed that the members held

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231. See generally In re Adelphia Commc’ns Corp., 368 B.R. 140, 148–49 (Bankr. S.D.N.Y. 2007). The Adelphia case is just one example of bondholder groups appearing and participating in Chapter 11 reorganizations. For an account of the role of bondholders in the Marvel Comics bankruptcy case, see generally Raviv, supra note 169.  
232. Notice of Appearance Pursuant to Rules 2002, 9007, and 9010(b) of the Federal Rules of Bankruptcy Procedure and Section 1109(b) of the Bankruptcy Code at 1, Adelphia, 368 B.R. 140 (No. 02-41729) [hereinafter Weil Notice of Appearance].  
234. Id.  
235. Id.  
236. See id. at 2, 4.  
237. Id. at 2.  
238. See generally id.; Weil Notice of Appearance, supra note 232; see also supra note 32.  
240. Id.
approximately $532 million in face value of the outstanding trade claims, but that “the exact amount of the Trade Claims cannot be presently determined.” Brown Rudnick did not list the date of acquisition of the claims or the individual holdings of each committee member, and explicitly stated that the aggregate amount of claims the committee held was unknown.

The Brown Rudnick statement admitted to a very important issue in Adelphia, namely, the holding of claims other than the claims represented through the ad hoc group. This problem was particularly troubling in Adelphia, as, although Brown Rudnick disclosed its clients’ other claims in the case, Rule 2019 did not require disclosure of investors’ holdings in other areas of the corporate structure, and other ad hoc groups were accused of short selling while actively involved in the motion in aid proceedings. The practice of short selling on other holdings within the capital structure (but not within the particular debt position represented in the bankruptcy case) can have significant impacts on investor participation in bankruptcy. As noted by David M. Stern, cocounsel to the official committee of unsecured creditors in Adelphia, short selling is not necessarily “inherently wrong.” However, short selling creates economic interests separate from those interests represented in the bankruptcy case, and such an interest may

241. The term “Trade Claims” referred to only those claims held by members of the Ad Hoc Adelphia Trade Claims Committee. See id. at 2.
242. Id. The statement also asserted that “[m]embers of the Committee requested that Counsel represent them in connection with the Chapter 11 Cases. Counsel has been and will be compensated by the Committee.” Id.
243. See id.
244. See supra note 242 and accompanying text.
245. See Transcript of Hearing Held October 30, 2006 at 7–10, In re Adelphia Commc’ns Corp., 368 B.R. 140 (Bankr. S.D.N.Y. 2007) [hereinafter Adelphia, Oct. 30, 2006, Hearing Transcript]. Brown Rudnick’s clients, the Ad Hoc Committee of Adelphia Trade Claim Claimants, was not involved in the short-selling issue in Adelphia. Id. Rather, their statement indicating that clients may have held other claims in the case is highlighted in light of other participants’ failure to include such information in their Rule 2019 statements. However, Brown Rudnick did not disclose what other claims were held by its clients. See generally Brown Rudnick Rule 2019 Statement, supra note 230.
246. Many institutional investors remain “unrestricted” and are allowed to continue buying and selling claims or equity interests against a corporate debtor throughout that debtor’s bankruptcy litigations because they do not have access to confidential company information. See In re Adelphia Commc’ns Corp., 368 B.R. 140, 152 n.11 (Bankr. S.D.N.Y.), appeal dismissed as moot, 371 B.R. 660 (S.D.N.Y. 2007); Roundtable, The Final Chapter: Negotiations in Restructuring, High Yield Report, Apr. 9, 2007, at 12, 12 (interviewing Timothy Coleman, Senior Managing Director, Blackstone Group).
247. Adelphia, Oct. 30, 2006, Hearing Transcript, supra note 245, at 9. Professors Kahan and Rock note the positive functions of short selling outside the bankruptcy context: Even if they are short-term oriented, hedge funds’ short-term strategies may perform valuable functions. For example, when hedge funds play their traditional role of arbitraging market inefficiencies, their pursuit of short-term profit will be one of the mechanisms that helps to bring the market price into alignment with the value of the firm. Kahan & Rock, supra note 186, at 1083 n.263. The practice of holding positions in multiple layers of a corporate structure is increasingly common in Chapter 11. See supra note 23.
implicate certain provisions of the Bankruptcy Code dealing with good faith negotiations in the formulation and acceptance of a plan of reorganization. However, as noted in one hearing in *Adelphia*, Rule 2019 does not cover this particular situation.

These examples from *Adelphia* illustrate the varying practices of Rule 2019 in action. For many years, ad hoc groups appeared and filed verified Rule 2019 statements without much discussion. The little case law on Rule 2019 had focused on vetting attorneys representing class action plaintiffs. “[C]ourts have not always uniformly enforced the rule’s disclosure requirements. In fact, some commentators have advocated against strict enforcement . . . .”

Thus, at the beginning of 2007, Rule 2019 acted mainly as a guideline for ad hoc groups. Ad hoc groups filed statements that gave some disclosures, but not all of the disclosures required in Rule 2019. In 2007, however, courts began to develop more fully the ways in which the rule applied to ad hoc investor groups. Part II of this Note discusses the two cases decided by bankruptcy courts addressing the required disclosures by ad hoc groups appearing in Chapter 11 reorganizations.

II. AD HOC GROUPS IN CHAPTER 11: RULE 2019 AND DISCLOSURE DISPUTES

In two recent cases from 2007, a new line of jurisprudence on Rule 2019 emerged as two bankruptcy courts split regarding how the rule applied to ad hoc, informal groups of investors holding debt and equity securities. Judge Gropper in *Northwest* acknowledged that his decision ran contrary to the common industry practice of incomplete disclosure, but relied on the plain meaning of Rule 2019 to require that a group calling itself a “committee” disclose under Rule 2019(a)(4) as a committee. On the other hand, Judge Schmidt’s decision in *Scotia* indicated that common practice could inform the meaning of Rule 2019, and thus, ad hoc groups, unlike the committees recognized throughout reorganization history, were just a “bunch of creditors.” Part II of this Note examines the two competing opinions and the positions on each side of requiring disclosure.

249. Id. at 7–8.
250. See Mayr, supra note 20, at 1 (noting that it had been “almost 70 quiet years on the books without controversy”).
251. See Rapisardi, supra note 39.
252. Id.
253. See *In re Northwest Airlines Corp. (Northwest I)*, 363 B.R. 701, 704 (Bankr. S.D.N.Y. 2007) (acknowledging the committee argument that the Rule “has been frequently ignored or watered down”); supra Part I.C.3.
by ad hoc groups as committees. Part II.A discusses Judge Gropper’s view requiring classification of ad hoc groups as committees, while Part II.B explores the various arguments against classification as a committee, including the positions advanced by the noteholder group in *Scotia* and the leading financial market participant organizations.

A. Northwest Airlines: Committee Classification and Disclosure

In the *Northwest* Chapter 11 case, a group of equity security holders calling themselves the Ad Hoc Committee of Equity Security Holders appeared through counsel in the reorganization proceedings. During the course of the case, the debtors filed a motion for an order compelling the Ad Hoc Committee to file a more complete verified statement pursuant to Rule 2019(a). Judge Gropper ruled that Rule 2019 required the Ad Hoc Committee to disclose “the amounts of claims or interests owned by the members of the committee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.”

1. Plain Meaning of Rule 2019

According to Judge Gropper, the “plain terms” of Rule 2019’s use of the word “committee” dictated that the investors disclose their claims data. Because the members purported to speak for the group, their appearance “implicitly” asked others to afford their position significant weight in the resolution of key issues in the case. Such a request required disclosure in

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256. See *Northwest I*, 363 B.R. at 701.
260. Id. at 701 (holding that the clients appeared as a “committee,” that their notice of appearance was as a committee, and that counsel was retained by the committee, so therefore, the committee members must disclose the nature and amount of their claims); see also Rapisardi, supra note 39 (“While garnering much attention, the disclosure of information is not unprecedented. As such, the bankruptcy court’s Northwest decision merely enforces the plain language of Rule 2019.”).
light of the history of Rule 2019, which dated back to the SEC report, because committee opinions should not be given an audience before the court unless the committee’s economic interests are revealed. Consequently, he ordered the Ad Hoc Committee to comply strictly with the provisions of Rule 2019 and subsequently denied their motion to file the information under seal.

First, the “plain” meaning of “committee” required that the ad hoc group disclose as a committee. Because the law firm appeared in the case “on behalf of” the Ad Hoc Committee, the group’s Rule 2019 statement revealed conclusively that counsel believed it was representing a committee under Rule 2019. Rejecting the argument that Rule 2019 did not require disclosure because the Ad Hoc Committee did not represent any party other than itself, Judge Gropper found the Ad Hoc Committee’s repeated reference to itself as a committee indicated that the members also considered it a committee. Unlike the case in which “a law firm represents several individual clients and is the only entity required to file a Rule 2019 statement, on its own behalf,” Rule 2019(a)(4) properly applied to the “formal organization of a group of creditors holding similar claims, who have elected to consolidate their collection efforts.” Consequently, the Ad Hoc Committee was a committee under Rule 2019.

Then, relying on the SEC report, the court stated that “[u]nofficial committees have long been active in reorganization cases.” However, as the SEC argued in its report, committee involvement in reorganizations could not go unchecked; disclosure was necessary to encourage fair and

262. See generally SEC, supra note 56.
264. See id.
265. See In re Northwest Airlines Corp. (Northwest II), 363 B.R. 704, 707 (Bankr. S.D.N.Y. 2007) (denying a subsequent motion to file an amended Rule 2019 statement under seal because the committee members’ “investment strategies” were not protected information and ought to be public).
267. Id. at 702. The statement filed by counsel to the equity security holders disclosed that the firm “appears on behalf of the Ad Hoc Committee of Equity Security Holders . . . ; it identifies the 11 members of the Committee; discloses 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 the members of the Ad Hoc Equity Committee after the commencement of the Cases.” Id. (alteration in original) (internal quotation marks omitted).
268. Id. at 703. Judge Allan L. Gropper cited the fact that the committee’s notice of appearance “was as a committee”; that the committee made certain motions in the hearing; that counsel was apparently retained “by the ‘Committee’”; and that the “law firm does not purport to represent the separate interests of any Committee member; it takes its instructions from the Committee as a whole and represents one entity for purposes of the Rule.” Id.
269. Id. (distinguishing the instant case from CF Holding Corp. because, in that case, “a firm represented multiple creditors” who were unrelated and were not acting as a group).
270. Id. at 703 (quoting Wilson v. Valley Elec. Membership Corp., 141 B.R. 309, 314 (E.D. La. 1992)).
271. Id. at 704.
equitable plans of reorganization by requiring committees to disclose their full economic interests.\(^\text{272}\)

Furthermore, Judge Gropper’s position was supported by a decision of Judge Richard Sear of the Eastern District of Louisiana, the chairman of the Advisory Committee on Bankruptcy Rules at the time Rule 2019 was adopted.\(^\text{273}\) In *Wilson v. Valley Electric Membership Corp.*, Judge Sear ruled that a class action plaintiff need not submit documentation of each underlying class member’s claim, because “Rule 2019 more appropriately seems to apply to the formal organization of groups of creditors holding similar claims, who have elected to consolidate their collection efforts, rather than to class actions.”\(^\text{274}\) That was “exactly the situation in this case, except that here there are shareholders rather than creditors.”\(^\text{275}\) The longstanding history of Rule 2019 gave Judge Gropper “no basis for fail[ing] to apply it as written.”\(^\text{276}\)

Finally, the Bankruptcy Code contemplated unofficial committees, and any such unofficial committee must comply with Rule 2019 strictly.\(^\text{277}\) Appearance as a committee meant that “the members purport to speak for a group and implicitly ask the court and other parties to give their positions a degree of credibility appropriate to a unified group with large holdings.”\(^\text{278}\) Thus, while ad hoc or unofficial committees play an important role in Chapter 11 bankruptcies, that role was subject to the disclosure rules regulating their appearance in bankruptcy cases.\(^\text{279}\) As a result, the

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272. *Id.* (citing the SEC report in holding that disclosure was necessary to comport with the goal of “provid[ing] . . . disclosure . . . in order to help foster fair and equitable plans free from deception and overreaching” and concluding that Rule 2019 was “‘a comprehensive regulation of representation in . . . chapter 11 reorganization cases’” (quoting Fed. R. Bankr. P. 2019 advisory committee’s note)); *see also* Rapisardi, supra note 39 (“Because of the limited oversight over ad hoc committees, bankruptcy courts have used Rule 2019 to verify an ad hoc committee actually represents the claims and interests which such committee purports to represent.”).


276. *Id.* at 704.

277. *Id.* at 703 (“[T]he Bankruptcy Code specifically provides for the possibility of the grant of compensation to ‘a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title [an official committee], in making a substantial contribution in a case under chapter 9 or 11 of this title.’” (second alteration in original) (quoting 11 U.S.C. § 503(b)(3)(D))); *see In re Hill Stores Co.*, 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992) (denying subordinated bondholders’ motion to appoint an official committee of subordinated bondholders and noting that, “if the subordinated bondholders believe that the cases would be advanced by their taking a more active role, they are not precluded from forming an unofficial committee . . . and seeking reimbursement of their expenses to the extent that they make a substantial contribution to the case, as permitted and even envisioned by § 503(b) of the [Bankruptcy] Code”).


279. *Id.*; Berman & Brighton, supra note 185, at 64 (“It appears that the ad hoc committee wanted the best of both worlds—namely, to form a committee to advance their collective goals . . . while at the same time retaining the right to act to advance their individual interests . . . If nothing else, this ruling is a ‘welcome to the bankruptcy court process’ greeting card for hedge funds. The benefit/burden concept is nothing new to those
committee members were required to make the more detailed disclosures mandated by Rule 2019(a)(4) applicable to members of a committee.280

2. Open and Public Reorganization Cases

Following his order requiring compliance with Rule 2019(a)(4), Judge Gropper denied a request to allow the equity holders to file their Rule 2019 statements under seal with the clerk of the bankruptcy court pursuant to section 107(b) of the Bankruptcy Code because such a decision would contradict the intent of the Bankruptcy Code that reorganizations be open to the public at large.281 Section 107(b) protects parties from having to publicly disclose confidential research, development, or commercial information, although this protection is an exception to the normal rule that bankruptcy proceedings ought to be public record.282 The ad hoc equity committee had sought protection because they felt their trading information, including the acquisition dates and prices paid for equity, was a commercial secret and they feared disclosing it would harm their business practices.283

Judge Gropper held that the individual investors’ claims data was not confidential commercial information because it did not cause “an unfair advantage to competitors by providing them information as to . . . commercial operations.”284 Because it was “improbable” that competitors

players that have been actively participating in the bankruptcy process for a long time . . . .”); see also Rapisardi, supra note 39 (admitting the important role of ad hoc groups).

280. See Northwest I, 363 B.R. at 703; cf. In re CF Holding Corp., 145 B.R. 124, 127 (Bankr. D. Conn. 1992) (noting that Rule 2019(a)(4) applies to the entity filing a verified statement). Since Rule 2019 only applies to entities or committees representing other creditors, subsection 2019(a)(4) applies to holdings of the entity appearing, i.e., the committee or the attorney. While uncommon, attorneys occasionally have claims of their own. See In re Okla. P.A.C. First Ltd. P’ship, 122 B.R. 387, 390 (Bankr. D. Ariz. 1990) (“It is not unusual in the Chapter 11 context for . . . informal committees to be represented by one law firm, with the law firm to have the claims of the creditors or interested parties assigned to it, so that the law firm may act on the parties’ behalf.”).


282. See 11 U.S.C. § 107(b)(1) (2000); Northwest II, 363 B.R. at 706 (heralding the Bankruptcy Code’s fundamental principle of public and open proceedings); see also 11 U.S.C. § 107(a) (stating that records are “open to an examination by an entity at reasonable times without charge”).

283. See Northwest II, 363 B.R. at 706; see also Roberts & Wielebinski, supra note 257, at 25 (“[H]edge funds are noted for their secrecy. They don’t want the public knowing who their investors are, what they invest in, what they pay for their investments, or, most importantly, what their return is on their investments. . . . Bankruptcy, on the other hand, is the antithesis of secrecy.”).

284. Northwest II, 363 B.R. at 706 (quoting In re Orion Picture Corp., 21 F.3d 24, 27 (2d Cir. 1994) (internal quotation marks omitted)). In a declaration submitted with the motion to seal, one member of the ad hoc group stated that disclosure clearly would damage our bargaining position and give our counterparties an unfair advantage if they were to know our basis or acquisition cost of the assets we were trying to sell. Just as car dealers do not disclose to customers their actual acquisition cost of their cars, and builders do not disclose to potential home buyers
of the funds would be able to discern their “investment strategies.” filing under seal ran contrary to the goal of “public dissemination” of information as a means to prevent the abuses of reorganization identified by the SEC report.285 Even if the committee members had interests in keeping information secret, the interest in preventing abuse of reorganization overrode those interests because disclosure

is based on the premise that other shareholders have a right to information as to Committee member purchases and sales so that they make an informed decision whether this Committee will represent their interests or whether they should consider forming a more broadly-based committee of their own. It also gives all parties a better ability to gauge the credibility of an important group that has chosen to appear in a bankruptcy case and play a major role.286

In essence, Rule 2019 “gives other members of the class the right to know where their champions are coming from.”287

3. Discretionary Approach of Rule 2019

One commentator and Chapter 11 practitioner, John Rapisardi, wrote that Judge Gropper’s application of Rule 2019 was consistent with the plain meaning of the Rule.288 Since courts decide whether and how to enforce or interpret Rule 2019, disclosure was not unprecedented.289 The discretion afforded to bankruptcy courts in deciding whether and how to apply Rule

their actual cost to build homes, we do not disclose to potential counterparties our basis in our investments.

Declaration of Daniel Krueger in Support of Motion to Seal at 3, Northwest II, 363 B.R. 704 (No. 05-17930), quoted in Northwest II, 363 B.R. at 708. But see Rapisardi, supra note 39 (“[A] significant amount of information mandated by the bankruptcy court in Northwest requires the Ad Hoc Committee to disclose information that is already public. Creditor positions at the commencement of the case are disclosed in the debtor’s schedules of assets and liabilities. . . . [E]quity security holders disclose equity holdings in their Schedule 13D SEC filings.”). The central debate, however, is over “the price at which parties purchase claims and stocks and the precise times of such purchases,” which is not public. See id. at 6.

285. See Northwest II, 363 B.R. at 707–08; see also SEC, supra note 56, at 902 (explaining that information “will provide a routine method of advising the court and all parties in interest of the actual economic interest of all persons participating in the proceedings”). Judge Gropper concluded that “there is no reason to assume that the drafter believed that the goals of the Rule could be achieved if the required information were filed secretly.” Northwest II, 363 B.R. at 708.

286. Northwest II, 363 B.R. at 709 (assuming that committee members did not owe fiduciary duties to nonmembers). Judge Gropper further noted that these equity holders also “own a very significant amount of debt” in addition to their equity positions. Id. He concluded that Rule 2019 “is based on the premise that other shareholders have a right to know whether the debt purchases were made at the same time as the purchases of stock, a fact that might raise questions as to divided loyalties.” Id. Finally, Judge Gropper was concerned that members of the committee admitted that they may sell their claims at some point, and this possibility is “exactly why there are disclosures required under Rule 2019.”

287. Id. at 709.

288. Rapisardi, supra note 39.

289. Id.
2019 to ad hoc groups is the proper protection in the event debtors and other parties in interest try to use Rule 2019 to “gain access to increase bargaining leverage or trade data” because bankruptcy courts are empowered to apply the Rule “as they see fair and just.”

B. Scotia Development: Ad Hoc Groups as Just a “Bunch of Creditors”

Shortly after the *Northwest* ruling, Judge Schmidt rejected Judge Gropper’s approach in favor of a “practical approach.” In *In re Scotia Development, LLC*, the debtor filed a motion seeking an order to compel a group of noteholders to comply strictly with Rule 2019. In a short order, Judge Schmidt denied the motion on the grounds that the ad hoc group was not a committee under the definition of Rule 2019. At the hearing announcing his ruling, Judge Schmidt reasoned that the group of noteholders were “at this point . . . just one law firm representing a bunch of creditors.” Admittedly, Judge Schmidt ruled in direct conflict with Judge Gropper’s decision in *Northwest*, but he did so because such a ruling was, in his opinion, “a practical approach.” Judge Schmidt’s brief articulation of his decision was based in part on the arguments propounded by the noteholders in *Scotia*, and it was supported by more detailed arguments from LSTA and SIFMA. Part II.B summarizes these positions, which rely heavily upon the history of Rule 2019 and the distinctions between the function of ad hoc groups and the function of protective committees under

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290. Id. at 6. Some have suggested that the *Northwest* case is a backdoor attempt to regulate otherwise unrestricted hedge funds, and that the “bankruptcy judges look to be seeking now to lay down some guideposts regarding hedge fund activities” in anticipation of the next wave of bankruptcies. Posting of Ben Feder to Overhedged, http://overhedged.blogspot.com/2007/10/are-bankruptcy-courts-particularly-in.html (Oct. 26, 2007, 10:07 EST). However, Judge Gropper was seriously concerned about the significant debt positions held by the Ad Hoc Committee members. *Northwest II*, 363 B.R. at 709; supra note 286. In addition, such a cross-structure holding presents a serious threat to the functioning of the bankruptcy system. See Berman & Brighton, supra note 185, at 64–65 (arguing that such a threat is “the greatest potential threat to the efficacy of the bankruptcy system” because “[w]hether [an investor’s] return [on investment] comes from a debt or an equity security . . . doesn’t matter” to the investor); supra notes 245–49. It is not entirely clear that Rule 2019, as written, requires such disclosure, although it was a main factor in the *Northwest* case.


292. *Scotia*, No. 07-20027, at 2 (Apr. 18, 2007) (holding that the noteholder group “is not a ‘committee’ within the meaning of Bankruptcy Rule 2019 . . . [and] is not subject to the disclosure requirements under Bankruptcy Rule 2019”).

293. *Scotia*, Apr. 17, 2007, Hearing Transcript, supra note 36, at 4–5 (noting that the ad hoc group’s counsel might have potential conflicts of interest as a result of its representation of multiple creditors and that those creditors must understand those conflicts in order to waive them). The court required counsel to continue disclosing the parties it represented, which fell far short of the disclosures sought by the debtors. Id.

294. Id. at 4.
the equity receivership system that was so heavily criticized by the SEC report.

1. Noteholder Position in Scotia

In the Scotia case, the noteholder group, the Ad Hoc Group of Timber Noteholders (Timber Noteholders) filed an extensive response to the debtor’s motion seeking strict compliance with Rule 2019. Because Judge Schmidt ruled in the Timber Noteholders’ favor but did not give a detailed articulation of his position, it is helpful to explore the noteholders’ position to inform Judge Schmidt’s ruling. This section explores the various arguments provided by the Timber Noteholders in support of the position that ad hoc investor groups are not committees under Rule 2019. Specifically, their position relied on the plain and legal meanings of committee and the history of Rule 2019. In addition, the Timber Noteholders maintained that Rule 2019 should not be used as a procedural mechanism to deprive investors of substantive rights in contravention of the statute permitting the enactment of rules of procedure in bankruptcy cases.

a. Plain Meaning of “Committee” in Rule 2019

The Timber Noteholders’ primary argument was that ad hoc groups are not committees by the plain meaning of the word “committee.” The legal definition of a committee is a “group of people appointed or elected to consider, determine, or manage a matter.” Because ad hoc groups are “self-selecting” and do not speak for anyone except the group of noteholders in the group, the group was not a committee. Nor did the group satisfy the nonlegal definition of committee, the Timber Noteholders contended, because it was not a group of people “officially delegated to perform a function.” Even though ad hoc groups like the group in Northwest frequently call themselves committees, such self-description is irrelevant if they do not meet the definition of a committee.

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295. See Noteholder Group’s Objection to Scotia Pacific Co. LLC’s Motion for an Order Compelling the Ad Hoc Committee to Fully Comply with Bankruptcy Rule 2019(a) by Filing a Complete & Proper Verified Statement Disclosing its Membership & Their Interests at 7, Scotia, No. 07-20027 (Apr. 6, 2007) [hereinafter Timber Noteholders’ Scotia Brief].
296. Timber Noteholders’ Scotia Brief, supra note 295, at 7 (quoting Black’s Law Dictionary (7th ed. 1999)).
297. Id. at 8 (citation omitted).
298. Id.; see also Flaschen & Mayr, supra note 39, at 988 (“The fact that ad hoc groups often colloquially describe themselves using the term ‘committee’ cannot be considered dispositive, any more than a creditor calling itself ‘secured’ means that it must be treated as a ‘secured’ creditor within the meaning of the Bankruptcy Code. In fact, legal and general dictionary definitions of the term ‘committee’ consistently contemplate a body that is...
Furthermore, ad hoc groups are not representative of any noteholders outside of the group. Representation, the ad hoc group argued, “‘is at the heart of the meaning of the term ‘committee.’” But not just any representation matters; rather, the representation that is important is that of fiduciaries and agents. Representatives act on another’s behalf in a principal-agent relationship. Crucially, the Timber Noteholders argued, they did not “stand for or act on behalf of anyone” and therefore did not represent anyone within the meaning of the Bankruptcy Rules. The Bankruptcy Code clearly contemplates that committees represent those who are not on the committee, yet ad hoc groups expressly disavow representing anyone but themselves.

b. History of Rule 2019

The Timber Noteholders also argued that the history of Rule 2019 indicates that ad hoc groups are not committees under the Rule by comparing modern ad hoc groups to the protective committees under equity receiverships and the Chandler Act. On the one hand, protective committees were fiduciaries to those they represented. The SEC report was designed to address abuses of the equity receivership system and to “combat the evils of protective committees.” The committees addressed by Rule 2019, therefore, are only those “true committees that stand in a fiduciary and representative capacity and have the ability to bind other creditors in the same class.” Ad hoc groups, on the other hand, are not like these protective committees—rather, the Noteholders argued, they are appointed/elected to act in a representative/fiduciary capacity for a larger universe of stakeholders than the committee’s members.”

300. Timber Noteholders’ Scotia Brief, supra note 295, at 8–9 (highlighting that “it is explicitly stated in the most important part of Rule 2019(a), its first clause,” that “it applies to every ‘committee representing more than one creditor’”).

301. See id. at 9 n.7 (stating that Rule 2019(a) applies to committees, lawyers, and indenture trustees, and that given lawyers’ and indenture trustees’ fiduciary relationships to their principals, it is logical that committees under Rule 2019 must also be fiduciaries of those they represent).

302. Id. at 9.

303. Id. The Timber Noteholders also argued that the word “represent” and variations thereof are used frequently in the Bankruptcy Code, and that “in each place it is clear that the term is used consistent with the definition noted above as denoting someone who represents someone else.” Id. (citing 11 U.S.C.A. § 101(24) (West Supp. 2006) (defining a “foreign representative” as “a person or body . . . authorized to act as a representative of such foreign proceeding”); 11 U.S.C. § 323(a) (2000) (“The trustee in a case under this title is the representative of the estate”); id. § 1114 (defining an “authorized representative” as the “representative . . . for persons receiving any retiree benefits”)).

304. Timber Noteholders’ Scotia Brief, supra note 295, at 11; see also Flaschen & Mayr, supra note 39, at 989 (“Ad hoc groups of investors do not act for anyone other than the group’s members and clearly do not serve as ‘agents’ or ‘fiduciaries’ to any party . . . .”).

305. See Timber Noteholders’ Scotia Brief, supra note 295, at 14–15 (citing the SEC’s conclusion that emphasis must be given to the fact that protective committees occupy a fiduciary position); see also supra notes 95–96 and accompanying text.


307. Id. at 16.
simply “informal groups that gather for the purpose of sharing expenses and conveniently speaking with one voice.”308 The differences between ad hoc groups and protective committees were critical to the Timber Noteholders’ argument in Scotia that the ad hoc group was not a committee.

c. Fairness of Rule 2019’s Application

The final argument presented in the Timber Noteholders’ brief was that ordering disclosure would abridge several of their fundamental rights, and that such an order would be inconsistent with the goals of the Bankruptcy Code and Bankruptcy Rules to achieve just, speedy, and inexpensive resolutions of bankruptcy cases.309 This equity, they argued, allowed the court to construe Rule 2019 in a way that minimized the burden placed upon creditor groups, and thus Rule 2019 should be read not to require burdensome disclosures from creditors.310

In addition, the debtor’s interpretation of Rule 2019 would violate the Rules Enabling Act’s directive that Bankruptcy Rules “shall not abridge, enlarge, or modify any substantive right.”311 Specifically, the Timber Noteholders argued that the debtors’ interpretation would affect four fundamental rights: the equality of treatment of creditors,312 their right to be heard in the bankruptcy case,313 the property rights of the Timber Noteholders as secured creditors,314 and their rights to maintain the

308. Id.
309. See id. at 20; see also Fed. R. Bankr. P. 1001 (requiring that Bankruptcy Rules be constructed with the goal of speedy, inexpensive, and just resolutions of cases in mind); see also Flaschen & Mayr, supra note 39, at 990 (arguing that due process and property rights are substantial rights that “should not casually be denied” in order to “enforce” a procedural rule”); accord In re Shank, 315 B.R. 799, 812 (Bankr. N.D. Ga. 2004) (concluding that strict compliance with Federal Rule of Bankruptcy Procedure 3001 was inconsistent with Bankruptcy Rule 1001’s goal of inexpensive resolution of cases).
310. See Timber Noteholders’ Scotia Brief, supra note 295, at 20–21 (citing Shank, 315 B.R. at 812 (“A bankruptcy case imposes burdens on creditors. . . . But that injury need not be compounded by imposing unnecessary costs on creditors who desire to participate fairly in the process. . . . Rule 1001’s directive requires a bankruptcy court to apply the bankruptcy rules to permit creditors to realize their fair share in a bankruptcy case without unnecessary expense.”)).
313. Timber Noteholders’ Scotia Brief, supra note 295, at 22 (citing 11 U.S.C. § 1109 (granting creditors standing as parties in interest in Chapter 11 cases and giving them the right to be heard on any issue)). The Timber Noteholders also argued that their due process protections would be lost if they were sanctioned pursuant to Rule 2019(b). See id. at 22–23; see also U.S. Const. amend. V (due process of law).
314. Timber Noteholders’ Scotia Brief, supra note 295, at 22–23 (citing U.S. Const. amend. V) (arguing that the rights as secured creditors are “property rights that are protected by the Takings Clause of the Fifth Amendment”); see also In re Treco, 240 F.3d 148, 158–
“confidentiality of their proprietary commercial information.” The putative use of Rule 2019 was particularly troubling to the noteholders.

Similarly, another putative measure feared by the Timber Noteholders was that Rule 2019 would be used “as a weapon” against ad hoc groups of security holders to silence security holders who want to participate but do not want to make onerous disclosures. Such attempts to silence security holders lacked good faith because a debtor cannot use price information to treat similar creditors differently; all creditors of the same class must be treated equitably under a Chapter 11 plan, regardless of price. Even a creditor’s motivation for enforcing its claim is legally irrelevant in analyzing Rule 2019. Thus, no inquiries are permitted to determine why creditors are taking certain positions, so long as they are, in good faith, seeking to maximize recovery on their claims.

60 (2d Cir. 2001) (“[S]ecurity interests have been recognized as property rights protected by our Constitution’s prohibition against takings without just compensation.”). However, not all securities are secured. See Raviv, supra note 169, at 13–15; Klein, supra note 168, at 505 n.1.

315. Timber Noteholders’ Scotia Brief, supra note 295, at 23 (citing 11 U.S.C. § 107(b)) (arguing that disclosure of confidential information can be compelled in litigation only when the information is “actually relevant to an issue in dispute”).

316. Id. (“[The debtor] understands full well the confidential and highly proprietary commercial nature of the information it is demanding. What [the debtor] is really seeking to do is nothing less than to silence the voices of Noteholders.... This is not a good faith objective, to say the least.”); see also LSTA/SIFMA Comment Letter, supra note 34, at 19–20 (suggesting that motions for ad hoc groups to comply with Rule 2019 are nothing more than attempts to deny note holders statutorily authorized relief).

317. See LSTA/SIFMA Comment Letter, supra note 34, at 22–23; supra note 180 and accompanying text.

318. See 11 U.S.C. § 1126(e) (permitting the designation of votes by creditors who the court deems are not voting in good faith). Designation of votes disqualifies those acceptances or rejections from consideration in calculating whether a class of creditors has accepted or rejected a plan of reorganization. See 7 Resnick & Sommer, supra note 39, ¶ 1126.06. For a class to accept the plan, there are two independent requirements. First, creditors holding at least two-thirds of the total amount of claims in the class must vote to accept the plan. 11 U.S.C. § 1126(e). In addition, more than half of the number of creditors in each class must vote to accept the plan. Id. However, these calculations specifically exclude creditors whose votes are designated under § 1126(e). Id. This can dramatically alter whether a class has accepted the plan. Class acceptance is a critical factor in determining whether a court may approve a plan of reorganization. See id. § 1129(a)(8)(A) (requiring that each class accept the plan); id. § 1129(a)(10) (requiring at least one class to accept the plan). A court may confirm a plan despite the rejection of one or more classes, see id. § 1129(b) (allowing confirmation if all requirements other than satisfaction of § 1129(a)(8) are met and certain other conditions are satisfied), but there must always be at least one accepting class for a plan to be confirmed, see id. §§ 1129(b), 1129(a)(10). If there were only one class voting to accept the plan and votes by creditors of that class were designated under § 1126(e), that could change the calculations of whether that class accepted the plan. See id. § 1126(c). Such a change would then prevent the court from confirming the plan.

319. Timber Noteholders’ Scotia Brief, supra note 295, at 24; see also In re Adelphia Commc’ns Corp., 359 B.R. 54, 63 (Bankr. S.D.N.Y. 2006) (“To be sure, a culture has developed in large chapter 11 cases in which many consider it acceptable, and indeed expected, to use the litigation process as a means to assert or follow through on threats, and to seek various kinds of relief, to secure ‘leverage’ in efforts to increase recoveries. I don’t like it. . . . But aside from saying, in precatory terms, that I don’t like such tactics and that
2. LSTA/SIFMA Position on Rule 2019

The two leading trade organizations of financial securities firms, SIFMA and LSTA have taken positions in the Rule 2019 debate. Together, they have filed briefs as amici curiae in several cases in which motions to compel ad hoc groups to comply strictly with Rule 2019 were pending and have recently submitted a letter calling for the revision of Rule 2019 to the Judicial Conference Committee on Rules of Practice, Procedure, and Evidence, the committee that oversees changes to the federal rules. As representatives of hundreds of institutional investors, LSTA and SIFMA hope to protect their members from disclosure requirements seen by institutional investors to be damaging to their business models. The trade groups argued that requiring Rule 2019 disclosures by these parties would discourage “sophisticated financial institutions . . . from playing active roles in chapter 11 restructurings, a result antithetical to the goals of the Bankruptcy Code.” This section discusses the various policy reasons against requiring detailed disclosures from ad hoc groups.

they are a good way to irritate the judge. I don’t think that I can or should do anything about them on a motion [to designate pursuant to 11 U.S.C. § 1126(e)]. . . . I believe that where, as here, creditors are acting to maximize their recoveries, their overly aggressive conduct in the chapter 11 process is not a basis for disqualifying their votes.”). The Timber Noteholders acknowledged that “[s]ome have argued that disclosure of holdings can be useful in cases like Northwest where the debtor’s capital structure includes numerous levels for investor participation, which can lead to conflicting motivations.” Timber Noteholders’ Scotia Brief, supra note 295, at 24 n.13. But see Adelphia, 359 B.R. at 64 (“[H]olding long positions in bonds of various debtors is much more closely akin to ordinary recovery maximization strategies than it is to the efforts of a business competitor to drive the debtor out of business, or to harm it in other ways.”). The Timber Noteholders’ argument that no inquiries are permitted into creditor positions is not necessarily universally accepted. See id. at 56 (“[A]s a general matter, there is no absolute rule prohibiting discovery of distressed debt investors’ debt trading activities” but such discovery must be limited “to situations where such [activity] was sufficiently relevant”). Inquiries into creditors’ holdings would be a legitimate topic of discovery upon “a showing of possibly (but not plainly) improper activities.” Id. at 56 n.4.


321. See supra note 34.


323. LSTA/SIFMA Musicland Brief, supra note 320, at 1. LSTA and SIFMA participated as amici in the Rule 2019 litigations on the ground that their collective memberships are “parties who regularly participate in ad hoc or informal groups of bond and bank debt holders during the pendency of chapter 11 cases filed by issuers of that debt.” Id.

324. Id.
a. Impact on Secondary Markets

First, LSTA and SIFMA argued that full compliance with Rule 2019, specifically disclosure of the date of acquisition of claims, “seeks public disclosure of a market participant’s most confidential and proprietary information: the price at which that institution purchased (and/or sold) its claims.” Such pricing information, contemplated long before the emergence of secondary markets for debt trading, is “wholly irrelevant to the orderly administration of the case and restructuring of the debtors.” Further, such information is indicative of their underlying business practices, and requiring such disclosure would give away “trade secret[s]” to the holder’s market competition. Consequently, requiring distressed debt investors to disclose the date of acquisition of a claim would be tantamount to requiring disclosure of confidential business secrets, which would “likely have a dramatic effect on the willingness of financial institutions to participate in the restructuring process.” This “exodus” from the market will lead to serious liquidity problems for distressed

325. Id. at 2.
326. Id.
327. Id. (“[E]ach views its strategy as a trade secret to be held in great confidence, not to be shared with its competitors. While a participant will disclose that it has joined a member of an informal group, it will strenuously resist disclosing information concerning its underlying trades for fear that competitors would then have a window into its unique formula for success . . . .”).
328. See LSTA/SIFMA Comment Letter, supra note 34, at 23 (discussing investment strategies of distressed investors). In general, distressed investors employ aggressive and complex investment strategies that often include a combination of diversification, leverage, long, short and derivative positions. The effectiveness of these strategies is dependent on the recognition of trends, inefficiencies, and valuation of the market that have not been recognized by other investors. Therefore, public disclosure . . . could compromise a fund’s ability to execute its own strategy and provide incremental value to its investors. . . . With that [public] access, competitors will be better able to reconstruct the unique trading systems developed by the fund that was forced to disclose.
329. LSTA/SIFMA Musicland Brief, supra note 320, at 3–4. LSTA and SIFMA detail three main ways in which the absence of these financial institutions will harm reorganizations. First, “small stakeholders will suffer the absence of a collective larger economic voice in the case” because it will leave smaller, similarly situated creditors with no practical, cost-effective way to participate in the expensive process of reorganization. Id. at 4. Second, the “debtor will lose a vital negotiating partner” because the “statutory creditors’ committee . . . cannot adequately advocate a position on behalf of any one constituency.” Id. In the case where debtors with complex capital structures are unable to negotiate with official committees because the committees contain a “wide cross-section of creditors,” no one will be able to fill that void. Id. Finally, LSTA and SIFMA argue that the required disclosure “provides no legitimate benefit” to a reorganization case because the aggregate holdings of groups will be “sufficient information to understand how loud that group’s voice may loom in the restructuring process.” Id. at 5.
securities of bankrupt companies, harming the original security holder and ultimately making lending to distressed companies less attractive.\textsuperscript{330}

b. Meaning of “Committee” in Rule 2019

Next, LSTA and SIFMA argued that these groups of holders, although calling themselves “ad hoc or informal committees,” are not committees but actually “nothing more than a collection of similarly situated holders of claims or interests represented by a set of advisors.”\textsuperscript{331} The trade groups argued that these informal groups of creditors do not satisfy the plain meaning\textsuperscript{332} or legal definition\textsuperscript{333} of a committee. They maintained that the term “committee” refers “only to groups that act in a representative or fiduciary capacity with respect to other creditors or interest holders.”\textsuperscript{334}

\textsuperscript{330}. See LSTA/SIFMA Comment Letter, supra note 34, at 24 (detailing how market participants often need to sell distressed securities when a company enters bankruptcy or do not wish to be a part of the bankruptcy and often are able to sell to distressed investors willing to go through the process). Such an argument seems analogous to a theory of statutory interpretation used by Judge Shira A. Scheindlin in resolving an appeal interpreting equitable subordination under section 510(c) of the Bankruptcy Code. See Springfield Assocs., L.L.C. v. Enron Corp. (In re Enron Corp.), 379 B.R. 425 (S.D.N.Y. 2007). Judge Scheindlin noted that when interpreting a statute, the “plain language” of the statute controls where it provides a clear answer. \textit{Id.} at 432. In determining whether the plain meaning of the statute is ambiguous, though, the court must “tak[e] care that it does not construe any provision ‘in a manner that would place it in conflict with other provisions.’” \textit{Id.} at 432. (quoting \textit{In re Smart World Techs., LLC}, 423 F.3d 166, 183 (2d Cir. 2005)). Thus, a court “may depart from the plain language if ‘literal application of the statute will produce a result demonstrably at odds with the intentions of [the statute’s] drafters.’” \textit{Id.} (alteration in original) (quoting United States v. Ron Pair Enters., Inc., 489 U.S. 235, 242 (1989)). Judge Scheindlin concluded that, “in order to ensure that untenable distinctions and unreasonable results are avoided, it is proper to consider the effect that the Court’s interpretation would have on the markets. The unnecessary breadth of [the lower court’s] decisions threatened to wreak havoc on the markets for distressed debt.” \textit{Id.} at 448.

\textsuperscript{331}. LSTA/SIFMA \textit{Musicland} Brief, supra note 320, at 1 (arguing that these groups “give voice to small holders who, acting separately, would have little say in the debtor’s restructuring”). The trade groups argue that these financial institutions “make decisions to trade claims or interests based on highly confidential and proprietary methods of valuation analysis” and that those participants “do not engage in a one-time transaction to buy or sell debt.” \textit{Id.} at 3. “[E]ach implements its respective investment strategy and manages its risk through a continual evaluation and adjustment to its position in a given credit.” \textit{Id.}

\textsuperscript{332}. \textit{Id.} at 6 (arguing that a committee is “a body of persons delegated to consider, investigate, or take action upon and usu[ally] to report concerning some matter of business” (alteration in original) (quoting Webster’s Third New International Dictionary, Unabridged 458 (Philip Babcock Gove et al. eds., 3d ed. 2002)));

\textsuperscript{333}. \textit{Id.} (defining a committee as “[a] body of persons who have been selected and appointed with authority to perform some public service or duty” (quoting Ballentine’s Law Dictionary 225 (3d ed. 1969)));

\textsuperscript{334}. \textit{Id.} (citing Certain Underwriters at Lloyd’s, London v. Future Asbestos Claim Representative (In re Kaiser Aluminum Corp.), 327 B.R. 554, 559 (D. Del. 2005)). In \textit{Kaiser}, the court held that “[t]he purpose of Rule 2019 is to ensure that plans of reorganization are negotiated and voted upon by people who are authorized to act on behalf of the real parties in interest.” 327 B.R. at 559 (citations omitted).
To support this proposition, LSTA and SIFMA cite In re CF Holding Corp., one of the few cases to have interpreted Rule 2019. 335 In CF Holding, the court noted that “[t]he purpose of Rule 2019 is to further the Bankruptcy Code’s goal of complete disclosure during the business reorganization process.” 336 Towards that end, Rule 2019 is designed “to cover entities which, during the bankruptcy case, act in a fiduciary capacity to those they represent, but are not otherwise subject to control of the court.” 337

The trade groups further distinguished the activities of the informal groups from more structured entities that act on behalf of their or others’ collective interests. They claimed there is no agreement binding participants together, minority positions on issues are not negated by majority positions, and membership in any particular group is fluid. 338 Rather than any formal committee, they argued, these groups are just a “‘bunch of creditors.’” 339 In fact, these creditors do not act as fiduciaries to each other since “[e]ach seeks only to do what is best in its individual economic interest at that particular time.” 340 Their interactions with each other do not suggest that any member can bind other members of the group or act on behalf of other creditors outside of the group. 341 Since these groups do not act as fiduciaries to each other or to similarly situated creditors as a whole, Rule 2019 does not apply to them because the rule refers only to committees that act in a fiduciary capacity. 342

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335. LSTA/SIFMA Musicland Brief, supra note 320, at 6–7.
336. In re CF Holding Corp., 145 B.R. 124, 126 (Bankr. D. Conn. 1992). Complete disclosure allows the court to police activities of those who acquire claims and interests at distressed or default prices. See supra notes 107–08 and accompanying text. However, LSTA and SIFMA argued that such information is often irrelevant because the Bankruptcy Code does not treat creditors who acquire claims differently based upon the price they paid for those claims. See LSTA/SIFMA Comment Letter, supra note 34, at 10. However, there are some situations in which pricing information may be required, and such disclosure is more readily available through discovery. Id. at 10–12 (citing rare motions to designate an entity’s acceptance or rejection of a plan pursuant to § 1126(e) and an inquiry into good faith of a plan proponent under § 1129(a)(3) as two examples of the Code’s use of subjective intent in Chapter 11 cases); see also In re Adelphia Commc’ns Corp., 359 B.R. 54, 56 & n.4 (Bankr. S.D.N.Y. 2006).
337. LSTA/SIFMA Musicland Brief, supra note 320, at 6–7 (internal quotation marks omitted) (admitting, however, that the parties agreed that the rule applies to attorneys who represent more than one creditor or equity security holder).
338. See id. at 7.
339. Id. (quoting Scotia, Apr. 17, 2007, Hearing Transcript, supra note 36, at 4–5 (Judge Richard Schmidt)). The purpose of these informal groups acting together is to enable lockstep negotiation towards a “global solution”; and to “maximize efficiencies and minimize costs” by engaging a single law firm. Id. at 8.
340. Id. at 8.
341. Id. (noting that parties may drop out at any time, group members holding dissenting views are free to take action on their own or even oppose group efforts, and above all “[t]hey act only for their own benefit, and seek to advance only their own economic interests”).
342. See id. at 11 (declaring that “the disclosure requirements of Rule 2019—just like that of its predecessors—are intended to prevent abuses by ‘committee’ members whose supposed function is to ‘protect’ other stakeholders as their fiduciary”).
Finally, LSTA and SIFMA argued that, if the goals of Rule 2019 “were truly important to bankruptcy reorganizations,” then the Rule is actually underinclusive.\textsuperscript{343} Rule 2019 only requires disclosures related to claim or stock acquisition from committees and groups that hire a single attorney to represent their interests, and not to investors who are not members of ad hoc groups but who may be seeking to profit from buying debt or equity at distressed prices.\textsuperscript{344} In essence, Rule 2019 penalizes collective action by making it less likely that debt and equity holders with common interests will work together, a goal that is inconsistent with the Rules Enabling Act and the Bankruptcy Rules.\textsuperscript{345} As a result, LSTA and SIFMA have developed a set of recommendations for revising Rule 2019 to make it more practical in current Chapter 11 cases.

d. LSTA and SIFMA’s Recommendations

In their letter seeking revisions to Rule 2019, LSTA and SIFMA argued that Rule 2019 is seriously outdated and requires revision, proposing that discovery of distressed acquisitions more fully comport with the goals of the Bankruptcy Code by focusing parties on disclosures that are more relevant to the goals of maintaining open and honest reorganizations and establishing the true economic interests at stake in a case.\textsuperscript{346} Discovery allows disclosure of relevant information only to those parties who need that information, thus removing business disclosures from the public

\textsuperscript{343} See LSTA/SIFMA Comment Letter, supra note 34, at 15.

\textsuperscript{344} Id. at 15, 17 (arguing that “if transparency truly allows the court and the debtor to ‘root out’ investors who act in bad faith . . . then the Rule should apply equally to all participants in a bankruptcy case”). As LSTA and SIFMA pointed out, individual creditors are capable of abusing the reorganization system just as much as groups. See id. at 17 (citing \textit{In re Papercraft Corp.}, 187 B.R. 486 (Bankr. W.D. Pa. 1995), rev’d and remanded, 211 B.R. 813 (W.D. Pa. 1997), aff’d and remanded, 160 F.3d 982 (3d Cir. 1998), on remand, 247 B.R. 625, 629–30 (Bankr. W.D. Pa. 2000)). Such abuse is achieved through Rule 3001(e), which governs the buying and selling of claims in bankruptcy and does not require that purchasers disclose the purchase price. See Fed. R. Bankr. P. 3001(e). See generally Fortgang & Mayer, supra note 180, at 21. Interestingly, Rule 3001(e) specifically exempts from regulations claims based on “a bond or debenture,” which seems to encourage “public markets in debt securities to function during a bankruptcy case without interference by the bankruptcy court.” See id. at 21.

\textsuperscript{345} See LSTA/SIFMA Comment Letter, supra note 34, at 22 (arguing that Rule 2019 conflicts with the “just, speedy, and inexpensive determination of every case and proceeding” demanded by Rule 1001 and the “policies embodied in the [Bankruptcy] Code—the most important of which is to solve complex business problems through collective action, negotiation, and compromise” (internal quotation marks omitted)).

\textsuperscript{346} See id. at 12 (“Traditional discovery . . . is limited to what is relevant. By requiring relevance, the Federal Rules ensure that the time and expense of disclosure about one’s business is not imposed pointlessly. Rule 2019 does not afford claim holders even the minimal protection of the relevance standard.”); \textit{cf. supra} notes 285, 288–90 and accompanying text.
dockets. Thus, discovery is a “reasonable and appropriate substitute” for public disclosures under Rule 2019. Such a change would also protect market participants from public disclosure on their individual transactions, a requirement necessary to keep investors in the distressed securities market, while debtors have other public means of finding out general information on the trading prices of their securities. Finally, as an alternative to disclosure through discovery, LSTA and SIFMA argued that in camera review may be a plausible “middle ground” between mandatory public disclosure and complete confidentiality.

The Northwest decision holding that ad hoc groups are committees under Rule 2019 is at odds with the Scotia ruling that the groups are just bunches of creditors. Because each interpretation requires a different level of detail in Rule 2019 disclosures, institutional investors, in particular, are in need of a resolution of this debate. Although the Northwest court provides incredibly strong policy reasons for its interpretation of Rule 2019, Part III argues that ad hoc groups are not committees under Rule 2019 because the drafters of the Rule’s predecessor statute would not have considered them committees under equity receiverships or Chapter X.

347. LSTA/SIFMA Comment Letter, supra note 34, at 12–13 (“[D]ata produced in discovery are not automatically placed in the public docket for the world to view over the Internet. Conversely, Rule 2019 requires the publication of such data in a filing which is then posted on the court’s electronic docket.”).
348. Id. at 13.
349. Id. at 22–23 (discussing the sophistication of investors and the likely outcome of lowered participation by institutional investors).
350. Id. at 14. According to LSTA and SIFMA, [T]he debtor’s financial personnel or outside financial advisors can (and do) contact trading desks and market makers who routinely make markets in distressed debt. Even easier, numerous print publications and electronic services like Bloomberg report daily on the prices being quoted for distressed debt, just as the Wall Street Journal publishes quotes for instruments being traded in other capital markets. . . . Through those sources, the debtor can easily determine the price at which its debt may be trading on any given trading day, including past trading days. Because that market is sufficiently well developed and its quotations are readily accessible, the debtor is in a position to evaluate the prices being paid for its debt generally without need for Rule 2019.

351. Id. at 25–26. This approach, they argued, comports with the viewpoint expressed by Judge Judith K. Fitzgerald in the various asbestos cases pending in U.S. Bankruptcy Court for the District of Delaware, in which those required to disclose under Rule 2019 were allowed to do so under seal to avoid violating holders’ confidentiality. Id. at 26 (citing Owens Corning, Oct. 6, 2004, Hearing Transcript, supra note 228, at 55). Judge Fitzgerald had previously issued an order setting forth Rule 2019 disclosure requirements in asbestos-related Chapter 11 cases, but permitting such disclosures to be filed under seal with the clerk of the court. See Amendatory Order Requiring Filing of Statements Pursuant to Fed. R. Bankr. P. 2019, In re Owens Corning, No. 00-03837 (Bankr. D. Del. Aug. 27, 2004); see also supra notes 227–28 and accompanying text.
Deciding whether ad hoc groups are committees under Rule 2019 is an important question in corporate reorganization law today. The history of Rule 2019 and the Bankruptcy Code require bankruptcy courts to adopt the Scotia rule that ad hoc groups are not committees under Rule 2019. However, given the drastic changes in the market, even since the adoption of the Bankruptcy Code in 1978, the fundamental policies on disclosure of the full economic interests at play underscored by Judge Gropper in Northwest are even more meaningful today. Given the significant changes in institutional investing since disclosure was first required in the 1930s, with the rise of hedge fund activity and the increasing complexity of debtors’ capital structures, Rule 2019 should be reevaluated in order to ensure that the disclosures it requires adequately advise parties of the true economic interests represented. Hence, LSTA and SIFMA’s request to revise the rule is critical to Chapter 11 reorganizations. In particular, this Note advocates additional disclosures related to creditors’ holdings across capital structures to advise the parties of the full extent of the economic interests at play. However, this information should be presented in a way that strictly comports with the language of Rule 2019, focusing on the time of acquisition rather than on identifying specific dates of acquisition. Such an interpretation achieves a compromise that should be acceptable to all those involved in Chapter 11 practice.

A. Historical Meaning of “Committee” in Rule 2019: The Improper Classification of Ad Hoc Groups as Committees

Classification of ad hoc groups of institutional investors as committees is inconsistent with the plain, legal, and historical definitions of a committee. Rule 2019 undoubtedly has its roots in the SEC’s response to its exhaustive study of protective and reorganization committees in equity receiverships and bankruptcy cases under the Bankruptcy Act of 1898. Reference to this study of protective committees highlights the fundamental differences between protective committees and modern ad hoc investor groups.

Protective committees were representative. Their members were held to the highest duties of loyalty and care. The protective committees spoke for creditors who did not get involved in the cases, primarily because they actually deposited the securities with the committee. These

352. See supra notes 295, 297–98, 332 and accompanying text.
353. See supra notes 295–96, 333 and accompanying text.
354. See supra notes 59, 113, 187 and accompanying text.
355. See supra notes 137, 145–48 and accompanying text.
356. See supra note 146 and accompanying text.
357. See supra notes 147–48 and accompanying text.
committees were expected to look out for those they represented, and individual security holders could rely on this, since protective committees largely drove the reorganization process.\textsuperscript{358} In equity receiverships, protective committees had significant control of the reorganization,\textsuperscript{359} a crucial factor to the SEC.\textsuperscript{360}

Modern ad hoc creditor and equity holder groups are much different, primarily because the Chapter 11 process is radically different than equity receivership or Chapter X.\textsuperscript{361} Control of the reorganization process, which was under the exclusive dominion of protective committees in equity receiverships, is now largely vested with the debtor in possession.\textsuperscript{362} The fiduciary and representative responsibilities of the protective committees in equity receiverships now lie with the official committees appointed pursuant to section 1102.\textsuperscript{363} Security holders now are nothing more than individual creditors, a far cry from the controlling and representative entities they once were.\textsuperscript{364}

However, the Bankruptcy Code does not require individual creditors simply to let others dictate their recoveries.\textsuperscript{365} Rather, the Bankruptcy Code explicitly gives every creditor or equity holder the right to be heard on all matters,\textsuperscript{366} a right that originated in the SEC report.\textsuperscript{367} Often, individual creditors may not appear because official committees are appointed to represent their interests.\textsuperscript{368} In addition, creditors wishing to be involved may not want to be subject to the fiduciary requirements imposed upon members of official committees.\textsuperscript{369} Thus, individual security holders can and do appear and participate in Chapter 11 cases because it is the best way to vindicate their claims.

However, sometimes it is more practical for several security holders to group together and hire one law firm to represent them. Although highly sophisticated, institutional investors\textsuperscript{370} use ad hoc groups to vindicate their legally valid claims, which are entitled to be treated the same as those

\textsuperscript{358} See supra notes 133–38 and accompanying text.
\textsuperscript{359} See supra notes 49, 134, 139 and accompanying text.
\textsuperscript{360} See supra notes 60–67 and accompanying text. What was troubling, though, was that often these protective committees had little at stake, and their voices were heard over the voices of those security holders whose financial interests were directly at issue in the reorganizations. Hence disclosure was a check against this particular abuse. See supra notes 93–94 and accompanying text.
\textsuperscript{361} See supra notes 118–40 and accompanying text.
\textsuperscript{362} See supra notes 125–29 and accompanying text.
\textsuperscript{363} See supra notes 149–57 and accompanying text.
\textsuperscript{364} Importantly, protective committees did not have standing to appear in cases but had to request to intervene. See supra notes 141–43 and accompanying text. Each of the security holders in an ad hoc group does have standing as a result of his or her status as creditor. See 11 U.S.C. § 1109 (2000).
\textsuperscript{365} See supra note 162.
\textsuperscript{366} See supra note 159 and accompanying text.
\textsuperscript{367} See supra notes 103–05 and accompanying text.
\textsuperscript{368} See supra notes 152–54 and accompanying text.
\textsuperscript{369} See supra note 165 and accompanying text.
\textsuperscript{370} See supra notes 23, 179–81 and accompanying text.
claims held by similarly situated creditors. Such a practice seems like it fully supports the Bankruptcy Rules’ emphasis on efficiency and practicality in the resolution of disputes. Thus, the best interpretation of Rule 2019 is one that recognizes this practical advantage, which is exactly what Judge Schmidt did in ruling that the noteholder group in Scotia was just “a bunch of creditors.”

Finally, the enactment of the Bankruptcy Code reflected a clear understanding by Congress that the investors who needed protection were those holding subordinated debt and equity. Indeed, the troubling aspect of citing this fact is that the lamb has become the lion; while, previously, the public held these securities, now these public investors, those who buy and sell on the public markets, are sophisticated institutional investors. That undoubtedly is what troubles many promoting the Northwest interpretation of Rule 2019. In fact, it is probably a good reason for Congress to look at this rule. However, until a new rule is made, Rule 2019 is the rule governing ad hoc groups, and the term “committee” must be interpreted narrowly.

Consequently, one key weakness of the Northwest decision is that there is no consensual agency relationship between the committee members and nonmember security holders. The assertion that Rule 2019 “gives other members of the class the right to know where their champions are coming from” misses the point. Ad hoc groups are not representatives or fiduciaries to nonmembers. Unlike protective committees, where individual security holders could expect (and even demand) loyalty and care from those on committees, the individual security holder has no basis for expecting ad hoc groups to represent his or her interest. The prior cases

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371. See supra note 180 and accompanying text.
372. See supra note 190 and accompanying text.
373. See supra notes 293–94 and accompanying text.
374. See supra notes 130–32 and accompanying text.
375. See Berman & Brighton, supra note 185, at 65 (“Perhaps it is even a wake-up call that many of the tools of the bankruptcy process need to be re-evaluated by the courts and Congress in light of the economic reality of the current dynamic marketplace, where the debt and equity of reorganizing companies are constantly being traded . . . .”).
376. In re Northwest Airlines Corp. (Northwest II), 363 B.R. 704, 709 (Bankr. S.D.N.Y. 2007); see also supra note 287 and accompanying text.
377. See supra note 303 and accompanying text.
378. It is the official committee who the individual security holder, just like any other creditor, must expect to be his “champion.” See supra notes 152–54, 158 and accompanying text; see also 11 U.S.C. § 1103(c)(5) (2000) (stating that committees act for those they represent); 11 U.S.C. § 1102 (detailing the appointment process for official committees). Similarly, Judge Gropper’s concern that members of an ad hoc group will sell and leave a group without a representative is also misplaced. In theory, the abandonment of litigation by an ad hoc creditor group does not leave individual security holders without representation—their representation is the official committee. See id. (mandating the appointment of a creditors’ committee as soon as practicable). For equity holders, in the event that no official committee exists, just as no official equity committee existed in Northwest, the U.S. trustee’s decision not to appoint an equity committee and the court’s refusal to appoint one mean that representation is inappropriate. See 11 U.S.C. § 1102(a)(1)–(2). Individual equity security holders are not given the right to representation in Chapter 11 cases, primarily because many
interpreting Rule 2019 all relied on the notion that Rule 2019 properly applied to those entities who were engaged in a consensual agency relationship. Agency requires two manifestations of consent: the agent’s consent to represent the interest of the principal, and the principal’s consent that the agent represent his interest. While Judge Gropper is absolutely correct that many passive security holders will rely on an ad hoc group to take positions on its behalf, the ad hoc groups do not agree to represent the interests of nonmember security holders. Hence, a basic agency relationship does not exist.

Because ad hoc groups of security holders are not committees within the meaning of Rule 2019, the Rule’s more detailed disclosure requirements do not apply to them. Instead, the only disclosures required for these groups are those required under Rule 2019(a)(2). The plain meaning of the Rule 2019 references any entity representing more than one creditor or equity security holder and courts have traditionally interpreted “entity” to include lawyers and law firms. Consequently, attorneys must file statements under Rule 2019 to disclose the “nature and amount” of their clients’ claims or equity interests and the “time of acquisition thereof.” Part III.B more clearly articulates the required disclosures under Rule 2019(a)(2) for ad hoc groups.

B. Renewed Policy Emphasis: Attainment of Judge Gropper’s Policy Goals and Ensured Participation of Institutional Investors

Requiring strict compliance with Rule 2019(a)(2) is an important means of achieving the policy goals articulated by the SEC report and echoed in Northwest that reorganizations should be open and honest and all parties be advised of the true economic interests at stake. Hence, with respect to ad hoc groups of security holders, Rule 2019 ought to be strictly enforced, not merely left to the discretion of the court. Unlike those cases in which public access to the information would be damaging, informing the other parties in interest of the nature and amount of claims held and the times when acquired is the first step towards successful resolution of disputes.

Judge Gropper’s citations to the SEC report in his opinions in Northwest underline the policy goals that disclosure achieves. The abuses recognized by the SEC were real. The reorganization process under equity receiverships allowed misuse and abuse, whether through the use of

cases do not yield recoveries for equity holders. The only right given to equity holders individually is the right to appear and be heard. See 11 U.S.C. § 1109.

379. See supra Part I.C.2.
380. See supra notes 207–25 and accompanying text.
381. See supra note 218 and accompanying text.
383. See supra notes 207–09 and accompanying text.
irrevocable proxies, through the organization of protective committees by corporate management and its bankers, or through the creation of protective committees whose members were not actual investors but rather were merely seeking to take advantage of the monetary gains possible for those who participate in reorganizations. In addition, the SEC seriously condemned the practice of buying debentures or stock of reorganizing companies at distressed or defaulted prices. The SEC’s recommendations were designed to prevent these abuses and achieve a discrete set of policy goals.

Namely, reorganizations needed to be in the control of bona fide security holders who wanted the right to be heard in all matters before the court. In addition, their representatives, those on protective committees, needed to be reminded that they occupied a fiduciary position and were prohibited from serving competing interests in the reorganization process. Finally, steps needed to be taken to curb abuse of the reorganization process, including the prohibition of deposit agreements, the removal of management and bankers from controlling essential bondholder lists, the exclusion of those seeking to hijack the reorganization process for personal profit, and the elimination of misrepresentation and nondisclosure in solicitation of votes for reorganization plans.

It is within this framework that the Chandler Act was designed to place reorganizations more squarely under the oversight and review of the courts. Each portion of the rules of practice enacted as part of the Chandler Act derive from the SEC’s report: Requiring disclosure of committee membership holdings ensured the goal of allowing participation only to bona fide investors. Filing the instrument authorizing agency allowed the court to monitor potential uses of proxy deposit agreements. Disclosure by attorneys or committees that represent multiple creditors was designed to ensure that the represented parties were actually parties in interest, who were given a statutory right to appear and be heard. And disclosure of the time of acquisition of claims was designed to weed out those who participated in the reorganization process in bad faith by acquiring claims and equity interests at distressed and default prices.

Disclosure of some sort is a necessary part of the Chapter 11 process. In modern bankruptcy, where the goals are to facilitate negotiation and compromise, it is crucial to know who the negotiating parties are—who is at the table. The intercreditor issues in Adelphia were eventually settled,
and not litigated to completion, because the parties were able to know each other’s positions and financial stakes in the bankruptcy.395

But for Chapter 11 to work, parties must actually come to the table. Distressed investors, who largely make up the debt and equity holders involved in bankruptcies,396 have said that requiring detailed disclosures will force them out of the bankruptcy process.397 Hence, an interpretation of Rule 2019 that keeps distressed investors in the game while still allowing parties to know who the key players are (and who they are not) is required. Disclosure under Rule 2019(a)(2) is a helpful first step in advising the parties of the economic interests truly at stake in the reorganization.398

However, what is to be disclosed remains a crucial issue to investor participation. Investors are concerned that Rule 2019 may be used as a

395. See In re Adelphia Commc’ns Corp., 368 B.R. 140, 238–44 (Bankr. S.D.N.Y. 2007) (discussing the standards for approving settlements and concluding that settlement was in the best interest of the parties given the range of likely litigation outcomes).

396. See supra notes 179–84 and accompanying text.

397. See supra notes 325–30 and accompanying text. In interpreting Rule 2019, then, care must be taken to read the rule in a way that least affects the market, much like Judge Scheindlin did by interpreting a section of the Bankruptcy Code with the effect that the court’s interpretation would have on the secondary distressed debt markets in mind. See supra note 330; see also Springfield Assocs., L.L.C. v. Enron Corp. (In re Enron Corp.), 379 B.R. 425, 432 (S.D.N.Y. 2007). In enacting the Bankruptcy Code, Congress recognized that bankruptcy law had to change with the times and work with market conditions, not against them. See supra notes 119–23 and accompanying text. Thus, any interpretation that discourages participation in bankruptcy by bona fide creditors cannot be consistent with the aims of the Bankruptcy Code. Nor is it even consistent with the goals of the SEC report, which placed participation by bona fide creditors at the top of the list of reform policies. See supra note 89 and accompanying text.

398. Disclosing the amount of claims held gives an idea of the financial stake at issue. However, disclosure of the “time of acquisition” is a perplexing problem. The SEC report and the Chandler Act were designed explicitly to curb what the SEC called “bad faith” purchases of debt and equity interests at distressed and default prices. The real conflict with respect to this phrase is that the Rule fails to take into account the current market practices of buying and selling distressed debt. As LSTA and SIFMA note, in today’s bankruptcy cases, “the buying and selling of distressed claims is the rule rather than the exception, particularly with respect to large public debtors.” LSTA/SIFMA Comment Letter, supra note 34, at 17. In the 1920s and ’30s, there was not a large secondary market for distressed debt and equity, and the fears addressed by the provisions were that insiders and their selected committees would take advantage of smaller security holders by securing their proxies. See supra notes 134–39 and accompanying text. Increasingly, the liquidity provided by distressed investors has helped troubled companies. See supra notes 166, 175, 325–30 and accompanying text. The secondary market participants for corporate debt largely demand confidentiality of information, while the Rule demands public disclosure of times of acquisition because of the SEC’s stated policy of deterring the buying of debt or equity at distressed and defaulted prices. The Timber Noteholders’ arguments that they are entitled to secrecy in their investments therefore seem contrary to the stated public policy of the Rule, which requires disclosure of the time of acquisition. If the debt or equity was acquired more than one year before the date of the debtor’s filing of the Chapter 11 petition, though, no disclosures need to be made. This distinction reflects the SEC’s policy of deterring what modern financiers would term “vulture funds.” See generally The Vultures Take Wing, supra note 37. However, the Bankruptcy Rules seem to encourage the continued trading of securities postpetition. See Fed. R. Bankr. P. 3001(e); Fortgang & Mayer, supra note 180, at 21; supra note 344. Therefore, in a battle of policies, it seems only logical that the current Bankruptcy Rules, which consider the secondary markets, should control.
means to silence security holders who do not wish to disclose what they consider confidential business secrets.\footnote{399}{See supra Part II.B.1.c.} To keep them involved, what disclosures will and will not be required for ad hoc groups to participate must be set forth explicitly and definitively. Thus, disclosure must be mandatory and not subject merely to the discretion of the court as proposed by Rapisardi.\footnote{400}{See supra Part II.A.3.}

In order to keep investors involved, Rule 2019 ought to be read to permit disclosures that interpret the time of acquisition provision of Rule 2019(a)(2) to require less exact details than disclosure of the date of acquisition as required in \textit{Northwest}. Perhaps the best compromise between these numerous and conflicting considerations is to interpret the time of acquisition provision of Rule 2019(a)(2) narrowly. Phrases such as “more than one year before the petition date,” “within one year before the petition date,” or “postpetition” convey a surprising amount of information while still not giving away full details and satisfy the time requirement of Rule 2019.\footnote{401}{“Time” is defined as, among other things, “a period designated for a given activity” or a “period necessary or available for a given activity.” American Heritage Dictionary of the English Language (Joseph P. Pickett et al. eds., 4th ed. 2004). It appears that some have confused the “time of acquisition” required under Rule 2019(a)(2) with requiring a date of acquisition. Such disclosure is clearly excluded from the Rule. See Fed. R. Bankr. P. 2019. In addition, the SEC was concerned with those who bought securities at depressed prices immediately before or during a reorganization. See supra notes 93–94 and accompanying text. This proposed definition of the “time of acquisition” requirement of Rule 2019 adequately provides the relevant information to evaluate whether security holders are involved with the practices that gave rise to such a disclosure requirement.} As these securities are often publicly traded on open secondary markets, records are kept showing the prices at which they traded. This allows disclosure of a range of values—enough to give the court and the players in the case a sense of whether or not the bad faith feared by the SEC exists, but enough protection to shield individual investors’ exact series of transactions. This compromise would advise all parties of the different economic interests at stake and appease hedge funds’ concerns about disclosing what they consider to be confidential business information. It allows parties to know who is at the table while ensuring that hedge funds will still come to the table in the first place. This seems a more practical compromise than the in camera review advocated by LSTA and SIFMA, which would fail to give any other party in interest the inclination that bad faith might exist. If exact acquisition prices need to be made known to the court, though, the more detailed information can be obtained through discovery or in camera review.

\textbf{C. Cross Structure Holding Disclosures: Important Expansions of Rule 2019’s Reach}

Disclosure of the nature and acquisition of the claims represented and the time of acquisition thereof fails to advise adequately the parties in interest
of the full extent of the economic interests at stake because this does not include disclosure of any holdings held in other parts of the debtor’s capital structure. In *Adelphia* and *Northwest*, one major issue in both cases was the cross-structure holdings of the investors involved in ad hoc groups because these cross-structure holdings were believed to influence the positions taken by the parties. Yet, as noted at one of many hearings in *Adelphia*, Rule 2019 does not address the issue of short selling positions across a capital structure. In fact, in response to a comment by counsel that the Rule 2019 statements failed to give an adequate picture of the economic interests at stake, Judge Robert E. Gerber asked, “Do you think there’s non-compliance with 2019, or do you think there’s a flaw in 2019 that it doesn’t require disclosure of enough different kinds of things?” Clearly, there is a distinct economic interest at play when an investor takes a short position in another area of the capital structure. Such an economic interest is not disclosed under Rule 2019’s current requirements that nature, amount, and date of acquisition of claims be disclosed because an attorney filing a statement pursuant to Rule 2019 only represents the client with respect to the holding that is common to all members of the ad hoc group. The necessity of this additional disclosure is due largely to the fact that the companies filing for Chapter 11 protection, like Adelphia and Northwest, have incredibly complex and sophisticated corporate and capital structures. It also appears that this was a major motivating factor behind the *Northwest* decision. Consequently, LSTA and SIFMA’s proposed

402. See supra notes 245–49, 290 and accompanying text.
404. Id. at 8.
405. See *id.* at 9 (arguing that an “additional ulterior . . . purpose of enhancing the short position of making a profit” would be critical to the issue of designation of votes cast for being in bad faith); supra notes 185–86 and accompanying text.
407. See Roundtable, supra note 246, at 14 (interviewing Kenneth A. Buckfire, cofounder of Miller Buckfire, who discussed the “complex capital structures” of companies that he predicts will be in the next “cycle” of Chapter 11 filings); Shearer, supra note 185, at 38 (saying that “the increased complexity of companies’ capital structure” will have a marked impact on workouts for distressed companies); supra notes 319–20.
408. See supra note 290. It is therefore understandable that Judge Gropper wanted to require disclosure of this information, couching it in terms of a “plain meaning” argument. However, the rationale that “[m]uch has changed in reorganization practice since the 1930[s], but the disclosure required by what is now Bankruptcy Rule 2019 is substantially the same,” In re *Northwest Airlines Corp.* (*Northwest II*), 363 B.R. 704, 708 (Bankr. S.D.N.Y. 2007), ignores the fundamental change in policy enacted in the Bankruptcy Code. In fact, the Bankruptcy Code was enacted precisely because the securities markets had radically changed since the 1930s. See supra notes 130–32 and accompanying text. Further, the SEC’s suggestions were designed to protect bona fide security holders from non-security holders, not necessarily to protect security holders from each other. See supra notes 93–94, 286–87 (discussing the need to protect non-group members from ad hoc group positions). Nevertheless, his initial inclination is right—competing economic interests will definitely influence positions taken on issues in a bankruptcy case. See supra note 290; see also Berman & Brighton, supra note 185, at 64–65 (detailing how cross-structure holdings affect positions taken on issues and identifying such changes in position as one of the greatest threats to the Chapter 11 process).
revisions to Rule 2019 should be taken up by the Judicial Conference Committee on Rules of Practice, Procedure, and Evidence, who should consider enhancing Rule 2019 to require disclosure of cross-structure holdings.

CONCLUSION

Ad hoc groups of institutional investors are not committees under Rule 2019. Therefore, Rule 2019(a)(4) does not apply to their members. However, Rule 2019(a)(2) still requires disclosure of the nature and amount of their claims or interests, and the times when acquired. The times when acquired can be adequately disclosed simply by disclosing whether debt or equity was acquired more than a year before the petition, prepetition, or postpetition. This solution protects the trading secrets of institutional investors while still giving debtors, the court, the U.S. trustee, and official committees information on the economic interests at stake in a reorganization. However, the significant changes in the credit markets, where distressed debt is easily traded, and the increasing complexity of corporate capital structures allowing cross-structure holdings require an addition to Rule 2019 that advises the court of any holdings beyond the particular debt or equity position represented by the ad hoc group. These compromises will ensure that all parties in a reorganization will know exactly who is at the table.

409. See supra Part II.B.2.d.