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Does Rule 2019 Apply to Ad Hoc or Informal Committees?
The *Six Flags* Decision

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The debate over whether ad hoc or informal committees or groups of creditors or interest holders ("ad hoc committees") must comply with Bankruptcy Rule 2019 recently intensified due to a split among several Bankruptcy Court decisions. Previously, both *In re Northwest Airlines Corp.*, 363 B. R. 701 (Bankr. S. D. N. Y. 2007), and *In re Washington Mut. Inc.*, 419 B. R. 271 (Bankr. D. Del. 2009) ("*WaMu*") held that ad hoc committees, actively participating in a case as a committee, were subject to Rule 2019. Following these decisions, many practitioners thought the law was settled ─ ad hoc committees were required to file the requisite Rule 2019 disclosures ─ while others continued the practice of not filing Rule 2019 disclosures or only filing partial Rule 2019 disclosures. Fueling the debate is the decision in *In re Premier Int'l Holdings, Inc.*, 2010 WL 198676 (Bankr. D. Del. Jan. 10, 2010) ("*Six Flags*"), which disagreed with *Northwest* and *WaMu*, and held that an informal committee of noteholders was not a committee representing more than one creditor by consent or operation of law and therefore not subject to Rule 2019. Thereafter, *In re Philadelphia Newspapers, LLC*, 2010 WL 41102 (Bankr. E. D. Pa. Feb. 4, 2010), agreed with *Six Flags*, evenly splitting the reported decisions.

One side of the debate argues for increased disclosure of the kind of information covered by Rule 2019, consistent with the "open kimono" policy of the Bankruptcy Code. To these advocates, providing such information will further level the playing field, presumably allowing parties in interest to negotiate with more pertinent information at hand, thereby resulting in better and more equitable distributions to all parties in interest. On the other side of the debate are those who seek to protect their confidential and proprietary trading information, and who outside the bankruptcy context carefully guard such information from disclosure. Those on this side of the debate argue that forcing disclosure of such information would actually result in reduced participation by various parties with available financing for Chapter 11 cases, to the detriment of debtors and their estates.

THE PLAIN MEANING OF RULE 2019 ─ 'CLEAR AS MUD,' SOME MIGHT SAY

Two contrasting readings of Rule 2019 have developed, resulting in different holdings on the applicability of Rule 2019 to ad hoc committees. The *Six Flags* decision is a good starting point to address the debate, as it created the split among reported decisions.

The *Six Flags* decision arose in the context of a dispute over the debtors' plan of reorganization, which was supported by an informal committee (the "SFO Committee") comprised of the holders of approximately 95% of the outstanding notes (the "SFO Notes")

issued by Six Flags Operations, Inc. ("SFO"). The Official Committee of Unsecured Creditors (the "Creditors' Committee") had moved to compel the SFO Committee to comply with Rule 2019 and disclose the amount of the SFO Committee members' claims (current and previously held) against each debtor, the dates the claims were acquired, the amounts paid for the claims, and any subsequent transfers of those claims. The Creditors' Committee sought to preclude the SFO Committee from participating in the Chapter 11 case until the disclosures were made. The Creditors' Committee did not seek such disclosures from its current ally in the plan dispute against the debtor, the ad hoc committee (the "SFI Committee") of approximately 67% of the outstanding notes (the "SFI Notes") issued by holding company Six Flags, Inc. ("SFI").

The debtors' plan proposed that holders of unsecured claims against SFO, including any SFO Noteholders, who participated in a $450 million rights offering would receive approximately 70% of the equity in the reorganized debtor. Holders of allowed unsecured claims against SFO, including those on the SFO Committee, would convert their claims into approximately 23% of the equity of reorganized debtor. The holders of allowed unsecured claims against SFI, including members of the SFI Committee, would convert their claims into approximately 7% of the equity of the reor-ganized debtor.

The Creditors' Committee argued for the disclosure because it believed the SFO Committee represented to the debtors the SFO Committee's level of holdings of SFI Notes and that the SFO Committee was also representing holders of such SFI Notes. The Creditors' Committee believed that the SFO Committee failed to disclose prior holdings and dispositions of SFI Notes, and had en-gaged in transactions to save themselves from the negative treatment they were negotiating to impose on the SFI Notes (and to their benefit as holders of SFO Notes) under the Chapter 11 plan. The Creditors' Committee believed the Rule 2019 disclosures were necessary to allow it and the court to evaluate the SFO Committee's credibility and motives in the cases.

THE DECISION

The *Six Flags* decision was based primarily on the plain meaning of the language of Rule 2019, to provide a "clear and objective" definition that parties could rely on without the need for court guidance in every case. *Six Flags* at *5, *14. According to the court, "[t]he question is whether the SFO … Committee is a 'committee representing more than one creditor.' If so, its members are subject to Rule 2019." *Id*. at *5.

The court found that the plain meaning of "committee" is "a body of two or more people appointed for some special function by … a [larg-er] body." *Id*. The court interpreted this to mean that "a *self-appointed* subset of a larger group, whether it calls itself an informal committee, an *ad hoc* committee, or by some other name, simply does not constitute a committee under the plain meaning of the word. In order for a group to constitute a committee under Rule 2019, it would need to be formed by a larger group either by consent, contract or applicable law ─ not by "self help." *Id.*

The court also determined the plain meaning of the word "represent" as it is used in Rule 2019, as contemplating "an active appointment of an agent to assert deputed rights. It is black letter law that a person cannot establish itself as another's agent such that it may bind the purported principal with the principal's consent unless the principal ratifies the agent's actions." *Id.*

Thus, according to the *Six Flags* court, "under the plain meaning of the phrase 'a committee representing more than one creditor,' a committee must consist of a group representing the interests of a larger group with that larger group's consent or by operation of law." *Id*. Because the SFO Committee did not represent any persons other than its members either by consent, contract, or operation of law, it was not a Rule 2019 committee and did not have to make any disclosures. *Id*.

THE *WAMU* DECISION

In contrast, according to the *WaMu* court, "[u]nder the plain language of Rule 2019 … the WMI Noteholders Group [was], in fact acting as an ad hoc committee or entity representing more than one creditor" and as such, was within the disclosure requirements of Rule 2019. *WaMu* 419 B.R. at 275. Although employing a "plain language" analysis, the court did not actually look to any definition of "committee," but rather seemed to assume that so-called ad hoc committees are within the scope of Rule 2019 and because the WMI Noteholders Group was very similar to an ad hoc committee, such Group was within the Rule. *See Six Flags* at *13 - *14. This analysis was very similar to the approach taken in the *Northwest* case. *See Northwest*, 363 B.R. at 702-703. Because the WMI Noteholder Group appeared to be similar to an ad hoc committee, and because the court assumed an ad hoc committee was a committee within Rule 2019, the court determined that such Group was a Rule 2019 committee. *WaMu* 419 B.R. at 275.

The *WaMu* court did look to the definition of the word "entity" to find that the WMI Noteholders Group was an entity for purposes of the Rule. *WaMu*, 419 B.R. at 275 n. 7. The term "entity" is defined by the Bankruptcy Code to "include person, estate, trust, governmental unit, and United States trustee." 11 U.S.C. § 101 (15). The Code defines the term "person" to include an "individual, partnership, and corporation." *Id.* § 101(41). The court pointed out that use of the word "includes" in the definition of "entity" means that it is not an exclusive definition, allowing the court to look to other sources for definitions of the "entity." As such, the court determined the WMI Noteholders Group was an entity for purposes of Rule 2019 "because it is an organization that has an identity apart from its individual members." *Id.* (The "entity" issue was not addressed in *Six Flags*, but the *Philadelphia Newspapers* case ruled the Steering Group there was not an "entity" for purposes of Rule 2019, as it was "not an organization that has a legal identity apart from its individual members." *Philadelphia Newspapers*, 2010 WL 411102 at *11.)

In the *Philadelphia Newspapers* case, which essentially followed the *Six Flags* decision, the court determined that a self-styled Steering Group of Pre-Petition Lenders was not a "committee" for purposes of Rule 2019. *Philadelphia Newspapers* at *1. Dispositive of the issue for the court were the facts that: 1) the Steering Group formed itself; and 2) it had not been

appointed by any larger deliberative body, either consensually, contractually or by operation of applicable law. *Id.* at *12.

OTHER CONSIDERATIONS ADDRESSED BY THE COURTS

The cases addressed other reasons why ad hoc committees should be treated as committees for purposes of Rule 2019. The *Six Flags* decision essentially disagreed with each.

The *WaMu* and *Northwest* decisions read the legislative history to support a reading of Rule 2019 to include ad hoc committees within its scope. However, the *Six Flags* decision determined that:

> upon a careful review of the facts and circumstances leading to the rule's adoption as well as its intended purpose, it is clear that the informal and ad hoc committees as they exist today are very different from the 'protective committees' that were the target of the reforms in the 1930's. *Six Flags* at *5.

After carefully reviewing the legislative history leading up to the adoption of Rule 2019, *see Six Flags* at *6 - *12, the *Six Flags* court compared the ad hoc committees of today and the protective committees of the 1930s. Each type of committee was or is typically comprised of "Wall Street banks and institutional investors" and formed to obtain leverage in the reorganization not otherwise available as individual stakeholders, as well as to be involved in negotiating and formulating a reorganization plan. *Six Flags* at *12. However, the court believed the differences to be more dramatic and sharp. The protective committees were essentially "able to control completely the entire reorganization ─ from inception to formulation to solicitation to implementation." *Id.* They were able to "bind creditors through the use of deposit agreements" and "were so intimately involved with management so as to be virtually in control of the business." *Id*. Such protective committees "could force disparate treatment of similarly situated creditors" and were "able 'to steal' the company for an inadequate 'upset price' at a foreclosure sale by credit bidding their debt." *Id.*

According to the *Six Flags* court, these expansive powers that rested with protective committees, are no longer an issue with respect to ad hoc committees, as such powers have been eliminated by the Bank-ruptcy Code:

> For example, the debtor is given exclusive authority to propose and to solicit a plan of reorganization; claims and interests may only be classified with substantially similar creditors [or interest holders]; creditors in the same class must be treated equally; a trustee or examiner can be appointed for cause. Even if an informal committee were to try to exercise the powers formerly available to protective committees, it would be prevented by the Bankruptcy Code. *Id*.

WaMu, however, read the legislative history to support a finding that an ad hoc committee is subject to Rule 2019. *WaMu*, 419 B.R. at 278. While acknowledging the contrary view, the *WaMu* court concluded that the history was not limited to protective committees. *Id.* Rather, according to the *WaMu* court. "[t]he predecessor of Rule 2019 was designed to '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.'" *Id.* (citations omitted). *See also Northwest*, 363 B.R. at 704 (discussing legislative history of Rule 2019).

The *Six Flags* court also expressed the view that "Rule 2019 is a prophylactic rule designed to provide information to the Court and others at the inception of the case to preserve the integrity of the reorganization process to follow." *Six Flags* at *14. As such, the *Six Flags* court thought it was a "mistake to focus on the conduct and role of the ad hoc committee to determine whether it is a committee under Rule 2019." *Id*. In adopting a bright-line definition of "committee," based on the plain language of the Rule, the court was striving to preserve the integrity of the reorganization process.

The *WaMu* and *Northwest* courts also suggested that members of an ad hoc committee take on heightened duties to other similar creditors of the same class. The *Northwest* court stated that "[b]y acting as a group, the members of the shareholders' Committee … negotiating decisions as a Committee should be based on the interest of the entire shareholders' group, not their individual financial advantage." *Northwest*, 363 B.R. at 708. The *WaMu* court, though finding it unnecessary to define the parameters of such duties, did "recognize that collective action by creditors in a class implies some obligation to other members of that class." *WaMu*, 419 B.R. at 279. The *Six Flags* court did not address this issue.

CONCLUSION

The ultimate answer to the debate may come from a legislative solution, as there is currently pending a proposed amendment to Rule 2019. In the meantime, practitioners will need to be sensitive to the competing interests and the split in the case law when advising clients on whether an ad hoc committee is within the disclosure requirements of Rule 2019. At this point, unless an ad hoc committee is involved in a case before one of the specific judges who wrote the opinions discussed in this article, it is difficult to know with any degree of certainty whether such a committee is required to make the Rule 2019 disclosure. Only by balancing the risks associated with the disclosure, including the risks to the business strategies of the members of the committee and such committee's continued participation in the case, can a decision to disclose or not be made.

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