WILMERHALE

Public or Private? Bankruptcy as a Crossroads of Information

2006-05-26

Is bankruptcy in the United States a public process? As a general matter, the United States justice system is an open one and court records are public records. But, as with any general rule, there are exceptions, and for every type of legal proceeding there are circumstances in which courts will seal records, close courtrooms and restrict public discussion about issues pending before them. Sections 107 and 1102 of the Bankruptcy Code, and the cases interpreting those statutes, illustrate the tension between these twin goals of openness and privacy.

Section 107: A Presumption of Openness

In bankruptcy, the general rule of openness, and a limited exception, are codified in 11 U.S.C. § 107. Section 107(a) provides that bankruptcy papers and dockets "are public records and open to examination by an entity at reasonable times without charge." Section 107(b) provides that a bankruptcy court shall protect against public disclosure of confidential business information and "scandalous or defamatory" matter, and Section 107(c), newly enacted in 2005, provides a mechanism for protection of individuals from identity theft. Section 107 reflects, on the one hand, a congressionally mandated balance between the presumed openness of the bankruptcy process, and, on the other hand, the need to protect certain types of sensitive or damaging information.

The Section 107(b) balance between publication and protection of allegedly "defamatory matter" was tested last year by the First Circuit Court of Appeals in the case of *In re Gitto Global Corp*., 422 F.3d 1 (1st Cir. 2005). In that case, a Chapter 11 proceeding was filed for a closely held corporate debtor, and an examiner was appointed. The examiner wrote a report identifying alleged improprieties in the management of the corporation by its former CEO and his father, and both of whom sought to restrict public access to the report on the ground that it was "defamatory matter" under Section 107(b). After a close review of the nature and purpose of Section 107(b), the First Circuit announced a definition of defamatory matter that is specific to Section 107(b) and not directly dependent upon nonbankruptcy defamation law. The First Circuit concluded that material triggers the defamatory matter exception in Section 107(b) when it would cause a reasonable person to alter his opinion of an interested party and is either (i) materially untrue, or (ii) potentially untrue, and either (a) irrelevant, or (b) included within a bankruptcy filing for an improper end.

The First Circuit reached this rather complicated standard in part because it wanted to avoid forcing

bankruptcy courts to hold short-form defamation trials (including determinations of fact as to whether the allegedly defamatory statements were true or false) each time an interested party raised a Section 107(b) challenge. Whatever the reasoning, the First Circuit's opinion, in word and in effect, favors the publicity of bankruptcy records over the privacy rights of parties involved in bankruptcy proceedings.

Section 1102: Information Sharing by Creditors' Committees

In a vacuum, the *Gitto Global* case is interesting, but its implications are narrow. When read in a broader context, however, it seems to fit a trend toward increased transparency in bankruptcy proceedings. Consider the additions to 11 U.S.C. § 1102 that were part of the 2005 amendments to the Bankruptcy Code. Section 1102(b)(3) now requires official creditors' committees to provide access to information to non-member creditors who hold claims of the type represented by the committee, and to solicit comments from them. Moreover, Section 1102(a)(4) permits a court to order a change in membership of an official creditors' committee "to ensure adequate representation of creditors" and, specifically, to include a creditor that is a small business concern. These changes point toward an awareness that an official committee, which normally includes only large (and in major cases, institutional) creditors, can in some instances act as a "bankruptcy insider" and can frustrate the notion that bankruptcy should be a process open to all creditors and that a court-appointed committee represents all creditors of a type (e.g., all unsecured creditors). The changes to Section 1102 indicate a congressional preference toward a public bankruptcy process, at least as far as creditors' committees are concerned, much like the interpretation of Section 107 recently adopted by the First Circuit with respect to allegations of insider impropriety.

Section 107: Limitations on Openness

As with any legal balance, however, the trend toward transparency has a counterpoint, which is motivated by the potential misuse of information gained through the bankruptcy process. Take, for example, the recent decision of Judge Farnan in Delaware district court, in *In re Kaiser Aluminum Corp., 327 B.R. 554 (D. Del. 2005)*. In that case, the court considered an appeal of an order of the bankruptcy court that restricted public access to information in Federal Rule of Bankruptcy 2019 filings. These filings contained information regarding the representation by certain lawyers of a number of individuals engaged in mass tort litigation against Kaiser Aluminum. Although the court stated that "Section 107 evidences a strong desire by Congress to preserve the public's right to access judicial records," the court found that the bankruptcy court had properly protected the mass tort litigants' privacy rights. Information regarding the specifics of the mass tort plaintiffs' lawyers' retention arrangements, how the lawyers came to represent the plaintiffs, and the identity of the individual plaintiffs was not required to be publicly disclosed, and would be made available only following a request filed with and approved by the court. Entered around the same time as one another, the *Gitto Global* and *Kaiser Aluminum* opinions reach different results when faced by similar arguments for and against publication and privacy.

Section 1102: Information Shielding by Creditors' Committees

Courts have already recognized important exceptions to the new rule requiring more openness with

respect to creditors' committees. In the pending airline bankruptcies, there has been significant cross-membership by creditors on multiple creditors' committees. This circumstance has raised the possibility that a creditor of one airline might use the information it learns as a member of that airline's creditors' committee in its dealings with a competitor airline of which it is also a creditor and for which it also serves as a creditors' committee member. The United States Trustee recognized the potential for misuse of non-public information regarding debtors (specifically in the United, Delta and Northwest cases), and requested that committee members who sit on more than one airline creditors' committee agree to "information blocking procedures." These procedures, in essence, require "ethical walls" within the committee members' organizations to prevent the disclosure of information regarding one airline to someone involved on the committee of a competitor airline. The bankruptcy courts in the airline cases approved the requests of the United States Trustee, and the affected debtors and creditors consented to the information blocking procedures. Consensual and necessary as they may be, these procedures run contrary to the spirit of the Section 1102 amendments regarding information sharing. The procedures react to the problem of too much public information, where the Section 1102 amendments react to the problem of too little. Similarly, bankruptcy courts have been willing to enforce confidentiality agreements between creditors' committees and debtors including in cases where the debtor is being investigated for pre-bankruptcy wrongdoing in the interests of keeping sensitive information from reaching competitors, potential litigants and others who might misuse it.

In reaction to the broad language of 1102 requiring information sharing ("a committee...shall provide access to information for creditors...and solicit and receive comments from creditors...."), creditors' committees have obtained court orders restricting their rights and obligations under the new rules. The court in *In re Refco*, 336 B.R. 187 (Bankr. S.D.N.Y. 2006), recently published its opinion and "comfort order" on these issues. Acknowledging that section 1102 represented a new statutory mandate requiring committees to share information with their constituents, the court nevertheless endorsed confidentiality measures, placing important limitations on the creditors' committee's ability to disseminate the debtor's confidential and proprietary information. For support, the court drew on past precedent for restricting information flow and cited federal regulations against the "selective" sharing of non-public information and the danger of allowing competitors, litigants and claims traders to access such information for selfish purposes as well as the risk that without these protections, the flow of sensitive information from debtor to committee would be hampered to the detriment of the bankruptcy estate. Regarding the committee's push for authority to keep confidential the committee members' discussions with committee counsel, the court acknowledged the existence of the privilege and the committee's right to protect it even from its creditor constituents in the interest of encouraging free discussion among committee members and counsel. As in the *Kaiser Aluminum* case, the *Refco* court placed considerable restrictions on the flow of sensitive information, even under a newly enacted statute that was designed to produce more openness.

Conclusion

There is no clear-cut answer to whether bankruptcy in the United States is, or should be, a completely public process. There certainly survives, from the history of bankruptcy, the concept that bankruptcy involves opening up the financial life of a company or individual to the world a sort of

public confession of financial "sins" that is to serve as an example and as an opportunity for inquiry (the modern Section 341 meeting can be a forum for this tradition). However, there also exists an awareness that not all information passing before the bankruptcy court or disclosed as a part of the bankruptcy process should be widely disseminated. After all, bankruptcy is not only its own legal and factual arena, but also captures within it many nonbankruptcy laws and facts. To make all bankruptcy matters public might, under an expansive definition of bankruptcy, cause a range of other matters to be public, and this extreme would ignore the complexities of publicity and privacy issues facing bankruptcy proceedings today and harm creditors and other parties in interest in bankruptcy cases. The pressure and balance between public and private bankruptcy promises to remain an issue in the courts.

For more information on this or other bankruptcy and commercial matters, please contact:

James A. Shepherd
+1 202 663 6314
james.shepherd@wilmerhale.com

George W. Shuster, Jr.
+1 617 562 6572
george.shuster@wilmerhale.com

Authors

George W. Shuster Jr.

PARTNER

george.shuster@wilmerhale.com

+1 212 937 7232