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Delaware Bankruptcy Court Requires Rule 2019 Disclosure By *Ad Hoc* Noteholder Committee and Suggests Fiduciary Duties May Be Owed To Other Similarly Situated Creditors

In a recent decision, *In re Washington Mutual, Inc., et al.*, 2009 WL 4363539 (Bankr. D.Del. 2009), the Bankruptcy Court for the District of Delaware held that a group of noteholders was subject to the disclosure requirements of Rule 2019 of the Federal Rules of Bankruptcy Procedure (“Rule 2019”) because it was acting as an *ad hoc* committee representing more than one creditor. The court also stated, in *dicta*, that such a group may owe “some obligation” to other members of the same class of creditors even though the group was not purporting to represent those other creditors, and that this obligation may consist of unspecified fiduciary duties. The decision is particularly important for financial institutions and investment funds, both in terms of the amount of disclosure required when acting in a collective capacity, and because members of the group could be found to be fiduciaries of all other members of the class, thereby exposing the *ad hoc* group to potential liability for any breach of that duty.

Background

Washington Mutual, Inc. (“WMI”), the former holding company of Washington Mutual Bank, commenced chapter 11 proceedings in Delaware following the Office of Thrift Supervision’s seizure of the bank in September of 2008. In connection with the chapter 11 case, counsel for a group of noteholders (the “Noteholder Group”) filed a notice of appearance and a verified statement, listing the names and addresses of 23 entities collectively holding over \$1.1 billion in principal amount of notes issued by WMI. The statement represented that each member of the Noteholder Group “makes its own decisions as to how it wishes to proceed and does not speak for, or on behalf of, any other creditor, including the other participants.” The statement did not include certain types of disclosure required by Rule 2019, such as (i) an itemization of the

amount of each claim, (ii) the date of acquisition of each such claim, (iii) the amounts paid for each such claim, (iv) a description of any sales or other dispositions of such claims, and (v) a recital of the facts and circumstances relating to the formation of the group. On August 6, 2009, JPMorgan Chase Bank (which had acquired the assets of WMI) filed a motion to compel the Noteholder Group to comply with Rule 2019. The Noteholder Group objected on the ground that it was representing the members of the group in their individual capacities rather than collectively, and therefore the disclosure requirements of Rule 2019 did not apply.

The Court's Analysis

Rule 2019(a) provides, in relevant part, that the verified statement of “every entity or committee representing more than one creditor or equity security holder” must include “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.” The Noteholder Group argued that it was not subject to these requirements because it was not an “entity or committee representing more than one creditor,” but rather was a “loose affiliation of creditors who, in the interests of efficiency, are sharing the cost of advisory services in connection with the case.” However, the court reasoned that, as an *ad hoc* committee typically is a “loose affiliation” of creditors with an “at-will” membership, the Noteholder Group featured “virtually all the characteristics typically found in an *ad hoc* committee, save the name.” Thus, the court held that the Noteholder Group was subject to the disclosure requirements of Rule 2019.

Pointing to the legislative history, the Noteholder Group contended that Rule 2019 was only intended to apply to “a body that purports to speak on behalf of an entire class or broader group of stakeholders in a fiduciary capacity with the power to bind the stakeholders that are members of such a committee.” The court rejected this argument because, in the court’s view, the rule was clear on its face and therefore resorting to the legislative history was neither necessary nor appropriate. The court further found that, in any event, the legislative history did not support the contentions of the Noteholder Group. Significantly, the court observed in *dicta* that members of a class of creditors who act as a group may owe fiduciary duties to other members of that class even when they are not purporting to represent them.

The court cited three cases to support this proposition. In the first case, *Young v. Higbee Co.*,¹ two preferred shareholders, who were members of the official stockholders’ committee, resigned from the committee

and, in their individual capacities, objected to confirmation of the debtor’s plan of reorganization that had been filed with the support of the committee. Following confirmation of the plan, the two shareholders appealed the confirmation order, contending that the plan improperly provided a distribution to holders of junior debt. While the appeal was pending, these stockholders sold their shares to certain of the junior debt holders, together with their rights in the appeal, and received disproportionately high compensation in return. The purchasers of the appeal then moved to dismiss the appeal, and the motion was granted over the objection of a third preferred stockholder. The Supreme Court found that although the appeal was not a formal class action, its outcome would have had a substantial effect on the interests of all preferred stockholders because it was based on the contention that all preferred stockholders would be injured by confirmation of the plan. The Court found that the preferred stockholders that brought the appeal owed a duty of good faith to all other preferred stockholders because their rights were necessarily affected by the appeal. Having availed themselves of “the statutory privilege of litigating for the interest of a class,” the stockholders could not be permitted to “shake off their self-assumed responsibilities to others by . . . [trading] in the rights of others” for their own personal gain.²

The second case cited by the court is *Official Committee of Equity Security Holders of Mirant Corp. v. The Wilson Law Firm, P.C. (In re Mirant Corp.)*.³ In *Mirant*, the court enjoined a law firm representing an *ad hoc* group of shareholders from disseminating misleading information in connection with the solicitation of votes against the debtors’ plan of reorganization. The court found that the law firm “donned the mantle of a fiduciary” because it had participated in the chapter 11 cases as a representative of the shareholders, assumed the role on its website as counsel to the *ad hoc* shareholders committee and sought compensation from the bankruptcy estate. The court,

² *Id.* at 213.

³ 334 B.R. 787, 793 (Bankr. N.D. Tex. 2005).

¹ 324 U.S. 204, 210 (1945).

citing *Higbee*, found that “[i]t is a well established principle of bankruptcy law that when a party purports to act for the benefit of a class, that party assumes a fiduciary role as to the class.”⁴ It is unclear whether a fiduciary duty would have arisen at all in the event the law firm did not tout itself as attempting to represent an *ad hoc* committee on behalf of all shareholders and seek compensation from the bankruptcy estate. Therefore, it is questionable whether *Mirant* provides support for the court’s analysis in *Washington Mutual*.

The third case cited by the court, *In re Northwest Airlines Corp.*, held, in relevant part, that the “negotiating decisions [of] a Committee should be based on the interest of the entire shareholders’ group, not their individual financial advantage.”⁵ The *Washington Mutual* court found that this language demonstrated “the importance of the relationship between the committee and other similarly situated shareholders.” However, it is not clear that this interpretation is consistent with the text of *Northwest Airlines*, which arguably does not refer to the obligation of the committee to act in the interest of the entire class of shareholders, but only the “entire shareholders’ group” that it represents (as opposed to individual members thereof).⁶

The conclusion of the *Washington Mutual* court that “collective action by creditors in a class implies some obligation to other members of that class” appears to be an extrapolation that goes well beyond the respective rationales of the foregoing cases. Furthermore, the court’s view is difficult to reconcile with the long-held principle that a creditor owes no duty to other creditors in the collection of its claim.⁷

⁴ *Id.*

⁵ 363 B.R. 704, 708 (Bankr. S.D.N.Y. 2007).

⁶ *See id.*

⁷ *In re W.T. Grant Company, et al.*, 699 F.2d 599, 609 (2d Cir. 1983) (in which the court concluded “[a] creditor is under no fiduciary obligation to its debtor or to other creditors of the debtor in the collection of its claim”).

Potential Impact

The court’s holding should give pause to financial institutions and investment funds that are considering acting in concert with other similarly situated creditors in a chapter 11 case. Membership in such a group may require disclosure of sensitive data. For example, a fund’s counterparty may gain an advantage by learning the basis or acquisition cost of assets the fund is trying to sell. Moreover, the disclosure requirement is a continuing obligation that requires periodic updating, thereby imposing administrative burdens. More importantly, the *Washington Mutual* decision may impose fiduciary obligations upon members of a group to act in the interests of similarly situated creditors who are not part of the group, which would restrict such members’ ability to act in their own self-interest and expose them to potential liability for breach of duty. These disadvantages need to be weighed against the benefits of acting as a member of a group, such as the increased leverage that is gained in litigation and settlement negotiations, as well as a sharing of legal and financial advisory expenses.

The *Washington Mutual* decision, while not binding on other courts, raises many intriguing questions. How can creditors who are not purporting to represent an entire class of similarly situated creditors be saddled with the responsibility of representing the interests of creditors outside their group (particularly without compensation)? Must the members of a group forego their own individual interests for the collective good of the entire class? What liability attaches to members of a group who breach their involuntarily-assumed fiduciary duty? It will be interesting to see how courts address these and other related issues. Until the dust settles, financial institutions and investment funds must consider these unanswered questions if they choose to act in concert with other creditors in a bankruptcy case.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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