

**REPRESENTATION OF MORE THAN ONE CREDITOR OR INTEREST HOLDER  
AND THE IMPACT OF FED. R. BANKR. P. 2019**

A professional may be retained by more than one creditor or interest holder to represent them in a bankruptcy case. Such arrangements offer the promise of efficiency, credibility and leverage for the clients by allowing them to pool information and resources, share the expenses of counsel and other professionals, and speak with a single voice, both in court and in negotiations with the debtor and other parties. Acting collectively also creates efficiencies for the court, the estate and the parties by avoiding duplicative appearances, filings and arguments. These groups lack the duties and many of the restrictions imposed on official committees. They also lack the rights of an official committee, including the rights to information under 11 U.S.C. § 1103(c), and reimbursement from the estate for professional fees under 11 U.S.C. § 330. Counsel representing one or more creditors or interest holders should evaluate the advantages and limitations of such representation, including the applicability of the disclosure requirements set forth in Bankruptcy Rule 2019.

**A. Rights and Limitations of *Ad Hoc* Committees.**

In contrast to official creditor committees, *ad hoc* committees lack a statutory basis in Bankruptcy Code. They are not an expressly defined entity under the Code, have no role provided under the Code, and may exist before a case is commenced and may continue after a plan is confirmed. An *ad hoc* committee's authority to appear and be heard in a bankruptcy case derives from the status of its individual members. Accordingly, there may be limitations, such as the inability to submit a joint claim or joint ballot.

The membership of an *ad hoc* committee is not determined by the United States Trustee, the Code, or the bankruptcy court. For instance, the Code authorizes official committees of creditors and interest holders, but *ad hoc* committees may include those and other parties, such as secured creditors or administrative claimants. In addition, membership is at will and the composition of the committee may change frequently and substantially during the course of the case. Because *ad hoc* committees lack the fiduciary duties applicable to official committees, they may advance their own self-interests without any obligation to represent non-members' interests. For example, *ad hoc* committees are not obligated, under 11 U.S.C. § 1102(b)(3), to share information with and solicit the opinion of other creditors or interest holders of the type represented by the committee.

Unlike official committees, *ad hoc* committees may retain professionals that do not comply with the requirements for disinterestedness and the restrictions on representation of adverse interests under 11 U.S.C. §§ 328(c) and 1103(b) applicable to official committees. Of course, professionals must abide by applicable state law ethical rules and guidelines.

While *ad hoc* committees lack many of the restrictions imposed on official committees, they also lack the rights of an official committee to information, including those rights set forth in 11 U.S.C. § 1103(c) to: (1) consult with the trustee or debtor in possession concerning the administration of the case; (2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan; (3) 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; (4) request the appointment of a trustee or examiner under

section 1104 of the Bankruptcy Code; and (5) perform such other services as are in the interest of those represented.

Nevertheless, if the debtor chooses to disclose nonpublic information to the *ad hoc* committee, they should be subject to trading restrictions otherwise applicable to members of an official committee to avoid self-dealing. See *In re Federated Dep't Stores, Inc.*, No. 1-90-00139, 1991 WL 79143 (Bankr. S.D. Ohio Mar. 7, 1991) (trading by official committees is subject to 3 conditions: 1) the entity must trade as a regular part of its business; 2) the member can establish reasonable ethical walls; and 3) proposed trading is subject to securities laws and regulatory oversight).<sup>1</sup> The establishment of adequate ethical walls may be difficult for smaller entities. Moreover, individual natural persons should not be permitted to trade because no ethical wall is possible. Counsel must be cognizant of these limitations and ensure members' compliance.

Finally, *ad hoc* committees are not entitled under the Code to reimbursement from the bankruptcy estate for professional fees and expenses, unless the *ad hoc* committee members can demonstrate that they have made a "substantial contribution" to the debtor's bankruptcy case within the meaning of 11 U.S.C. § 503(b)(3)(D) and (b)(4), or as oversecured creditors under 11 U.S.C. § 506(b). The United States Trustees closely scrutinize both substantial contribution claims brought by *ad hoc* committees and their professionals and settlements that affect the payment of substantial contribution claims to ensure compliance with applicable standards for reimbursement. Among other things, the United States Trustees look at whether the *ad hoc*

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<sup>1</sup> In *In re Spiegel*, the bankruptcy court rejected a securities trading order and expressed concern about such orders in general. *In re Spiegel*, 292 B.R. 748, 751 (Bankr. S.D.N.Y. 2003). The court stated that trading in securities of the debtor by committee members, regardless of how the creditor internally divides its office, creates "an appearance of impropriety." *Id.* Ultimately, the court could not determine that committee members met the *Federated* standards absent further development of the factual record regarding, *inter alia*, the nature of the members' business and their relationships with their clients.

committee was motivated and acted solely in its members' self interest, and whether the activity duplicated the activity of an official committee. In such cases, reimbursement is not appropriate.

**B. Disclosure under Fed. R. Bank. P. 2019.**

Federal Rule of Bankruptcy Procedure 2019(a) requires any "entity or committee" that represents more than one creditor or equity security holder in connection with a bankruptcy case, other than an official committee and retiree committee appointed under §§ 1102 and 1114, to file a verified statement identifying each client and the nature of their claims or interests, together with certain facts about the professional's employment. Specifically, Rule 2019(a) requires the filing of a verified statement setting forth:

- (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) a recital of the pertinent facts and circumstances in connection with the employment of the entity or indenture trustee, and, 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 employment of the entity, the organization or formation of the committee, or the appearance in the case of any indenture trustee, the amounts of claims or interests owned by the entity, the members of the

committee or the indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.

Fed. R. Bank. P. 2019(a). The rule requires the prompt filing of a supplemental statement setting forth any material changes in the facts contained in the verified statement. If the committee fails to comply with the disclosure requirements of Rule 2019, then on motion of any party in interest or on its own initiative, the court may refuse to permit the committee to be heard further or to intervene in the case.

Although historically there has been very little case law under Rule 2019(a), two recent decisions attracted significant attention by addressing whether the Rule applies to *ad hoc* committees in chapter 11 cases. Members of these committees may be hedge funds and other distressed-debt investors that are playing an increasingly active and important role in corporate reorganizations, and some of them may hold debt at various levels of the debtor's debt structure. The two decisions, *Northwest Airlines* and *Pacific Lumber*, split on the issue of whether more detailed Rule 2019(a) disclosure is required for *ad hoc* committees.

In *In re Northwest Airlines Corp.*, 363 B.R. 701 (Bankr. S.D.N.Y. 2007), the court held that an *ad hoc* equity committee comprising certain equity holders failed to comply with the disclosure requirements of Rule 2019, and ordered the *ad hoc* committee to file a modified 2019 statement. The original 2019 statement disclosed the members' holdings in the aggregate. Judge Gropper ruled that each member of the *ad hoc* committee was required to disclose the amounts of their claims and interests, when they acquired the claims and interests, the amounts paid, and any sales or other dispositions of the claims and interests.

In explaining the need for the enhanced disclosures, the court noted that even though the committee did not purport to act as the fiduciary for other shareholders, it was holding itself out

as a collective group and thereby “implicitly ask[ing] the court and other parties to give their positions a degree of credibility appropriate to a unified group with large holdings.” *Id.* at 703. The court found that an *ad hoc* committee appearing in this capacity was “required to provide the information plainly required by Rule 2019 on behalf of each of its members.” *Id.*

The *ad hoc* committee, which had opposed the expanded disclosure, later requested that it be allowed to file portions of its revised 2019 statement under seal, arguing that such disclosures would reveal proprietary information, including trading secrets and methodologies. The United States Trustee responded that public policy favors open access to documents filed in bankruptcy cases and that the committee members had not demonstrated that their trading data was confidential information or trade secrets. The bankruptcy court denied the committee’s request to file the revised disclosures under seal, holding that any interest that an individual committee member had in keeping information confidential was overridden by the interest in public disclosure that Rule 2019(a) seeks to protect. *In re Northwest Airlines Corp.*, 363 B.R. 704 (Bankr. S.D.N.Y. 2007).

In explaining its refusal to allow the disclosure to be filed under seal, the court noted that even though the committee did not purport to act as a fiduciary for other shareholders, Rule 2019 was based on the premise that those shareholders had the right to the disclosures so that they could decide on an informed basis whether the *ad hoc* committee truly represented their interests. *Id.* at 708-09. Additionally, the court explained that the information required under Rule 2019(a) provides all parties a greater ability to gauge the credibility of the *ad hoc* committee. *Id.*

Shortly after the *Northwest Airlines* decisions, the debtor in the *Pacific Lumber* case filed a motion seeking to compel an *ad hoc* committee of noteholders to make detailed disclosures under Rule 2019, similar to those required in *Northwest Airlines*. *In re Scotia Development*,

*LLC*, No. 07-20027 (Bankr. S.D. Tex. 2007), Docket No. 492. The debtor argued that the committee had interfered with the reorganization process by adopting an aggressive and improper litigation posture and filing absurd pleadings with the court, while hiding “behind a veil of secrecy” that was patently contrary to the open disclosure policies underlying the Bankruptcy Code and the express provisions of Rule 2019(a). *Id.* at \*1-2. The committee argued that it was not a “committee” under Rule 2019 because it did not purport to represent any others who were not on the committee. In an unpublished April 2007 decision, Judge Schmidt agreed that the committee was not a “committee” under Rule 2019 and, therefore, did not need to make disclosures in compliance with that Rule.

The Loan Syndications and Trading Association (“LSTA”) and Securities Industry and Financial Markets Association (“SIFMA”), both leading trade associations for the commercial loan and securities markets, participated as amicus in support of the debtor. *See In re Scotia Development, LLC*, No. 07-20027 (Bankr. S.D. Tex. 2007), Docket No. 610. They argued that a public disclosure requirement under Rule 2019 would create windfalls in favor of debtors and destroy the incentive for investors to purchase claims against debtors.

The LSTA and SIFMA have submitted a joint letter to the Judicial Conference Committee requesting that Rule 2019, in its current form, be repealed as “obsolete.” *See* Letter from LSTA and the SIFMA to Peter G. McCabe, Sec’y, Comm. on Rules of Practice & Procedure of the Judicial Conference of the United States (Nov. 30, 2007).<sup>2</sup> The National Bankruptcy Conference submitted a letter to the Advisory Committee on Bankruptcy Rules dated September 22, 2008, opposing the repeal of Rule 2019 and suggesting ways in which it might be

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<sup>2</sup> Available at <http://www.sifma.org/regulatory/pdf/BankruptcyRule2019Letter.pdf>.

amended.<sup>3</sup> And Bankruptcy Judges Gerber and Drain of the Southern District of New York have also submitted letters opposing the repeal of the rule and suggesting amendments.<sup>4</sup>

### C. A Word About Conflicts and Privilege

An attorney representing more than one creditor or interest holder in the same case owes duties to each client. Such representation raises potential privilege and conflict of interest issues with respect to information shared by each client with the attorney and information shared by the attorney with each client.

These issues arise even in the context of representing *ad hoc* committees because the committee has no more rights or standing than the members have individually. From a privilege standpoint, while the “joint defense” or “common interest” doctrine might protect information shared between members and the attorney as to third parties, there would likely be no privilege as to those same disclosures in subsequent litigation between the members. Similarly, as to conflicts of interest, because *ad hoc* committees only advance their individual members’ interests, there is the potential for conflicts to arise during the course of the representation. Because the interests of the individual members may diverge at some point during the case, the attorney may be faced with divided, or at least shared, loyalties as between committee members.

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<sup>3</sup> The National Bankruptcy Conference’s website lists communications with the Advisory Committee on Bankruptcy Rules at [http://www.nationalbankruptcyconference.org/other\\_communications.cfm](http://www.nationalbankruptcyconference.org/other_communications.cfm). The link to the September 22, 2008 letter is unavailable.

<sup>4</sup> Judge Robert Gerber’s letter dated January 9, 2009, to the Advisory Committee (08-BK-M) is available at <http://www.uscourts.gov/rules/BK%20Suggestions%202008/08-BK-M-Suggestion-Gerber.pdf>. Judge Robert Drain’s letter to the Advisory Committee dated January 13, 2009 (08-BK-N), is available at <http://www.uscourts.gov/rules/BK%20Suggestions%202008/08-BK-N-Suggestion-Drain.pdf>.