

ALERT



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Increased Scrutiny Placed on Trading by Members of Creditors' Committees

Over the past several years, the increased participation by hedge and private equity funds in the distressed debt market has resulted in their greater membership on unsecured creditors' committees in chapter 11 cases. These funds must be mindful of their obligations to avoid trading on the material non-public information that they may learn as members of creditors' committees. Two recent events may signal a trend towards increased scrutiny of committee members' trading practices. First, Barclays Bank recently paid almost \$11 million — and its head proprietary trader paid \$750,000 — to settle SEC charges of insider trading while serving as a member of six different creditors' committees. Second, Dura Automotive, which is currently reorganizing in chapter 11, is in the process of investigating a recent spike in the price of certain of its securities.

The Barclays Settlement

The Barclays settlement stemmed from a complaint filed by the SEC against the bank and its head proprietary trader for alleged violations of the Securities and Exchange Act. The SEC alleged that in 2002 and 2003, the Barclays trader was a member of at least six official and unofficial chapter 11 creditors' committees and traded distressed securities of the debtors. In addition to duties to the issuer-debtor that may have been created as a committee member, the trader had signed either committee bylaws containing confidentiality and fiduciary duty acknowledgments or confidentiality agreements directly with the debtor. The SEC alleged that during this time the trader, as a committee member, obtained material nonpublic information, including information about the debtors' business plans, management projections and various status reports.

According to the SEC's complaint, Barclays failed to impose so-called "firewalls," a typical protocol used to prevent trading of the debtors' securities on the basis of material nonpublic information. The SEC did acknowledge, however, that in a few instances Barclays entered into so-called "Big Boy" letters with its trading counterparties to advise them that Barclays may possess material nonpublic information. Big Boy letters contain representations by the signing counterparty of its financial sophistication and acknowledgements that the other party may be an insider who has knowledge of undisclosed material nonpublic information. Traders who may be insiders often require the trading counterparty to execute a Big Boy letter as legal comfort against an insider trading claim later brought by the counterparty. To date, however, neither the courts nor the SEC have provided formal guidance on the effectiveness of Big Boy letters. However, the SEC's complaint against Barclays appears to signal that the SEC does not believe that Big Boy letters are a defense to Exchange Act violations.

Ultimately, Barclays and its trader settled the SEC's charges and agreed to pay damages and penalties without admitting or denying the SEC's allegations. The trader further agreed to a permanent injunction against his serving as a member of any creditors' committee in any bankruptcy case involving an issuer of securities. A copy of the SEC's complaint can be obtained at <http://www.sec.gov/litigation/complaints/2007/comp20132.pdf>.

Trading Spike Draws Attention in Dura Automotive's Chapter 11 Cases

Dura Automotive filed for chapter 11 protection on October 30, 2006. The company recently formulated its business plan and is currently developing its chapter 11 plan of reorganization and bankruptcy exit strategy based upon that business plan. On May 22, 2007, and on the morning of May 23rd, the debtors made confidential presentations about its business plan to its official unsecured creditors' committee and an unofficial committee of second lien debt holders. At 2:00 p.m. on May 23rd, there was an unusual spike in the price of certain of the debtors' securities. Specifically, relatively large blocks of bonds started to trade, and the price of the bonds increased by approximately 17%. Shortly thereafter, the debtors commenced an investigation into the

matter and asked the two committees to produce a report, based upon communications, emails and other evidentiary material, regarding the potential involvement of any committee members in any leakage, release or misuse of confidential information. The committees are expected to produce their reports to the debtors shortly.

Committee Members Must be Aware of the Restrictions Against Insider Trading

The Barclays settlement and the Dura investigation may indicate a trend towards greater scrutiny placed on the trading of distressed securities, with a particular emphasis on whether committee members trade in a debtor's securities based on material non-public information. The SEC's complaint against Barclays also appears to cast doubt on the ability of a committee member to rely on a Big Boy letter signed by the trading counterparty. Distressed trading funds that serve as members of creditors' committees should take care either to avoid trading in the debtors' securities altogether, or to establish appropriate ethical walls between the fund's committee member, who has access to material non-public information, and the fund's trading desk, which can trade based on public information only.

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