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Mr. Peter G. McCabe
Secretary
Committee on Rules of Practice and Procedure of the Judicial Conference of the United States
Administrative Office of the United States Courts
Thurgood Marshall Federal Judiciary Building
One Columbus Circle, N.E.
Washington, D.C. 20544

Re: Proposed Amendment to Rule 2019 of the Federal Rules of Bankruptcy Procedure

Dear Mr. McCabe:

We write with reference to the proposed amendment to Rule 2019 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). White & Case LLP regularly represents debtors, creditors, equity security holders and other parties in interest in large chapter 11 cases. While our firm regularly represents groups of hedge funds and other distressed investors in such cases, we have not been retained by any such investors and do not speak on their behalf with respect to the matters addressed herein. Instead, we submit this comment as professionals engaged in the practice of restructuring companies and representing diverse interests in these cases.

The express intention of the proposed amendment to "substantially . . . expand the scope of its coverage and the content of its disclosure requirements"[1] would actually exacerbate problems that surround the current Rule and its application and thereby add new complications and confusion for all parties and for the Courts themselves. In addition, the apparent focus of the proposed amendment would not only prejudice distressed investors but could in fact chill the salutary role these investors play in the reorganization process.

Rule 2019 was originally promulgated, over thirty years ago, at a time when the secondary market in debt barely existed. Parties extended credit and then held heir claims until some recovery was achieved. The only early exit available was to sell claims to a handful of factors for cents on the dollar. The world has changed enormously, and now a highly developed industry exists that enables the fluid trading of debt by original creditors at market prices. This vast secondary market enhances the process of reorganization. The proposed amended Rule may severely depress this engine if undue emphasis is placed upon the pricing of claims trading

[1] Proposed Amendments to the Fed. R. Bankr. P., R. 2019 [hereafter Proposed R. 2019], adv. comm. n., *available at* http://www.uscourts.gov/rules/proposed0809/BK_Rules_Forms_Amendments.pdf (accessed Dec. 29, 2009).

instead of on a judicial process in which legal obligations are dealt with according to established rules of priority and validity. This would make creditors less likely to form groups, so as to avoid the Rule's disclosure requirements, and would effect a net harm to the efficiency of the reorganization process.

Rule 2019 is being wielded as a sword by parties in interest that it was never intended to protect. It has ceased to serve the purpose for which it was promulgated, and far from adopting an amendment that would cause new problems to no benefit, we urge the Committee instead to repeal Rule 2019.

A. Current Rule 2019 Is Generating Wasteful, Useless and Distracting Litigation, and It Should Be Repealed

Even in its current form, Rule 2019 and its implications for distressed-debt investors are being used by debtors and other stakeholders as a litigation tactic, to deter groups of distressed-debt investors from taking active, though legitimate, positions in reorganization cases.[2] In our experience, having seen Rule 2019 levied against *ad hoc* groups several times, the Rule is never raised except as such a litigation tactic. Courts are divided over whether the current Rule applies to ad hoc groups, a point the proposed Rule explicitly clarifies. The Rule should not operate, however, as an admission ticket for creditors who simply choose to organize for the purpose of seeking otherwise statutorily available relief.

Some commenters likely will argue that ad hoc groups and distressed-debt investors should be subject to disclosure requirements because they tend to advance aggressive positions and run them to ground. If the positions they are advancing are legitimate, however, the threat of having to make Rule 2019 disclosures should not be allowed to be used as a deterrent. If the positions are not legitimate or are not presented for a proper purpose, Rule 9011 gives the court and other parties an effective and appropriate means to curb their behavior. This goes as well for the concern expressed by other commenters and embodied in the proposed Rule that the Rule should apply to short and other hedging positions; if a party claims standing on the basis of a long position and then attempt to harm the debtor and its estate to benefit a short position, the courts have sufficient power to sanction such abuse of the process.

Rather than adopting a new Rule that merely amplifies those criticisms, we urge the Committee to repeal the Rule altogether. Where the information truly is relevant—and we submit that a generalized notion of transparency or desire to know a party's motivations almost never make it so—discovery is the appropriate device for adducing it. Through discovery and the courts' inherent powers, sufficient means exist to generate disclosure of the information that the Rule requires where it is relevant, and to allow the disclosure to be made in a manner that is tailored to the situation presented. A "one size fits all" disclosure requirement is neither necessary nor suited to Rule 2019's object.

B. The Proposed Rule Would Discourage the Formation of Creditor Groups, Which Provide Beneficial Efficiencies in Reorganization Cases

The proposed Rule would apply automatically to any group of creditors, which generally organize to share advisor costs and advance common positions. Their presence allows for broad-

[2] *See* Letter from SIFMA & LSTA to Peter G. McCabe, at 19 (Nov. 20, 2007) (collecting examples).

based participation in reorganization cases while reducing the absolute number of parties that other stakeholders must negotiate and litigate with. This both advances bankruptcy policies favoring broad creditor participation and reduces the overall transaction costs for all stakeholders. For the same reasons that the proposed Rule would chill participation by distressed investors generally, however, it will further chill their willingness to organize. A distressed investor may choose to act alone in the hopes that the court will never require it to disclose its holdings, whereas by joining a group it undertakes that obligation. The result would be more lawyers in the courtroom and more individual stakeholders demanding a seat at the negotiating table. As one judge has observed, "[I]t's important to have groups be able to represent parties so that we don't have 500 noteholders in here with 500 lawyers. We've got enough lawyers involved already. That[, *i.e.*, having groups, is] a good thing."[3]

C. The Proposed Rule Requires the Disclosure of Information That Distressed Investors Regard as Confidential and Proprietary, That is of Limited Utility and Then Only in Rare Cases, and That the Discovery Process is Adequate to Address in Appropriate Cases

The policies underlying the Bankruptcy Code favor broad participation in the reorganization process by all parties in interest.[4] Indeed, creditors are not only allowed but are *expected* "to take an active role in protecting their claims."[5] As such, any rule change that would limit or discourage creditor participation should be eyed with caution, particularly if it falls unevenly on a particular and important constituency, as the proposed Rule does.

The proposed Rule would require creditors who participate in ad hoc groups (and, at the court's discretion, any creditor making or opposing a motion) to disclose a wide array of economic interests:

> any claim, interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right that grants the holder an economic interest that is affected by the value, acquisition, or disposition of a claim or interest.[6]

It would also require disclosure of "the nature of, and if directed by the court, the amount paid for, each disclosable economic interest held in relation to the debtor as of the date . . . the group or committee was formed."[7]

The proposed Rule intentionally goes well beyond the disclosure requirements of the current Rule, which pertains only to "claims or interests."[8] The stated purpose of this breadth is "to cover any economic interest that could affect the legal and strategic positions a stakeholder takes

[3] Tr. Hr'g Apr. 10, 2007, *In re Scotia Development LLC*, Case No. 07-2007 (Bankr. S.D. Tex.).
[4] *See* 11 U.S.C. § 1109(b) ("A party in interest . . . may raise and may appear and be heard on any issue in a case under this chapter."); S. Rep. No. 95-989 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5902 (stating that section 1109 provides, in unqualified terms, that any creditor, equity security holder, or an indenture trustee shall have the right to be heard as a party in interest.")
[5] *In re* Szostek, 886 F.2d 1405, 1414 (3d Cir. 1989); *In re* Sweetwater, Inc., 836 F.2d 1263, 1267 (10th Cir. 1988).
[6] Proposed R. 2019(a).
[7] Proposed R. 2019(c)(2)(B).
[8] Fed. R. Bankr. P. 2019(a)(4).

in a chapter 9 or chapter 11 case."[9] Similarly, the provision for court-ordered disclosure by individual creditors is to be made appropriate "when a court believes that knowledge of the party's economic stake in the debtor will assist it in evaluating the party's arguments."[10]

We submit that stakeholders have a legitimate interest in such information only in the rarest case, that disclosure harms the disclosing stakeholder more than it assists the court or any other stakeholder, and that the discovery process is adequate to address the rare case in which the information is relevant.

There are very few occasions on which the Bankruptcy Code and Rules make a stakeholder's subjective motivation in taking a legal or strategic position relevant to an issue, for example, when proposing a plan,[11] when voting on a plan,[12] and broadly when making submissions and representations to the court.[13] In each of those circumstances, the very fact that a stakeholder's motivations would be *relevant* makes information relating to it available through discovery.

The proposed Rule, by contrast, would serve as an open invitation for stakeholders to seek disclosure in the name of transparency and the alleged importance of knowing where another party is coming from in negotiations and litigation. In litigation, as noted above, this information is rarely relevant. In negotiations, the information is rarely useful. As one commenter has stated, it is naïve to think that a sophisticated investor would take a lower recovery simply because another stakeholder, knowing the cost of the investor's stake, held out based on that information. Being a sophisticated investor, he would know that he is entitled in bankruptcy to a recovery based on the full amount of his claim.[14] The introduction of this irrelevant and ultimately useless information into the reorganization process would serve only to distract and hinder that process.

While the information to be disclosed under the proposed Rule would provide little benefit to the reorganization process, distressed investors would face real and substantial economic harm from the disclosure. For example, trading counterparties could deduce an entity's position and strategy, including how the entity valued or discounted any particular event in the reorganization process and could use that information to price a proposed trade with that entity, rather than simply charging or offering the price other market participants are willing to bear. That price discrimination would negatively affect the ability of that investor to participate in the market on the same terms as an entity that chose not to participate in the reorganization and thereby keep its otherwise-disclosable information confidential.

Moreover, the disclosure of investors' trading prices, if it were to become relevant to their recoveries, would have a chilling affect in the secondary markets for distressed securities, inasmuch as it would foster uncertainty around the ultimate value of an investment.

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[9] Proposed R. 2019, adv. comm. n.
[10] *Id.*
[11] 11 U.S.C. 1129(a)(3).
[12] 11 U.S.C. § 1126(e).
[13] Fed. R. Bankr. P. 9011(b)(1).
[14] It is firmly established that "the price paid for a claim does not affect the amount of the creditor's claim, or the creditor's voting power." Fairfield Exec. Assocs. v. Hyperion Cap. Credit Partners, L.P. (*In re* Fairfield Exec. Assocs.), 161 B.R. 595, 602 (D.N.J. 1993) (citing *In re* Pittsburgh Rys. Co., 159 F.2d 630, 632-33 (3d Cir. 1946)).

These risks exist for distressed investors under the current version of Rule 2019, but the proposed Rule amplifies them by requiring disclosure of a much broader range of economic interests. The businesses of distressed investors such as hedge funds depend on the execution of complex trading strategies based "on the recognition of trends, inefficiencies, and valuations of the market that *have not been recognized by others*."[15] Forcing firms to disclose *all* of their positions affected by a reorganization case will only hamper their ability to execute those strategies.

Moreover, as one commenter on Rule 2019 has observed, even while advocating for the sort of amendments currently under consideration,

> the dynamics of the reorganization process [have] changed dramatically. In many, if not most, of the largest cases, the traditional creditors in chapter 11 cases—those left holding the bag when businesses fail—have in large part been replaced as players in the chapter 11 process by investors in distressed debt who become stakeholders in the reorganization process by choice.
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> That by itself is not necessarily bad, and is sometimes a good thing. Investors in distressed debt provide an escape mechanism for the predecessor creditors who were (or would be) left unpaid at the time of the bankruptcy filing. With distressed debt investors buying up the debt, the predecessor creditors can then sell their bonds, claims, or participations in bank debt, and thereby realize some recovery on their positions at an earlier time, and with greater certainty, than they might ultimately achieve in distributions on their claims. And in some cases, investors in distressed debt provide other valuable services, such as needed financing or bidding for assets before the end of the chapter 11 case.[16]

Therefore, chilling participation in reorganization cases by distressed investors, aside from being inconsistent with bankruptcy policy, would have a net negative effect on the process and its participants.

The result of requiring disclosure would be both a distortion of the secondary debt markets and a chill on participation in the reorganization process by participants in those markets.[17] The proposed Rule would put distressed investors in a Hobson's dilemma of choosing whether to actively protect their economic interests by participating in bankruptcy proceedings, on the one hand, and protecting their confidential and proprietary information, indeed their business model, on the other.

For the foregoing reasons, we respectfully urge the Committee to repeal Rule 2019.

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[15] Letter from SIFMA & LSTA to Peter G. McCabe, at 23-24 (Nov. 20, 2007).

[16] Letter from Hon. Robert E. Gerber to Advisory Comm. on Bankr. Rules, at 2 (Jan. 9, 2009).

[17] We submit that the Rule's ostensible protection, by providing that pricing information need only be disclosed if the court so orders, is a dead letter. The trading prices of a debtor's obligations are readily obtainable from multiple public sources, and so anyone who knew when a firm bought and sold those obligations could easily determine the approximate prices paid.

I am available at the Committee's convenience to discuss this matter further.

Very truly yours,

/s/ Thomas E Lauria

Thomas E Lauria