BANKRUPTCY COURT REQUIRES MEMBERS OF *AD HOC* CREDITOR OR EQUITY HOLDER COMMITTEES TO MAKE SIGNIFICANT DISCLOSURES

Summary

In *In re Northwest Airlines Corp., et al.*,[1] the United States Bankruptcy Court for the Southern District of New York ruled that any entity representing an *ad hoc* committee of creditors or equity holders in a bankruptcy case must disclose, among other things, the amount of debt claims and equity interests purchased by each member of the committee during the year prior to the filing of the chapter 11 cases and the time of acquisition and, as of the time of the committee's formation, and after, the amount of debt claims and equity interests purchased and sold, the times when such claims and interests were acquired and the amounts paid for such claims and interests.

The *Northwest Airlines* decision may significantly alter the ability of investors involved in bankruptcy cases to organize groups to act collectively through shared counsel without making these disclosures. Based on this ruling, courts might also require disclosures concerning committee members' holdings in securities of the debtor other than those for which they are represented by the *ad hoc* committee. Given the active and growing role of hedge funds and similar investors in the chapter 11 process and the frequency with which they invest at multiple levels of a debtor's capital structure, this ruling may represent a significant change in the balance of information among constituencies and in the strategies employed by hedge funds and others in bankruptcy cases.

Creditors or equity holders acting through their own counsel, as long as such counsel is not also appearing on behalf of other creditors or equity holders, and members of official (*i.e.*, statutory) committees of creditors or equity holders are not affected by this ruling. By its terms, Rule 2019 of the Federal Rules of Bankruptcy Procedure (the "*Bankruptcy Rules*") does not apply in those situations.

The Case

In the *Northwest Airlines* chapter 11 cases, an *ad hoc* committee of equity security holders ("*Committee*"), comprised of various funds, sought extensive relief from the bankruptcy court. The Committee also filed statements pursuant to Bankruptcy Rule 2019, listing, among other things, the members of the Committee and the aggregate claims and equity holdings held by members and stating generally that some members' interests were acquired after the commencement of the chapter 11 cases (the "*Rule 2019 Statement*"). In practice, this level of disclosure has not been uncommon for counsel representing *ad hoc* committees of creditors or equity holders in large chapter 11 cases.

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[1] *In re Northwest Airlines Corp., et al.*, Case No. 05-17930 (ALG) (Bankr. S.D.N.Y. Feb. 26, 2007) [Docket No. 5032].

In response to the Committee's request, the debtors argued that the Committee was not entitled to the relief it sought because the Committee had failed to comply strictly with Bankruptcy Rule 2019, which requires every entity or committee representing more than one creditor or equity security holder to file a verified statement with the bankruptcy court setting forth the following information for each of its members:

> (1) the name and address of the creditor or equity security holder;
>
> (2) the nature and amount of the claim or interest and the time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition;
>
> (3) . . . in the case of a committee, 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; and
>
> (4) with reference to the time of . . . the organization or formation of the committee . . . 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.

Fed. R. Bankr. Pro. 2019(a).

The Committee argued, among other things, that Bankruptcy Rule 2019 requires the entity representing the Committee—in this case, the Committee's counsel—to disclose only claims against or interests held by counsel, not claims or interests held by individual Committee members.

The bankruptcy court rejected the Committee's arguments. The bankruptcy court noted that it was the Committee that was appearing in the bankruptcy cases, seeking discovery and other relief from the bankruptcy court and retaining counsel to act on the Committee's behalf. The bankruptcy court noted that counsel "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 [Bankruptcy Rule 2019]."

The bankruptcy court noted that when a creditor or equity holder group seeks relief from the bankruptcy court, the group "implicitly ask[s] the court and other parties to give [its] positions a degree of credibility appropriate to a unified group with large holdings. . . ." The bankruptcy court ordered the Committee to file an amended Rule 2019 Statement that included the amount of debt claims and equity interests purchased by each member of the Committee during the year prior to, the filing of the chapter 11 cases and the time of acquisition and, as of the time of the committee's formation, and after, the amount of debt claims and equity interests purchased and sold, the times when such claims and interests were acquired and the amounts paid for such claims and interests.

A few days later, the Committee requested the right to file the following information under seal and to provide that information only to the debtors and the official creditors' committee:

- the aggregate amount of stock and claims purchased and sold by each member of the Committee during the year prior to the filing of the chapter 11 cases; and
- the aggregate amount of stock and claims purchased and sold by each member of the Committee after the filing of the chapter 11 cases.

The Committee argued that such disclosure included proprietary business information of the individual Committee members, many of which are hedge funds and similar types of investors. If individual Committee members were required to disclose this type of information publicly, the Committee argued, such requirement would have a chilling effect on the participation of creditors and shareholders in the chapter 11 process. The Committee also argued that by forcing members of the Committee to disclose the information, the bankruptcy court would restrict distressed debt and equity markets and prevent the concentration of claims and interests held by sophisticated groups, which can facilitate the chapter 11 process.

The bankruptcy court did not agree with the Committee's arguments and required the filing of the Rule 2019 Statement on the public docket.[2] Other parties in the *Northwest Airlines* case have filed motions requesting a reconsideration of the bankruptcy court's opinion, and an appeal is possible. Nevertheless, hedge funds that are considering forming or joining an *ad hoc* committee in a chapter 11 case to save costs and coordinate strategy by using the same counsel now will have to weigh those benefits against the disadvantages associated with being ordered to make extensive disclosures.

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If you have any questions concerning this memorandum, please contact John Longmire (212-728-8574, jlongmire@willkie.com), Morris J. Massel (212-728-8980, mmassel@willkie.com) or the attorney with whom you regularly work.

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2 *In re Northwest Airlines Corp., et al.*, Case No. 05-17930 (ALG) (Bankr. S.D.N.Y. Mar. 9, 2007) [Docket No. 5220].