ENSURING PROPER BANKRUPTCY SOLICITATION: EVALUATING BANKRUPTCY LAW, THE FIRST AMENDMENT, THE CODE OF ETHICS, AND SECURITIES LAW IN BANKRUPTCY SOLICITATION CASES

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INTRODUCTION

> You are an attorney who represents ABC Bank. One of ABC's clients, Bad Debtor, has recently filed for bankruptcy. After three months in bankruptcy, Bad Debtor receives bankruptcy court approval for its disclosure statement. ABC Bank vehemently opposes its treatment under the plan and asks you to prepare for a fight. You draft a letter for ABC Bank to sign providing 100 reasons to vote against Bad Debtor's plan. It is mailed soon after the disclosure statement package is sent by Bad Debtor to each claimant in the case. You then have a conference call with your client and are asked what else can be done. You suggest that ABC Bank call each claimant to personally request that they vote against the plan. ABC Bank, of course, promptly does so. Not long after, Bad Debtor files a motion: (a) to hold ABC Bank in contempt of court for violating the bankruptcy solicitation rules; (b) to disqualify any rejections obtained from creditors who received a letter or phone call from ABC Bank; (c) to sanction you for violating ethics rules on contact with a represented party; and (d) to request that the attorney fees Bad Debtor incurred prosecuting this motion be paid by ABC Bank.

This parade of horribles is hardly an impossibility. The Bankruptcy Code[1] provides that a party cannot "solicit" votes from a creditor until an approved disclosure statement has been provided to that creditor.[2] It further requires that such solicitations must be made in "good faith."[3] But nowhere does the Code define

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[1] 11 U.S.C. §§ 101–1330 (2000).
[2] *See* 11 U.S.C. § 1125(b) (2000).
[3] *See id*. §§ 1125(e), 1126(e).

"good faith" or even "solicit." Without such guidance, it is unsurprising that it is difficult to determine where each court will draw the line between a prohibited "solicitation" and a permitted "negotiation." The prospect of free negotiation after disclosure approval, on the one hand, is weighed against a bankruptcy court's desire to protect the public from misinformation on the other.[4] In addition, courts often are asked a difficult question in solicitation cases: are you soliciting votes against the plan which has an approved disclosure statement or are you really soliciting votes for an alternative plan which has not yet garnered disclosure statement approval?[5]

Courts also have to determine what to do when a solicitation violation occurs. Under the Bankruptcy Code, a bad solicitor could lose "safe harbor" protections from securities law[6] and a bad solicitee could find votes solicited improperly will not be counted.[7] Yet, despite the fact that contempt requires a clear violation of a court order,[8] ethic rules violations seem to require some sort of intent,[9] and a shift in attorneys fees is in derogation of the American rule on attorneys fees,[10] courts are more likely to take one of these routes than one of the two specific remedies provided by the Code.[11]

Ill-defined solicitation rules and poorly defined penalties for violating such rules make the determination of proper vote solicitation in bankruptcy cases very difficult. But one sure rule can be garnered from current case law: application of the appropriate rule or penalty is as likely to be right as it is wrong. This Article attempts to make travels through the bankruptcy solicitation maze less hazardous by, in Part I, defining which bankruptcy and non-bankruptcy considerations must be reviewed in each solicitation situation, by critically reviewing the penalties that have been imposed for solicitation violations in Part II, and, by applying the rules and considerations to real world bankruptcy situations in Part III.

Specifically, Part I.A of this Article begins by tracing the history of bankruptcy solicitation provisions from the Bankruptcy Act to the enactment of the Bankruptcy Code, noting where Congress intentionally adopted prior law and where Congress made changes. The Part concludes that the specific changes and the legislative history help demonstrate that solicitation must be narrowly defined, that misinformation provided in a solicitation can only be penalized if the solicitee acted in bad faith, and that the widespread mailing of an unapproved disclosure statement should always be prohibited. Part I.B then examines a frequently raised concept in solicitation cases: First Amendment protections. It finds that restrictions on speech in the solicitation arena are limited in nature and are designed to protect the public. As such, these restrictions are always valid. Part I.C then examines ethical

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[4] *See infra* Parts I.A.4.a–b.
[5] *See infra* Part I.A.4.c.
[6] *See* 11 U.S.C. § 1125(e).
[7] *See id*.
[8] *See infra* Part II.C.
[9] *See infra* Part I.C.
[10] *See infra* Part II.G.
[11] *See generally infra* Part II.

restrictions that have been raised as issues in several bankruptcy cases. It argues that such restrictions are not applicable to bankruptcy solicitations, as attorneys are required to provide clients with certain advice regardless of infringements on other ethical rules and because the Bankruptcy Code itself provides an exclusion from the applicable ethical rules. Finally, Part I.D turns to securities laws and summarily notes that failure to fall within the "safe harbor" of the Bankruptcy Code can lead to potentially devastating results for any vote solicitor.

Part II of this Article examines the various penalties that have been imposed when a court finds an improper solicitation has taken place. It concludes that courts frequently impose such penalties inappropriately. For instance, contempt may be found without a clear violation of a court order, or fee shifting may be imposed without recognizing that the American rule on fees prohibits such a shifting without an express statutory provision.

Finally, Part III provides a review of various solicitation devices used in cases and assesses the propriety of each. Taking the principals highlighted in Part I, it answers whether several common solicitation methods are legal and appropriate in light of bankruptcy law, First Amendment principals, ethical restrictions, and applicable securities regulations.

I. BANKRUPTCY SOLICITATION LIMITATIONS

A. Bankruptcy Code Solicitation Restrictions

This Part begins by reviewing the legislative history of bankruptcy solicitation restrictions to determine what purposes such restrictions were intended to serve.[12] It then examines the leading bankruptcy case on bankruptcy solicitation[13] before examining the goals of the solicitation provisions as stated by courts and commentators.

1. Bankruptcy Solicitation Under the Bankruptcy Act

Under the predecessor to the Bankruptcy Code, the Bankruptcy Act,[14] two corporate reorganization chapters were created: chapter X and chapter XI.[15] Chapter X was labeled the "Corporate Reorganization" chapter and was designed largely for publicly traded companies.[16] Chapter XI was labeled the "Arrangement" chapter and was intended to serve the nonpublic, small businesses.[17]

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[12] *See infra* Part I.A.1.
[13] *See infra* Part I.A.2.
[14] Bankruptcy Act §§ 1–703, 11 U.S.C. §§ 1–1103 (1976) (repealed 1978).
[15] H.R. REP. NO. 95-595, at 221 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6181.
[16] *See id.*
[17] *See id.* at 6182.

Chapter X contemplated "very rigid and formalized procedures, and the imposition of strict financial rules governing a plan or reorganization."[18] In each chapter X case, the management of the company was ousted and replaced by an independent trustee, the court valued the business,[19] and the Securities and Exchange Commission reviewed and issued an "advisory report" on the company to inform creditors and stockholders of the contents of the plan.[20] Importantly, the SEC report could take anywhere from one to sixth months to create.[21]

If a plan were approved by the court after the SEC review,[22] each creditor and shareholder was sent a court-approved summary of the plan, the court's opinion, the SEC's advisory report, notice of the confirmation hearing, and any other information as the court might direct before ballots could be solicited.[23] In theory then, creditors had access to sufficient information to make an intelligent assessment of how to vote on each plan.[24] Nevertheless, Congress was critical of chapter X:

> [N]egative results under chapter X have resulted from the stilted procedures, under which management is always ousted and replaced by an independent trustee, the court and the Securities and Exchange Commission examine the plan of reorganization in great detail, no matter how long that takes, and the court values the business, a time-consuming and inherently uncertain process.[25]

Congress further found that the problems with chapter X were amply demonstrated by statistics; less than ten percent of business reorganization cases used chapter X even though what could be accomplished under the chapter was much greater than under chapter XI.[26]

The second type of corporate reorganization under the Bankruptcy Act, an "Arrangement," can be found in chapter XI of the Act. In chapter XI cases, the

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[18] *Id.* at 6181.

[19] *Id.* at 6183.

[20] H.R. REP. NO. 95-595, at 225, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6185. The court was required to submit the plan to the SEC only if the indebtedness was more than $3 million or the court deemed it "worthy of consideration." Chapter X Rule 10-303(b).

[21] H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6185.

[22] While the creation of the SEC report was often required in a case, the SEC's report was only advisory, *see supra* note 22 and accompanying text. "The Commission, in a broad sense, acts as an *amicus curiae*. 'There is no division of jurisdiction. Ultimate approval or disapproval of plans is left solely with the judge.'" 6 COLLIER ON BANKRUPTCY ¶ 7.36, at 1305 (Lawrence King 14th ed. 1978) (internal citation omitted).

[23] Bankruptcy Act § 175, 11 U.S.C. § 575 (1976) (repealed 1978); Chapter X Rule 10–303(e); *see also* Paul R. Glassman, *Solicitation of Plan Rejections Under the Bankruptcy Code*, 62 AM. BANKR. L.J. 261, 263 (1988).

[24] *See* 6 COLLIER, *supra* note 23, ¶ 7.38, at 1319–20.

[25] H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6181.

[26] *Id.* at 6182.

debtor frequently retained control over its business by becoming debtor in possession[27] and by obtaining the exclusive right to file a plan of reorganization.[28]

Chapter XI contained a "quick procedure for an arrangement of a business' unsecured debts" but did not, Congress noted critically, "permit the adjustment of a secured debt or of equity."[29] To confirm a chapter XI case, a majority of affected creditors—measured both by number and value—had to accept the proposed arrangement in each class.[30]

Chapter XI did not require the elaborate disclosures required in chapter X simply because it was believed most creditors in such cases were trade creditors who could make informed decisions on a debtor's proposed plan based on their inherent knowledge of the debtor's business.[31] Thus, the court was not required to review either the terms of the debtor's proposed arrangement or the materials proposed to be used in connection with soliciting acceptances of the plan and the SEC did not actively participate in such cases.[32] Under chapter XI, the solicitation of votes was allowed both before and after a bankruptcy petition was filed.[33]

2. Enacting the Bankruptcy Code Solicitation Provisions

When Congress decided to rewrite the country's bankruptcy laws, they clearly recognized that de facto SEC and court approval, as required under chapter X, could not continue. In comments incorporated into the Bankruptcy Code's legislative history, the leading commentator, Homer Kripke, stated, "the SEC seems totally to have failed to realize the cost to all parties of the delay and disruption caused" by failing to timely submit reports.[34] He concluded that:

> [T]he constituency which trustees and the SEC serve are far more interested in a rapid conclusion of a plan, with as much fairness as the foregoing practical realities permit, than in a long destructive delay in a pursuit of an illusory standard of accuracy and perfection, which could be appealed by individual securityholders at the cost of still further delay.[35]

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[27] Bankruptcy Act § 342, 11 U.S.C. § 742 (1976) (repealed 1978).

[28] *Id*. § 323, 11 U.S.C. § 723 (1976) (repealed 1978).

[29] *See, e.g.*, Bankruptcy Act §§ 306, 307, 356, 357, 11 U.S.C. §§ 706, 707, 756 & 757 (1976) (repealed 1978) (limiting applicability of chapter XI to unsecured debts); *see also* H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6182 (same).

[30] Bankruptcy Act §§ 361, 362, 11 U.S.C. §§ 761, 762 (1976) (repealed 1978).

[31] H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6185.

[32] Glassman, *supra* note 24, at 265.

[33] Bankruptcy Act § 336(4), 11 U.S.C. § 736(4) (1976) (repealed 1978).

[34] H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6218 (comments of Homer Kripke on "Summary of Staff Comments," dated March 30, 1977, by the SEC Staff on H.R. 6, Draft of March 21, 1977).

[35] *Id.* at 6219.

Chapter XI, in turn, was found by Congress to be too limiting. The chapter could not generally affect secured parties or equity holders and disclosure frequently was minimal.[36]

The new chapter 11 was intended to consolidate the important features of both chapters X and XI into one chapter by adopting the flexibility of chapter XI of the Act and "incorporate[ing] the essence of the public protection features of . . . chapter X."[37] In effect, Congress wanted the process to be speedy, as consensual as possible, and, largely via full disclosure, to provide creditor protections. This meant that the Code should not generally "impose a rigid financial rule for the plan"[38] but should instead leave parties "to their own to negotiate a fair settlement."[39]

Congress believed that the premise of the financial standards for confirmation in bankruptcy should not be based on SEC review and approval but on the same premises recognized in securities law:

> If adequate disclosure is provided to all creditors and stockholders whose rights are to be affected, then they should be able to make an informed judgment of their own, rather than having the court or the Securities and Exchange Commission inform them in advance of whether the proposed plan is a good plan.[40]

Section 1125(b) was the result. Section 1125(b) provides the key requirements regarding disclosure and solicitation under the Bankruptcy Code. It provides:

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[36] *Id*. 6182–83.

[37] *Id.* at 6183.

[38] The rigidity rules established in chapter X make sense in light of the period. Chapter X was enacted soon after The Depression, as part of the Chandler Act of 1938. As noted in a letter to Congress from Professor Kripke, included in Bankruptcy Reform Act of 1978 as an appendix, a lot changed since the 1930's.

> Even before the Chandler Act was passed, there were the beginnings of restrictions on the evils of the 1920's in form of the securities legislation generally, the Glass-Steagall Act, the requirements of audited financial statements, and the generally changed public atmosphere with the SEC as watchdog. After the Chandler Act, there was enacted the Trust Indenture Act of 1939 which puts the indenture trustee in the forefront as protecting the holders of public debt securities. There has also been enacted the Investment Company Act of 1940, which precludes the likelihood of extensive bankruptcies in the investment company field by imposing rigorous capital structure requirements. This has also been accomplished in the public utility field by the Public Utility Holding Company Act of 1935, but that Act had been too recent in 1938 to permit a realization of the extent to which it had precluded repetition of the evils of the 1920's for a substantial segment of the corporate world in which the abuses had been most extensive.

Id. at 6217 (comments of Homer Kripke on "Summary of Staff Comments," dated March 30, 1977, by the SEC Staff on H.R. 6, Draft of March 21, 1977). The professor concluded that "much has changed and that to some extent the protections of 1938 proved to be a case of overkill." *Id.*

[39] H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6183.

[40] *Id.* at 6185.

> An acceptance or rejection of a plan may not be *solicited after the commencement of the case under this title* from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing *adequate information*.[41]

Three important restrictions are thereby created by the section: (1) adequate information, as defined in section 1125(a),[42] must (2) *first* be provided, thus setting forth a temporal restriction, before (3) a party can *solicit* (not defined) acceptances or rejections of a proposed plan or reorganization.

Congress did provide a definition for adequate information in the Code. It is "information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor . . . to make an informed judgment about the plan . . . ."[43] It is clear from this provision, and from congressional history, that the exact parameters of "adequate information" were to depend on the requirements of each case.[44] As the senate report stated, "[b]oth the kind and form of information are left essentially to the judicial discretion of the court, guided by the specification in subparagraph (a)(1) that it be of a kind and in sufficient detail that a reasonable and typical investor can make an informed judgment about the plan."[45] Section 1125(d) provides that a determination of adequate information is "not governed by any otherwise applicable non-bankruptcy law, rule or regulation."[46]

While determining where the exact parameters of adequate information lie are not the subject of this Article,[47] it is important to note what adequate information is

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[41] 11 U.S.C. § 1125(b) (2000) (emphasis added).

[42] *Id*. § 1125(a).

[43] *Id*. § 1125(a)(1).

[44] H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6356 (explaining court should "take a practical approach as to what is necessary under the circumstances of each case, such as the cost of preparation of the statements, the need for relative speed in solicitation and confirmation, and, of course, the need for investor protection.").

[45] S. REP. NO. 95-989 (1978), *reprinted in* U.S.C.C.A.N. 5787, 5907. By providing a standard based on the "history of the debtor" and the "condition of the debtor's books and records" and by allowing the information provided to be tailored to the "holders of claims or interests of the relevant class," Congress allowed great flexibility to courts to determine what "adequate protection" was. This was not unintentional. Tying the amount of information to the needs of the creditors and the ability of the debtor to provide the information ensured that the incredible costs that could be incurred with fixed standards—for example, if an audited financial statement was required in each case, small cases and cases where the books are in shambles (not an uncommon occurrence for a company going into bankruptcy) would be doomed to failure as the cost to obtain the statement would exceed the value of the company—would only be incurred when necessary. *See generally* H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6186.

[46] 11 U.S.C. § 1125(d).

[47] In any event, adequate disclosure has been written extensively about. *See, e.g.*, Glenn W. Merrick, *The Chapter 11 Disclosure Statement in a Strategic Environment*, 44 BUS. LAW. 103 (1988); Nicholas S. Gatto,

not; it is not a requirement relating to the veracity of statements provided in the disclosure statement. Providing adequate information, as section 1125(a)(1) states, only ensures that a minimal amount of information is provided to each creditor so that an informed decision can be made by that creditor.[48] For this Article, it is assumed that adequate information relates to the amount of information required for a disclosure statement, and that such information will be provided. That leaves two issues: (1) what is a solicitation; and (2) when does the solicitation occur.

Congress did not define what constitutes a "solicitation" under section 1125(b). The senate report, however, stated that "solicitations with respect to a plan do not involve just mere requests for opinions."[49] As noted, section 1125(b) provides that "[a]n acceptance or rejection of a plan may not be solicited" if adequate information (a disclosure statement) is not first provided to the creditor.[50] Thus, by it terms, something less than the entire possible universe of solicitation related activities[51] is included in 1125(b). Only the solicitation of an "acceptance or rejection of a plan" is expressly prohibited.[52]

Section 1125(b) further provides that restrictions on solicitation, as defined above, are temporally limited. Acceptances and rejections may not be solicited "*after* the commencement of the case . . . *unless, at the time of or before such solicitation*, there is transmitted to" the party who holds the claim sought to be solicited an approved disclosure statement.[53] Thus, on its face, 1125(b) allows solicitation without restriction after the disclosure statement has been distributed.

Section 1125(b) was intended to work in concert with two other Bankruptcy Code provisions. The first, section 1126(e), allows a court to designate any vote that was solicited in "good faith or in accordance with the provisions of this title."[54] The second, section 1125(e), is a "safe harbor" provision. It provides that a party who solicits "in good faith and in compliance with the applicable provisions of this title" is not liable for such solicitation under any applicable law, rule or regulation governing solicitation.[55]

Without section 1125(e), a bankruptcy court would have no discretion to approve disclosure statements that would be sent to public classes, but would be

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Note, *Disclosure in Chapter 11 Reorganizations: The Pursuit of Consistency and Clarity*, 70 CORNELL L. REV. 733 (1985); Note, *Disclosure of Adequate Information in a Chapter 11 Reorganization*, 94 HARV. L. REV. 1808 (1981).

[48] Judges should recognize that any other interpretation may simply create a *de facto* evaluation of the whole disclosure statement by the court at a time the court was not intended to be involved; the court is not to simply replace the SEC as evaluator of a given plan.

[49] S. REP. NO. 95-989 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5907.

[50] 11 U.S.C. § 1125(b) (2000).

[51] *See infra* text Part I.A.4.a (discussing definition of solicitation). Of course then, one could solicit a creditor in bankruptcy with respect to some other matter—say to vote for the democratic candidate for senate—and obviously not be in violation of § 1125(b)'s restriction on soliciting acceptances or rejections of a plan.

[52] 11 U.S.C. § 1125(b).

[53] *Id.* (emphasis added).

[54] *Id.* § 1126(e).

[55] *Id.* § 1125(e).

required to ensure that a full proxy statement or prospectus was always provided in accordance with securities law.[56] Congress explained that a full prospectus or proxy statement for a large public company could cost over $1 million to develop and that such an expense "would be nearly prohibitive in a bankruptcy reorganization."[57]

Section 1125(e) was also intended to replace the more stringent fraud requirement found under securities law. Where under securities law fraud included "honest, open, good faith omission to state a materially [sic] fact" and thus made persons who did not know the existence of a material fact, and had no way of knowing of its existence, but who purchased or sold a security without stating that fact, potentially liable,[58] the Code took a different approach. If a person soliciting acceptances of a plan is told by a bankruptcy court that adequate information is provided, solicitations made in good faith and in compliance with the provisions of chapter 11 could not lead to potential claims of fraud.[59] As noted by Congress:

> In the final analysis the exoneration which subsection (e) grants must depend on the good faith of the plan proponents and of those who participate in the preparation of the disclosure statement and in the solicitation. Subsection (e) does not affect civil or criminal liability for defects and inadequacies that are beyond the limits of the exoneration that good faith provides.[60]

As will be addressed in this Article, *infra*, these seemingly simple Code provisions raise difficult issues in practice, most revolving around defining which "solicitations" are proper (the "content issue") and some issues revolving around whether a solicitation occurs after a disclosure statement is provided (the "temporal issue"). While the relevant legislative history suggests several considerations that should be addressed in any solicitation analysis—Congress intended that creditors make informed choices regarding a plan; the court should not usurp the creditor role by becoming the arbiter of the fairness of a plan; a speedy process is better than a

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[56] H.R. REP. NO. 95-595, at 228 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6187.

[57] *Id.* Congress further explained:

> If a creditor or creditors' committee relies on an order of a Federal bankruptcy court that the disclosure statement contains adequate information, that is, states all material facts that should be stated under the circumstance, and meets any other applicable requirements of chapter 11, then that creditor or committee should not be held liable for soliciting acceptances based on a securities law theory that he failed to disclose adequately. Such liability would gut the effectiveness of the disclosure section, and require compliance with all securities laws in spite of the pendency of the reorganization case.

Id. at 6189.

[58] *See* H.R. REP. NO. 95-595, at 230, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6190; *see also id.* at 6365–66 ("Without [subsection 1125(e)], a creditor that solicited an acceptance or rejection in reliance on the court's approval of a disclosure statement would be potentially liable under antifraud sections designed to enforce the very sections of the securities laws from which subsection (d) excuses compliance.").

[59] H.R. REP. NO. 95-595, at 230, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6190.

[60] S. REP. NO. 95-989 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5908.

cumbersome fail-safe process; and, negotiation between creditor and debtor are to be encouraged—the considerations are non-exclusive and thus often lead to additional questions. A review of the leading case on solicitation highlights some of the problem areas.

3. The Leading Case: *Century Glove*

The Third Circuit's *Century Glove, Inc. v. First American Bank*[61] opinion is the leading bankruptcy solicitation case. Because the reported lower court decisions help illustrate the competing issues at stake, this Article first reviews the bankruptcy court decision[62] and the district court decision[63] before turning to the Third Circuit opinion.

The facts of *Century Glove* are rather straightforward. Century Glove was a debtor in bankruptcy.[64] During the exclusivity period, Century Glove filed a disclosure statement which was approved by the court.[65] At the disclosure statement hearing, a creditor of Century Glove, First American Bank ("FAB") advised the Court and all parties that it had drafted an alternative plan of reorganization which would be filed at the end of Century Glove's exclusivity period.[66]

Following Century Glove's disclosure approval, an attorney for FAB contacted attorneys for other creditors to try and convince them to vote against Century Glove's plan.[67] During those conversations, the attorney noted that while no other plan was approved, FAB had drafted a plan which was not formally "on the table."[68] Nevertheless, when the creditors' attorneys asked for a copy of the "draft" plan, the FAB attorney honored their request, providing a copy of the plan marked "draft" and indicating in the cover letter that the plan was distributed to the creditors for their comments.[69] Additionally, the FAB attorney included a letter written to the unsecured creditors' committee by its counsel which questioned the committee's endorsement of the Century Glove plan.[70] Several creditors who received the informational package from FAB's counsel and FAB voted to reject the plan.[71] Century Glove sought to designate these votes as invalid because they were allegedly procured in bad faith.[72]

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[61] 860 F.2d 94 (3d Cir. 1988).
[62] *In re* Century Glove, Inc., 74 B.R. 952 (Bankr. D. Del. 1987).
[63] First Am. Bank v. Century Glove, Inc., 81 B.R. 274 (D. Del. 1988).
[64] *Id.* at 275.
[65] *Id.*
[66] *Id.*
[67] Century Glove v. First Am. Bank, 860 F.2d 94, 95 (3d Cir. 1988).
[68] *Id.*
[69] *Id.* at 95–96.
[70] *Id*. at 96. There was also some debate in the case over whether this letter was protected by client-attorney privilege or not. *Id.*
[71] *Id.*
[72] *Century Glove*, 860 F.2d at 96.

At the bankruptcy court level, the court began its analysis by recognizing that the debtor was not the exclusive party who could solicit votes in a case.[73] If this were the case, explained the court, the provision in section 1125(b) providing requisite percentages for the solicitation of acceptances or *rejections* of a plan, would be unnecessary.[74] What debtor, the court rhetorically asked, solicits rejections of its own plan?[75] Nevertheless, the court also found that the ability to solicit was not unrestricted. The court concluded that FAB violated section 1125(b) because, although a disclosure statement had been provided to the creditor, solicitations, "must be limited by the contents of the plan, the disclosure statement, and any other court-approved solicitation material. The solicitee may not be given information outside of these approved documents."[76]

Thus, the court found that the temporal requirement—that a disclosure statement be provided before solicitation began—was satisfied but that the content requirement—defining what a "solicitation" is—was not satisfied.

Although the statutory basis for all of Bankruptcy Judge Balick's conclusions are not perfectly clear, the court did explain that FAB not only solicited rejections, it provided copies of an unapproved alternative. By so providing, the court assumed that FAB "clearly violated the language of [section] 1125" because it provided information outside the approved documents.[77] The court also found that FAB violated "the spirit of" section 1121(b), providing the debtor a 120 day exclusive period after the filing of a bankruptcy petition to file a plan of reorganization, by "apparently seeking approval of a plan which was not yet filed and which it could not file . . . ."[78]

The bankruptcy court found that FAB's failure to comply with the provisions of the Code and "the spirit of the law" warranted sanctions.[79] Rather than turn solely to the specific Code approved penalties for "bad" solicitation—for example, loss of the section 1125(e) safe harbor protections—the court examined the apparent grant in Bankruptcy Rule 2019(b) to prohibit a party who is involved in solicitation improprieties from being heard further in a case.[80] Finding that this penalty was too harsh, and without reference to any other Code provision, the court imposed monetary sanctions (attorney's fees of the debtor) on FAB.[81] Votes that were found to be influenced by FAB's "improper" solicitation were also invalidated pursuant to section 1126(e).[82]

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[73] *In re* Century Glove, Inc., 74 B.R. 952, 955 (Bankr. D. Del. 1987).
[74] *Id*.
[75] *Id.*
[76] *Id.*
[77] *Id.* at 958.
[78] *In re Century Glove*, 74 B.R. at 958.
[79] *Id*.
[80] *Id.*
[81] *Id.*
[82] *Id.*

On appeal to the district court, the bankruptcy court's decision on invalidation of a vote and its decision on costs were reversed.[83] The court immediately turned to the content requirement and found that section 1125(b) did not on its face require approval of all solicitation materials.[84] The section mandates only that a solicitation cannot be made "unless, at the time of or before such solicitation there is transmitted to such holder, the plan or summary of the plan, and a written disclosure statement approved . . . by the court."[85] Thus, the content requirement seemed to be automatically satisfied, subject to certain limitations, if the temporal element of section 1125(b) was met.

The district court found that the Bankruptcy Code "should be interpreted to foster free negotiation among creditors who are considering the merits of a proposed plan."[86] As post-disclosure statement lobbying of voting parties is clearly allowed, subject only to the bad faith, and conformity with bankruptcy law requirements found in section 1126(e), the "lower court's finding that a solicitee may not be given information outside of court-approved materials contravenes the policy of free creditor negotiations."[87] Thus, the fact that FAB provided copies of its own plan did not suggest that improper acceptances were being sought. "Solicitation" and "solicit," concluded the court, "must be interpreted very narrowly to refer only to a specific request for an official vote either accepting or rejecting a plan of reorganization."[88]

The case was then appealed to the Third Circuit. The circuit court first focused on the temporal issue: whether FAB was required to get court approval before it could disclose additional materials to Century Glove's creditors which supported it requests to reject Century Glove's plan.[89] The court concluded that the Code did not so require. It was not true that:

> only approved statements may be communicated to creditors. The statute . . . never limits the facts which a creditor may receive, but only the [time] when a creditor may be solicited. Congress was concerned not that creditors' votes were based on misinformation, but that they were based on no information at all.[90]

As Congress intended to help encourage creditors to negotiate and section 1125(b) sets a floor rather than a ceiling, the Circuit concluded that section 1125 did not on its face empower the bankruptcy court to require that all communications

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[83] First Am. Bank v. Century Glove, Inc., 81 B.R. 274 (D. Del. 1988).
[84] *Id.* at 278.
[85] *Id.* (citing 11 U.S.C. § 1125(b) (2000)).
[86] *Id.* at 279.
[87] *Id*.
[88] *First Am. Bank*, 81 B.R. at 280.
[89] Century Glove, Inc. v. First Am. Bank, 860 F.2d 94, 100 (3d Cir. 1988).
[90] *Id.* at 100 (citing H.R. REP. NO. 95-595 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6185).

between creditors be approved by the court.[91] The court further found that even providing a plan with material misrepresentation (mostly in the form of omissions) and a privileged letter were not violative of section 1125 either: "Once adequate information has been provided a creditor, § 1125(b) does not limit communication between creditors. *It is not an antifraud device.*"[92]

The Third Circuit then focused on whether FAB had in fact solicited acceptances of its own (unapproved) plan in violation of section 1121. The court concluded that the answer was no. "Solicitation" must be read narrowly to ensure free creditor negotiation.[93]

> The purpose of negotiations between creditors is to reach a compromise over the terms of a tentative plan. The purpose of compromise is to win acceptance for the plan. We find no principled, predictable difference between negotiation and solicitation of future acceptances. We therefore reject any definition of solicitation which might cause creditors to limit their negotiations.[94]

Perhaps most importantly, the Circuit noted:

> The ability of a creditor to compare the debtor's proposals against other possibilities is a powerful tool by which to judge the reasonableness of the proposals. A broad exclusivity provision, holding that only the debtor's plan may be 'on the table,' takes this tool from creditors. Other creditors will not have comparisons with which to judge the proposals of the debtor's plan, to the benefit of the debtor proposing a reorganization plan. The history of § 1121 gives no indication that Congress intended to benefit the debtor in this way.[95]

The Circuit cautioned, however, that because the creditor's actions may not be solicitations, such pre-disclosure communications may then be subject to the stricter limitations of the securities laws.[96] In light of these determinations, the Circuit concluded that parties, like FAB, who present draft plans for consideration by another creditor, but are not requesting a creditor's vote, are not soliciting acceptances of a plan.[97]

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[91] *Id.*
[92] *Id.* at 101(emphasis added).
[93] *Id.*
[94] *Century Glove, Inc*., 860 F.2d at 101–02.
[95] *Id.* at 102.
[96] *Id.*
[97] *Id.* at 102–03.

Collectively, the *Century Glove* cases illustrate issues that arise in almost every bankruptcy solicitation case. The next section of this Article addresses these fundamental issues.

4. The Core Solicitation Issues

The *Century Glove* cases illustrate that decisions regarding solicitation matters are not easily resolved. Three intertwined issues are raised in the *Century Glove* opinions involving at least three Bankruptcy Code provisions that do not always work in harmony: (1) is a given act a solicitation or a negotiation; (2) can a court act to ensure that misinformation is not provided *via* a solicitation; and (3) when does the solicitation against a plan become a solicitation related to another plan which has no approved disclosure statement? These issues are addressed in turn.

a. Solicitation vs. Negotiation

Section 1125(b) provides that an "acceptance or rejection of a plan may not be *solicited*" unless a disclosure statement is first provided.[98] The terms "solicit" and "solicitation" are, however, not even defined in the Bankruptcy Code or its legislative history.[99] "Consequently, what constitutes a 'solicitation' under § 1125(b) is a matter left for determination by case law."[100] Several courts have logically turned to dictionaries to assist them interpreting the provision.[101]

Webster's defines solicit as, *inter alia*, "to approach with a request or plea" and "to urge (as one's cause) strongly."[102] Black's Law Dictionary defines "solicit" as:

> To appeal for something; to apply to for obtaining something; to ask earnestly; to ask for the purpose of receiving; to endeavor to obtain by asking or pleading; to entreat, implore, or importune; to make petition to; to plead for; to try to obtain; and though the word implies a serious request, it requires no particular degree of importunity, entreaty, imploration, or supplication.[103]

As section 1125(b) only outlaws the solicitation of an "acceptance or rejection of a plan," it would seem that a plain meaning approach would require that only explicit pleas for acceptances or rejections of a plan are prohibited. To the extent there is confusion, however, the legislative history appears to be consistent with

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[98] 11 U.S.C. § 1125(b) (2000) (emphasis added).

[99] *See In re* Clamp-All Corp., 233 B.R. 198 (Bankr. D. Mass. 1999) (explaining solicitation is not defined); *In re* Snyder, 51 B.R. 432, 436 (Bankr. D. Utah 1985) (stating same).

[100] *In re Clamp-All*, 233 B.R. at 204.

[101] *See, e.g., In re* Dow Corning Corp., 227 B.R. 111, 117–18 (Bankr. E.D. Mich. 1998) (discussing meaning of "solicit").

[102] MERRIAM WEBSTER'S COLLEGIATE DICTIONARY 1118 (10th ed. 1997).

[103] BLACK'S LAW DICTIONARY 1392 (6th ed. 1990).

such an interpretation. It states that the Code was designed to create a structure that will favor settlement.[104] Congress stated that the Bankruptcy Code was not designed to "impose a rigid financial rule for the plan"[105] but was instead intended to leave parties "to their own to negotiate a fair settlement."[106] Case law also seems to recognize this mandate.

In a leading case on pre-petition solicitation, *In re Snyder*,[107] the court took a narrow view of solicitation to ensure negotiation among the parties. In that opinion, the court addressed whether a letter sent directly to creditors by a debtor's representative was a solicitation when the letter proposed, and invited discussion on, one of five alternative resolutions of all matters in return for an out-of-bankruptcy restructuring.[108] The bankruptcy court found that the letter was not a solicitation. "Solicit" and "solicitation," concluded the court, must be read narrowly to ensure that the terms "do not encompass discussions, exchanges of information, negotiations, or tentative arrangements . . . . If these activities were prohibited by [s]ection 1125(b), meaningful creditor participation in chapter 11 cases would cease to exist."[109]

Snyder recognized, as other courts have more fully articulated, that settlement is good. As noted in *In re Kellogg Square Partnership*:[110]

> the law should favor settlements. This should be no less true in the context of a [C]hapter 11 case than in any other matter under the jurisdiction of a court. The Bankruptcy Courts should apply this maxim so as to encourage the formulation of reorganization plans that incorporate consensual arrangements between plan proponents and creditors and other parties in interest. A confirmed plan is, in essence, a new contract between the debtor and all of its creditors . . .[111]

The Third Circuit's *Century Glove*[112] opinion also recognized that Congress wanted creditors to be in active negotiation with debtors over plans of reorganization.[113] It concluded that closely regulating communications between the parties would obviate Congress' goal.[114]

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[104] H.R. REP. NO. 95-595, at 224 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6183.
[105] *Id.*
[106] *Id.*
[107] 51 B.R. 432 (Bankr. D. Utah 1985).
[108] *Id.* at 437.
[109] *Id*.; *see also In re* Gilbert, 104 B.R. 206 (Bankr. W.D. Mo. 1989) (stating same); First Am. Bank v. Century Glove, Inc., 81 B.R. 274, 280 (Bankr. D. Del. 1988) (stating same).
[110] 160 B.R. 336 (Bankr. D. Minn. 1993).
[111] *Id.* at 339 (citation omitted).
[112] 860 F.2d 94 (3d Cir. 1988).
[113] *Id.* at 100.
[114] *Id*. at 100–01; *see also In re* California Fidelity, Inc., 198 B.R. 567, 571–72 (B.A.P. 9th Cir. 1996) ("[A] broader construction of the term would curtail free and honest negotiations among creditors and, therefore, inhibit creditor participation in the debtor's reorganization."); *In re* Gulph Woods Corp., 83 B.R.

Recognizing the importance of negotiation bodes in favor of a narrow interpretation for solicitation, as Congress and the express limitations in section 1125(b) mandate. Broader interpretations of the provision are simply not supportable as they engraft conclusions regarding exclusivity under section 1121, *see* discussion *infra*, into the definition of the term "solicitation."[115] As section 1125(b) is narrowly tailored to prohibit pleas to votes for or against a plan, statutory construction principles mandate that courts should construe the statute as narrowly as it is written.[116] If a party violates another Code provision such as exclusivity, *see* discussion *infra*, that matter needs to be addressed separately.

b. Protecting the Public from Misinformation

Courts, such as the bankruptcy court in *Century Glove*,[117] often suggest that section 1125(b) can be used to curb misrepresentations.[118] This is simply not true. As the Third Circuit's *Century Glove* opinion noted, section 1125 is not an antifraud device.[119] In fact, there is no express restriction on misinformation applicable to bankruptcy solicitation cases. As noted above, Congress recognized that data of the debtor was not always accurate,[120] and therefore, that the stringent anti-fraud requirements found in securities laws should not be reproduced in the Bankruptcy Code.[121] Instead, bankruptcy courts were instructed in the Code to look at the intent of the actors rather than at the information (or misinformation, as the case may be) provided by such actors.

The Code specifically provided three penalties when solicitations were made in bad faith. Section 1125(e)[122] provided that the "safe harbor" protection from securities law and any other applicable law would only be provided to parties who solicited in good faith, section 1126(e)[123] allowed a court to designate votes that were not obtained in good faith, and section 1129(a)(3)[124] requires a plan to be proposed in good faith.

Recent cases have recognized that misinformation in solicitations is prohibited but few have cited appropriate Bankruptcy Code sections to support their decisions.

339, 342 (Bankr. E.D. Pa. 1988) ("Oral communications among and between creditors or other interested parties should not be prohibited, since 'free negotiation among parties regarding a proposed plan,' . . . is a desideratum.") (citation omitted).

[115] *See*, *e.g.*, *In re* Clamp-All Corp., 233 B.R. 198 (Bankr. D. Mass. 1999).

[116] *See* Pa. Dept. of Pub. Welfare v. Davenport, 495 U.S. 552, 557–58 (1990) (explaining statutes should be interpreted as plain meaning requires).

[117] 74 B.R. 952 (Bankr. D. Del. 1987).

[118] *See supra* Part I.A.3.

[119] 860 F.2d 94, 101 (3d Cir. 1988); *see also supra* Part I.A.3.

[120] *See* 11 U.S.C. § 1125(a)(1) (2000); H.R. REP. NO. 95-595, at 226–27 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6186; *see also supra* Part I.A.2.

[121] *See supra* Part I.A.2.

[122] 11 U.S.C. § 1125(e) (2000).

[123] *Id*. § 1126(e).

[124] *Id*. § 1129(a)(3).

For example, in *In re Apex Oil Co*.,[125] the court simply reviewed a compilation of solicitation rulings to date and stated that a soliciting party could solicit without court approval if "the information provided is truthful and absent of any false or misleading statements or legal or factual mischaracterizations."[126] Additionally, in *In re Gulph Woods Corp*.,[127] the court concluded that the dispatching of "what is unmistakably a solicitation to accept or reject a Plan . . . during the voting period which contained falsehoods or mischaracterizations . . . would violate § 1125(b), because it would tend to unfairly influence votes."[128]

These cases, like the *Century Glove* bankruptcy court decision,[129] recognize that misinformation may be improper, and the court may have the power to curb it but fail to recognize that the intent of the party rather than the existence of falsehoods is the standard. Such courts simply go too far when they assume more power than provided by the express "good faith" provisions of sections 1125(e), 1126(e), 1129(a)(3). Again, Congress intentionally did not use the standards adopted in securities law but restricted only solicitations not made in good faith and in compliance with the provisions of chapter 11.[130] Courts should not penalize well-intentioned parties who misinform.[131]

Additionally, courts should not affirmatively set out to restrict solicitations that occur after adequate information is provided. As already stated, the legislative history notes that neither the court nor the SEC was to determine whether a given plan was a good plan before solicitation; to ensure speed, the court was simply to determine whether adequate information was provided.[132]

In summary, while solicitations should contain accurate information, the standard for reviewing accuracy is not, as courts often suggest, found in section 1125(b). Instead, section 1125(b) stands for the proposition that ignorance is bliss.

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[125] 111 B.R. 245 (Bankr. E.D. Mo. 1990).

[126] *Id.* at 249; *see also In re* Snyder, 51 B.R. 432, 437 (Bankr. D. Utah 1985) (lacking citation to any specific provision, court found unauthorized solicitation includes that which is made after dissemination of disclosure statement and which contains misrepresentations of deliberate falsehoods and misleading statements calculated to deceive parties entitled to vote).

[127] 83 B.R 339 (Bankr. E.D. Pa. 1988).

[128] *Id.* at 342–43; *see also In re* Rook Broadcasting, Inc., 154 B.R. 970, 976 (Bankr. D. Idaho 1993):

> Creditors who are not knowledgeable or informed with regard to the debtors' affairs will not be presented with information regarding the debtors and the proposed plan until the court has determined the disclosure statement contains information adequate for the creditor to make an informed choice . . . Those creditors who are ignorant of the debtor and its affairs, the ones for whose protection section 1125 requires court approval of the disclosure statement, [could] instead be presented with numerous documents containing inconsistencies, omissions, and misleading or incorrect statements. The debtors and the Court would be forced to attempt to "chase down" these problems, with little real hope of undoing the damage.

Id.

[129] *See supra* Part I.A.3.

[130] H.R. REP. NO. 95-595, at 229–31 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6198–90; *see also supra* Part I.A.2.

[131] *See* H.R. REP. NO. 95-595, at 229–31, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6189–90.

[132] *Id.* at 226, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6185; *see also supra* Part I.A.2.

c. Protecting a Debtor's Right to Exclusivity

Perhaps the greatest fodder for confusion in bankruptcy solicitation cases is whether a given solicitation is related to an approved disclosure statement or whether the solicitation is instead really a solicitation of a second unapproved, other plan. That is, when a party slyly suggests that an unapproved alternative might be better or provides outright a "draft" of an alternative plan which treats creditors more favorably, is the creditor soliciting the "acceptance or rejection" of the unapproved alternative plan?[133]

Section 1121(b) of the Bankruptcy Code provides the debtor with a modifiable 120 day "exclusive" period in which it can file a plan of reorganization.[134] A period of exclusivity, concluded Congress, gives the debtor "adequate time to negotiate a settlement, without unduly delaying creditors."[135] Bankruptcy Rule 3017 further provides that the proposed plan and disclosure statement shall be mailed with the notice of the hearing "*only* to the debtor, any trustee or committee . . . , and any party in interest who requests in writing a copy of the statement or plan."[136]

It seems relatively easy to agree that a solicitation related to a second unapproved disclosure statement occurred when facts are present like those in *In re Media Central*.[137] In that case, the debtor sought and received approval for a disclosure statement.[138] It then mailed the disclosure statement with an additional insert which suggested that specific sections of the plan could be modified in two different ways if a majority of creditors voted for one of the plan modifications.[139] (In effect, three different plans were solicited.) The ballot enclosed with the materials included check-boxes for the approved plan and the two alternatives.[140] The bankruptcy court found that the mailing amounted to multiple plans requiring multiple disclosure statements.[141] Negotiation is good, said the court, but "cannot be accomplished through solicitation of votes on unfiled plans having no court approved disclosure statements."[142]

The *In re Aspen Limousine Services, Inc*.[143] court was faced with a similar problem. There, the debtor's plan had already been distributed to creditors when a competing party drafted its own disclosure statement and sought, but had yet to

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[133] *See, e.g., In re* Century Glove, 74 B.R. 952 (Bankr. D. Del. 1987); *see also supra* Part I.A.3 (discussing same).

[134] 11 U.S.C. § 1121(b) (2000).

[135] H.R. REP. NO. 95-595, at 232, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6191; *see also* Century Glove, Inc. v. First Am. Bank of N.Y., 860 F.2d 94, 102 (3d Cir. 1988) (citing same).

[136] FED. R. BANKR. P. 3017 (emphasis added).

[137] 89 B.R. 685 (Bankr. E.D. Tenn. 1988).

[138] *Id.* at 687–88.

[139] *Id.*

[140] *Id.* at 688.

[141] *Id.* at 689–90.

[142] *In re Media Central*, 89 B.R. at 690.

[143] 198 B.R. 334 (Bankr. D. Co. 1995).

receive, final court approval.[144] Several days before the final hearing on the competitor's disclosure statement, the competitor mailed out a "solicitation" to all creditors which compared its plan to the return on the debtor's plan, and *inter alia,* claimed that creditors had "another option that represents a superior alternative," that creditors should vote to reject the debtor's plan because "[t]he facts are overwhelmingly in favor of the" competitors plan, and that the competitors plan was "superior in all material respects."[145]

The court found that the competitor's actions clearly violated section 1125.[146] Recognizing the importance of comparisons,[147] the court nevertheless found that competitor went much too far here.[148] The competitor "went over the line and affirmatively, aggressively, and cavalierly solicited support for its own plan, not merely rejections of the Debtor's Plan."[149] Accordingly, despite the fact that the creditor's plan was approved, the competitor was held in contempt and sanctioned attorney's fees and $1,000.00.[150]

Collectively, these opinions seem to make one thing clear: do not, as section 1125(b) states, affirmatively request votes for a plan which is not approved. Providing unqualified options on a ballot, as occurred in *Media Central*, would appear to be the worst indication that such a vote is in fact being garnered. Other cases have been more difficult to decide.

The leading opinion on solicitation, *Century Glove*, encourages comparisons to other proposals.[151] The "ability of a creditor to compare the debtor's proposals against other possibilities is a powerful tool by which to judge the reasonableness of

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[144] *Id.* at 336–37.

[145] *Id.* at 337.

[146] *Id.* at 340.

[147] *Id.* (providing as example *Century Glove, Inc., v. First Am. Bank of N.Y.*, 860 F.2d 94, 102 (3d Cir. 1988)).

[148] *Id.*

[149] *In re* Aspen Limousine Serv., Inc., 198 B.R. 334 (Bankr. D. Co. 1995). *Collier* claims that the bankruptcy court in *Aspen Limousine Service* distinguishes *Century Glove* on the basis that the case did not involve a small business, that all creditors were sent the unapproved plan, and that the creditor was not seeking comments on an unapproved plan. 7 COLLIER ON BANKRUPTCY ¶ 1125.03[1][a][i], at 1125-18 n.15. With the exception of the last distinction, this analysis appears to be incorrect. While the *Aspen* case may have been a small business case, thus making the procedures slightly distinguishable from *Century Glove*, nothing suggests that the outcome would be different than in a non-small business chapter 11 case. Additionally, while the solicitations of all creditors in this case may have been more egregious than the solicitation of but the few creditors that took place in *Century Glove*, that did not seem to play into the court's decision. The outcome instead appears to have been based on the simple fact that the court saw the competitor's actions as affirmative vote solicitations for an unapproved plan. *See In re Aspen*, 198 B.R. at 340. Couching such solicitations in the language of negotiation, such as by asking for comments, probably would have helped as *Collier* suggests. But so too would have numerous other changes, such as less vehement requests to reject the existing plan.

[150] *In re Aspen Limousine Serv.*, Inc., 198 B.R. at 340. The name one attaches to a proposal should not change the requirement that a disclosure statement first be provided. For instance, a creditor that filed a "Commitment . . . to Pay Portion of Collateral Proceeds to Designated Creditors" which provided certain creditors payments in the event the stay was lifted or the case was converted to chapter 7, was effectively proposing an alternative liquidating plan which did not satisfy any of the requirements of chapter 11. *See In re* CGE Shattuck, LLC, 254 B.R. 5 (Bankr. D.N.H. 2000).

[151] 860 F.2d 94, 102 (3d Cir. 1988).

the proposals," concluded the Third Circuit.[152] But the court also acknowledged that section 1125 did prevent solicitations of a plan that was not on file[153] and that the debtor did have a limited exclusivity period.[154] The balance in that case weighed, as reviewed above, in favor of a narrow view of solicitation.

Other courts have reached different results. For example, in *In re Apex Oil Co.,*[155] the court simply reviewed relevant case law to date and stated, *inter alia*, that a party could not propose *or suggest* an alternative plan which has yet to gain court approval.[156] In the recent *Clamp-All Corp.* opinion,[157] the bankruptcy court reviewed the Congressional history of section 1121 and noted that the two goals the section was intended to serve were a reasonable time to obtain confirmation without the threat of a competing plan and a limit on the time a debtor could stay in chapter 11 without reorganizing.[158] The court stated: "It was intended that at the outset of a chapter 11 case a debtor should be given the unqualified opportunity to negotiate a settlement and propose a plan of reorganization without interference from creditors and other interests."[159]

The *Clamp-All Corp.* court went on to criticize the Third Circuit's *Century Glove* analysis because it failed to recognize Congress' intention to allow the debtor a period to propose a plan without threat.[160] It found that the distribution of an unapproved disclosure statement, even in draft form, clearly violated sections 1121(b) and 1125(b) of the Bankruptcy Code and Bankruptcy Rule 3017(a).[161]

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[152] *Id.*; *see also In re Aspen Limousine Serv., Inc.*, 198 B.R. at 340 (citing same).
[153] *Century Glove*, 860 F.2d at 101.
[154] *Id.* at 102.
[155] 111 B.R. 245, 249 (Bankr. E.D. Mo. 1990).
[156] *Id*. (emphasis added).
[157] 233 B.R. 198 (Bankr. D. Mass. 1999).
[158] *Id.* at 206.
[159] *In re Clamp-All Corp.*, 233 B.R. at 207 (citing *In re* Texaco, Inc., 81 B.R. 806, 809 (Bankr. S.D.N.Y. 1988) (citing H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 5787)).
[160] *Id*. at 207–08. An early pre-Third Circuit *Century Glove* opinion, *In re* Temple Retirement Community, Inc., 80 B.R. 367 (Bankr. W.D. Tex. 1987), is also frequently cited for the proposition that solicitation must be narrowly construed. A careful analysis of that case, however, suggests differently.

In *Temple*, a bankruptcy court was asked to decide whether an indentured trustee had to inform bondholders that a group (not the majority) of bondholders dissented with the proposed plan and that this group of "dissenting bondholders" believed a sale of the assets to another entity would provide a more advantageous result to the bondholders and others than the current plan. *Id.* at 368. The court stated its belief that while this sale to another was merely the suggestion of an alternative, the request for the imprimatur of the indentured trustee (a party who most bondholders would feel was fair and unbiased), was to suggest that another available plan was available if this one was voted down. *Id.* at 369. The court explained that the "dissenting bondholders are certainly not prohibited form arguing that the Debtor's plan does not exhaust the panoply of possibilities for reorganization, nor are they prohibited from pointing out failings which they perceive to be present in the Debtor's plan," but the "bald suggestion of an alternative plan developing in the wings" which was to effectively garner the endorsement of the indenture trustee was impermissible. *Id*.

The substance of *Temple* then stands for the more limited proposition regarding indentured trustee endorsement of an alternative rather then the more global pronouncement that all solicitations suggesting alternatives are bad.
[161] *In re Clamp-All Corp.*, 233 B.R. at 209.

Although well reasoned, the *Clamp-All Corp.* opinion may go too far. Congress wanted to provide the debtor with the exclusive ability to file a plan of reorganization for a limited time[162] but the exclusivity provision did not state that other parties could not suggest that a better alternative method existed. That would not make sense. For instance, after reviewing a draft debtor plan during "negotiation," a creditor could certainly suggest to the debtor that the funding levels or financing arrangement should be changed in the next draft. Such discussions seem not to effect the exclusive right of the debtor created by section 1121(b). Why then cannot the same creditor subsequently share its suggestions with other creditors in a communication which requests the rejection of this plan and hopes that a better or "richer" plan might be submitted by the debtor in the future? As the debtor might be able to propose the second plan within the exclusivity period, or obtain an extension of exclusivity, the suggestion that an alternative exists simply does not seem to effect exclusivity.

A proper analysis would seem to require that anytime a non-approved disclosure statement is provided to voters, a line has been crossed. The proponent of that disclosure statement is, in substance, trying to solicit votes for a plan which can not have, and does not have, a corresponding disclosure statement which is approved.[163] Any actions short of such a distribution, however, should be allowed.

B. First Amendment Considerations

Bankruptcy courts have turned to the First Amendment, usually as an alternative or supporting basis, to support their notion that solicitation is broadly defined. In their written opinions, such courts even include statements that suggest restrictions on solicitation are almost un-American.[164] While such references may make hearts beat a little louder everywhere, other courts have taken a decidedly different tack. One early Act case provided that:

> The invocation of the fetish of free speech is of no avail here. In judicial proceedings there is no uncontrolled right of speech. The litigant can neither whisper to the judge nor wear placards

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[162] *See* 11 U.S.C. § 1121(b) (2000).

[163] Such a proponent also violates Bankruptcy Rule 3017 by mass distribution of such a disclosure statement.

[164] For example, recognizing that solicitation should be defined narrowly to ensure settlement, one court created its own dispute among the parties in order to invoke a reference to the First Amendment. *See In re* Gulph Woods, 83 B.R. 339, 342 (Bankr. E.D. Pa. 1988). If the parties are suggesting that no communication between creditors which is not court approved should occur, the court believes "[s]uch a rule would most probably clash with the first amendment to the Constitution . . . We do not think that it is consistent with fundamental principles of American democracy to clamp prior restraints upon communications regarding the voting process, here as in any other American election process." *Id.* at 342; *see also In re* Gilbert, 104 B.R. 206, 215 (Bankr. W.D. Mo. 1989) (citing *Gulph Woods*, 83 B.R. at 343) ("This determination is necessary fact-specific in view of the delicate balance this Court is charged with striking between first amendment principles and the purposes of Section 1125(b) and Section 1126(c).").

> proclaiming his unfairness. Even a defendant on trial for his life is permitted to speak only at appropriate times and places, under control of the presiding judge.[165]

It is far from clear that either position has correctly defined the right in the bankruptcy solicitation cases.

Modern case law often suggests that the distinction that must be made is whether the proposed speech is an expression of commercial or non-commercial speech. This Part questions whether this distinction is material. Whether certain actions are economically motivated or not, the better reasoned cases recognize that some limitations can be placed on communication in bankruptcy cases without violating the First Amendment. Simply, the nature of the speech does not always determine the outcome. As discussed below, several bankruptcy cases involving the automatic stay support this interpretation as does the leading Supreme Court case on speech related to commercial transactions.

1. Limits on the First Amendment

At the heart of the First Amendment bankruptcy solicitation issue is what restrictions can be placed on a party's right to solicit parties in a case. Where once the Supreme Court found that all speech related to commerce garnered no Constitutional protection,[166] more recent Supreme Court decisions have granted commercial speech some limited protection.[167] As stated in a leading constitutional treatise, "the fact that a [party] seeks a profit certainly cannot justify stripping the communication of all first amendment protection."[168] Society, after all, "has a strong interest in the free flow of commercial information."[169]

One of the few commentators to address whether bankruptcy solicitation is commercial speech argues that solicitation is, at least in part, a social, rather than a commercial, issue.[170] That piece argues that solicitation is "social speech" because the underlying reorganization addresses compromises on "retirees and employees, the role of management vis-a-vis ownership, the primacy of creditor repayment over corporate rehabilitation and the role of the reorganization process in resolving mass

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[165] *In re* Portland Electric Power Co., 97 F. Supp. 903, 909 (D. Ct. Or. 1947).

[166] *See* Vallentine v. Chrestensen, 316 U.S. 52, 54 (1942); *see also* CHESTER J. ANTIEAU, 1 MODERN CONSTITUTIONAL LAW ¶ 4.03, at 53 (1999).

[167] *See, e.g.*, Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc., 425 U.S. 748, 772 (1976); *see also* ANTIEAU, *supra* note 167, ¶ 4.03, at 53.

[168] LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 12-15, at 891 (2d ed. 1988); *see also* Ohralik v. Ohio State Bar Ass'n, 436 U.S. 458, 457 (1978) ("[W]e . . . have afforded commercial speech a limited measure of protection, commensurate with its subordinate position in the scale of First Amendment values, while allowing modes of regulation that might be impermissible in the realm of noncommercial expression.").

[169] Friedman v. Rogers, 440 U.S. 1, 8–9 (1979).

[170] Claude D. Montgomery et al, *Solicitation Under Section 1125 of the Bankruptcy Code: Century Glove and the First Amendment*, 23 SETON HALL L.REV. 1570, 1570 (1993).

tort problems."[171] While these secondary justifications could be criticized because of their seeming economic basis (rather than social basis), perhaps a more fundamental criticism is at issue. The authors ignore the fact that one of the most significant purposes of bankruptcy is to ensure the greatest economic benefit to society as a whole.[172] In addition, the authors never fully articulate how to apply their First Amendment principals to bankruptcy cases.[173] They are not alone. Courts have also failed to define exact parameters.

First Amendment issues are raised in two situations in bankruptcy law: solicitation disputes and stay violation cases.[174] Because the latter has provided a more detailed analysis of commercial speech versus "pure" speech and whether the distinctions matter, these cases are addressed first.

a. The Automatic Stay Cases

In *Turner Advertising Co. v. National Service Corp. (In re National Service Corp.)*,[175] the debtor was a Sears authorized plumber who used the Sears name in his business.[176] One of the debtor's pre-petition creditors was a billboard advertiser, Turner Advertising Company.[177] Soon after the bankruptcy filing, Turner apparently let it be known that it was going to superimpose a message over the debtor's ads which stated either "Beware, This Company Does Not Pay Its Bills" or "Beware, This Company is in Bankruptcy."[178] The debtor, accordingly, sought and was granted an injunction to stop Turner from posting the altered billboards.[179] After the district court affirmed the bankruptcy court's decision, the case was appealed to the Fifth Circuit.

The Fifth Circuit concluded that the issue was not whether the speech was in furtherance of protecting the public from false or misleading information or what degree of protection was afforded to commercial speech but was instead whether commercial speech was at issue at all. The court explained:

> While the term "commercial speech" has never been defined explicitly by the Supreme Court, the Court has described commercial speech as communication "related solely to the economic interest of the speaker and its audience" or that speech

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[171] *Id.*

[172] *See, e.g.*, *In re* Stonegate Sec. Serv., Ltd., 56 B.R. 1014, 1019 (Bankr. D. Ill. 1986) ("All bankruptcy statutes are designed to protect our economic system.").

[173] Montgomery et al, *supra* note 171, at 1597–99.

[174] *See* 11 U.S.C. § 362(a)(6) (2000) ("[A] petition filed . . . operates as a stay, applicable to all entities, of . . . (6) any act to collect, assess or recover a claim against the debtor that arose before the commencement of the case under this title.").

[175] 742 F.2d 859 (5th Cir. 1984).

[176] *Id.* at 860.

[177] *Id.*

[178] *Id.*

[179] *Id.*

> "which does no more than propose a commercial transaction." . . . . In the case at bar, we are convinced that TAC's [the advertiser's] message does not constitute mere commercial speech. TAC's message is not a solicitation for the sale or purchase of a product or service. TAC's message is not mere advertisement since it is not being published by one whose profit interests are served by the view espoused. Finally, it is noted that TAC's message is not in the form of a paid advertisement. Rather, *the message more closely resembles a public service message*, and one for which TAC is not being remunerated. TAC's message simply states two unassailable facts, that NSC is in bankruptcy and that NSC cannot pay its bill.[180]

It is important to note that this case involved a request for a prior restraint and that the court found the speech in question to constitute "pure speech."[181] As "pure speech," the court concluded that future restraints on distribution were required to satisfy a "heavy presumption" in order to be found constitutionally invalid.[182] The underlying claim that the speech was in fact "pure speech," however, appears to be subject to the most criticism. Was TAC's message really intended to provide a "public service message" or was it, as seems to be likely, designed to encourage some sort of settlement with TAC? Moreover, was the circuit court really the court to determine the intent of the parties and does a finding of "pure speech" mean, as the case implies, that no restrictions can be placed on communication?

A subsequent stay case, *In re Stonegate Security Services, Ltd.*,[183] appears to have largely adopted the reasoning of *In re National Service*. In *Stonegate*, a creditor parked a truck outside the debtor's place of business which was painted with a sign stating that the debtor did not pay its suppliers.[184] The debtor filed a motion to hold the creditor in contempt of court for a violation of section 362(a)(6).[185] On appeal, the district court noted that no evidence was taken on what purpose the creditor had in parking the truck[186] and that if the creditor was simply venting anger or frustration with the debtor without intending to frustrate the reorganization process, the First Amendment should, and would, protect the creditor's actions.[187] Thus, despite the fact that the creditor had removed the truck once before pre-petition, when a promise to pay had been forthcoming (indicating that the creditor's intentions were monetary recovery), the district court found that the creditor here was acting like a "solitary picket" and deserved the protections of

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[180] *Id.* at 861–62 (emphasis added).
[181] Turner Adver. Co. v. Nat'l Serv. Corp. (*In re* Nat'l Serv. Corp.) 742 F.2d 859, 861–62 (5th Cir. 1984).
[182] *Id.* at 862.
[183] 56 B.R. 1014 (N.D. Ill. 1986).
[184] *Id.* at 1016.
[185] *Id.*
[186] *Id.* at 1017.
[187] *Id.* at 1020.

the First Amendment.[188] Again, the finding of intent was not made by the trial court but by an appellate court and the court implied that pure speech was not subject to any restraint.

Three subsequent stay cases seem to have more accurately determined the intent of creditors harking the First Amendment call as well as the appropriate standard to review restrictions on communication. In the first case, *In re Sechuan City, Inc.*,[189] the creditor landlord posted signs outside the debtor's restaurant asking patrons not to visit the restaurant because the debtor did not pay its bills.[190] The court found, based on admissions, such signs were posted to embarrass the debtor into paying its bills.[191] The court recognized that while no clear definition of "commercial speech" has been articulated, it was not a matter that the First Amendment found of paramount importance as it was not political or otherwise of public concern.[192] Thus, the speech was subject to other governmental interests, including enforcing section 362(a)(6).[193]

In *In re Andrus*,[194] the court found that acts by a creditor post-discharge, which including threats regarding non-payment and the posting of signs, were not protected by the First Amendment. Even if "pure speech," concluded the district court, a content-neutral injunction would be enforced if the injunction burden was "no more than necessary to serve a significant government interest."[195] As two interests were served here the court did not believe that a contempt order issued against the offending creditor by the bankruptcy court ran afoul of the First Amendment.[196]

Similarly, the court in *In re Crudup*[197] was faced with a creditor who had sent letters to the debtor's wife and parents which traced the debtor's financing problems with the creditor and suggested that the debtor should "step up to the plate" and settle with the creditor or the creditor would "blanket" the town with information regarding the debtor's finances.[198] Although the creditor claimed the letters were not intended to collect a debt, the court found that creditor's claims unbelievable.[199]

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[188] *Id.*
[189] 96 B.R. 37 (Bankr. E.D. Pa. 1989).
[190] *Id.* at 39.
[191] *Id.*
[192] *Id.* at 42–43.
[193] *Id.* at 43.
[194] 189 B.R. 413 (E.D. Ill. 1995).
[195] *Id.* at 416–17.
[196] *Id*. at 417 (quoting United States v. O'Brien, 391 U.S. 367, 377 (1968)). The Court stated that the appropriate constitutional test is as follows:

> [A] government regulation is sufficiently justified if it is within the constitutional power of the Government; if it furthers an important or substantial governmental interest; if the governmental interest is unrelated to the suppression of free expression; and if the incidental restriction on alleged First Amendment freedoms is no greater than is essential to the furtherance of that interest.

Id.
[197] 287 B.R. 358 (Bankr. E.D.N.C. 2002).
[198] *Id.* at 359–60.
[199] *Id.* at 361.

Citing the *Andrus and Sechuan* cases, the court concluded the limited speech curtailed by the automatic stay was not protected by the First Amendment.[200]

In summary, if the party is acting to merely share its view, and not to enhance its recovery, then maybe "pure speech" is at issue. However, a close review of the cases seems to demonstrate that actions by these parties is more likely to be economically motivated. If the creditor would not be so "expressive" if they were paid, then such action is economically motivated and should not be protected as "pure speech." In any event, *Sechuan, Andrus,* and *Crudup* make clear that "pure speech" which does not regard matters of "public concern" is not fully protected by the First Amendment. If a competing important government interest is at stake, and the impediment on speech is narrowly drawn, the restriction on speech should be enforced. Under this test, bankruptcy solicitation limitations appear fully enforceable.

b. The Non-Stay First Amendment Cases

Sechuan, Andrus and *Crudup* suggest that the distinction that needs to be applied to First Amendment cases in bankruptcy is not whether a transaction is labeled "commercial" or not but what purpose is served by protecting the transaction. The leading case on what protections are afforded to commercially *related* speech (not "commercial speech"), *Central Hudson Gas & Electric Corp. v. New York*,[201] supports that interpretation.

In *Central Hudson*, the Supreme Court addressed whether New York State could completely ban utility advertising which promoted the use of electricity. In that case, the Court distinguished cases where the government was trying to protect the public from misleading communication and unlawful activity.[202] It found that "there can be no constitutional objection to the suppression of commercial messages that do not accurately inform the public about lawful activity. *The government may ban forms of communication more likely to deceive the public than to inform it*, . . . or commercial speech related to an illegal activity.[203]

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[200] *Id.* at 363–64.

[201] 447 U.S. 557 (1980).

[202] *Id*. at 564–65.

[203] *Id*. (emphasis added). In *Hudson Gas*, the Court went on to establish the standard for protecting commercial speech that was neither illegal nor designed to protect the public from misinformation. Finding that encouraging utility customers to buy more electricity was "related solely to the economic interests of the speaker and its audience" and therefore constituted the purest form of commercial speech, the Court formulated a four-part test to analyze what protections were to be provided to such speech. *Id.* at 561, 566. Commercial speech, the Court found:

> must concern lawful activity and not be misleading. Next we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest.

Id. at 566.

Banning solicitation until a disclosure statement is provided arguably falls into the former category. As stated by the Supreme Court in another opinion, if conduct is illegal, the fact that it is "in part initiated, evidenced, or carried out by means of language, either spoken, written, or printed" is not deemed an abridgment of the freedom of speech.[204] The government may ban forms of communication regulating communications such as the exchange of information about securities, corporate proxy statements, and the exchange of price and production information among competitors have all been found to be conduct that fall within this protection exception.[205] An early post-*Hudson*, pre-Code case, *In re W.T. Grant Co.*,[206] demonstrates the appropriate application to a bankruptcy solicitation case.[207]

In *W.T. Grant Co.*, a trustee sought to stop certain holders of convertible debentures from sending misleading communication to other debenture holders. Citing to *Central Hudson*, the court concluded that the First Amendment did not come into play. "The [Supreme] Court has defined Commercial speech as 'expression related solely to the economic interests of the speaker and its audience.'"[208] The Supreme Court has further drawn a "commonsense distinction between speech proposing a commercial transaction, which occurs in an area traditionally subject to government regulation, and other varieties of speech."[209]

Thus the court found that the solicitation was governed completely by the "bad" conduct test. Specifically, the solicitation at issue in this case falls within:

> two of the categories of commercial communications which are commonly regulated by means of prior restraint without encroaching on First Amendment freedoms: corporate proxy statements and exchange of information about securities. So to

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[204] Ohralik v. Ohio St. Bar Ass'n. 436 U.S. 447, 456 (1978) (citation omitted).

[205] *Id.* (citation omitted).

[206] 6 B.R. 762 (Bankr. S.D.N.Y. 1980).

[207] A more recent solicitation case, *In re* Dow Corning Corp., 227 B.R. 111 (Bankr. E.D. Mich. 1998), suggested a somewhat different route in *dicta*. In that case, the debtor told that court that it planned to issue a press release and that it would affirmatively seek favorable press when it released its disclosure statement. *Id.* at 113–14. Despite the debtor's claim that it would not seek votes, two of the committees in the case objected to their plan on that ground that Dow Corning was soliciting votes. *Id*. at 114. The committees requested that the debtor's actions either be subject to pre-action court review or be prohibited altogether. *Id.*

The court first concluded that if the media communications at issue were solicitations, they would be commercial speech subject to prior restraint. *Id*. at 116. However, the court disputed that the actions here constituted a solicitation and questioned whether restraints on the speech violated the First Amendment. Commercial speech, stated the court, is speech "which does 'no more than propose a commercial transaction.'" *Id.* (citation omitted). Recognizing that the Supreme Court has traditionally limited the scope of commercial speech to that which is "pure advertising – an offer to buy or sell goods and services or encouraging such buying and selling," *Id.* (citations omitted), the court concluded that under this definition, speech which was intended to make more generalized statements regarding commercial matters was not commercial speech at all. *Id*. The court, nevertheless, did not proceed on these grounds because the parties had assumed that the speech at issue was subject to commercial speech review. *Id*. Thus, the statements by the Dow Corning court are dicta.

[208] *In re W.T. Grant Co.,* 6 B.R. at 767 (citing *Hudson Gas*, 447 U.S. at 562.).

[209] *Id.* at 767–68 (citing *Hudson Gas*, 447 U.S. at 562).

> allow Objectants' claim that the type of expression in the solicitation is protected would "invite dilution [of the Constitutional protection], simply by a leveling process of the First Amendments' guarantee to the latter kind of speech."[210]

The court then went on, as did the later cases of *In re Sechuan City, Inc.*[211] and *In re Andrus*[212] (discussed above), to examine the nature of the speech. The commercial nature of the speech did not automatically remove it from the First Amendment penumbra, said the court.[213] Simply,

> the level of judicial scrutiny applied to preserve these protections is considerably lower than forms of expression involving political or associational purposes. Objectants are not "engaged in solicitation . . . as a means of effective political expression and association." Instead their only purpose is to advance their own commercial interests.[214]

2. Application to Bankruptcy Cases

It has been argued that the First Amendment protects certain actions that violate the automatic stay.[215] But even in such instances, cases often recognize that what these creditors are really attempting to perform is an end-run around the bankruptcy principal of equitable distribution. When applied to solicitation cases, First Amendment references appears to have even less merit. *Central Hudson Gas v. Public Service Commission*[216] makes clear that restrictions on speech can be placed to ensure potentially deceiving information is not distributed to the public and to protect the public from illegal activity. Where the restriction merely delays distribution until a disclosure statement can be provided or restricts the disclosure to that which is not false or misleading, the restriction should be valid. Questions arise only at the edges, where it is unclear what purpose the communication serves in the first instance. Some of these questionable instances are discussed in Part III *infra*.

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[210] *Id.* at 768 (footnotes omitted).
[211] 96 B.R. 37 (Bankr. E.D. Pa. 1989).
[212] 189 B.R. 413 (E.D. Ill. 1995).
[213] *In re W.T. Grant Co.*, 6 B.R. 762, 768 (Bankr. S.D.N.Y. 1980).
[214] *Id.* at 768 (footnotes omitted). Although the court recognized that the speech at issue here was subject to some minimal form of protection, it nevertheless concluded that it could restrain the debenture holders' solicitation in this case.
[215] *See supra* discussion in Part I.B.1.a.
[216] 447 U.S. 557 (1980); *see also supra* discussion Part I.B.1.b.

C. Ethical Restrictions

Rule 4.2 of the Model Rules of Professional Conduct of the American Bar Association (the "Rules of Professional Conduct") provides, "In representing a client, a lawyer shall not communicate about the subject of the representation with a party the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized by law to do so."

The purpose of Rule 4.2 is to prevent lawyers from taking advantage of uncounselled lay persons and, allegedly, to preserve the integrity of the lawyer-client relationship.[217] In essence, the rule treats the client as a ward of the all-knowing (and very paternal) attorney. Since the purpose of Rule 4.2 is "fundamentally concerned with the *duties* of the attorneys, not with the *rights* of parties," the Rule cannot be obviated by a client's consent.[218]

The exact application of the rule may seem hard to fathom in the bankruptcy solicitation arena. However, two bankruptcy decisions have made Rule 4.2 an issue mandating consideration. These opinions remind us that any contact with a represented opposing party, including contact in a solicitation, could violate Rule 4.2. The potential scope of the rule appears in fact to be enormous; can attorneys, for instance, even advise their clients regarding their ability to solicit? Before addressing the specific intricacies of the rule, this Article first examines the two bankruptcy decisions.

1. The Bankruptcy Opinions

Only two cases have suggested that certain solicitations could lead to attorney ethical violations. In the leading case, *In re Snyder*,[219] an involuntary petition was filed against the debtor, Philip G. Snyder.[220] Soon after, an order for relief was entered and a chapter 11 trustee was appointed.[221] Before any plan or disclosure

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[217] *See* MODEL RULES OF PROF'L CONDUCT R. 4.2 cmt. (2001); *see also* ABA Comm. On Prof'l Ethics and Responsibility, Formal Op. 396 (1995), *available at* Formal Op. 95-396 WL*11 ("There is nothing more central to what it means to be a client in the American system of justice than to know that, having hired a lawyer, the client need not worry about being taken advantage of by lawyers, with special skills and training, who represent others."); MODEL RULES OF PROF'L CONDUCT 4.2 cmt. (2001) (preventing lawyers from using superior skills and training to obtain "unwise statements" from opposing party, protects privileged information and facilitates settlements by allowing lawyers skilled in negotiation to conduct discussions (citing Polycast Tech. Corp. v. Uniroyal, Inc., 129 F.R.D. 621 (S.D.N.Y. 1990)); *see also* Frey v. Dep't of Health & Human Servs., 106 F.R.D. 32 (E.D.N.Y. 1985) (noting that court and commentators have stated provision meant to prevent situations in which adverse counsel would take advantage of represented party); United States v. Batchelor, 484 F.Supp. 812, 813 (E.D. Pa. 1980) (noting societal interest that laypersons not make decisions with major legal implications without advice of counsel); Wright v. Group Health Hosp., 691 P.2d 564, 567 (Wash. 1984) ("[P]resence of the party's attorney theoretically neutralizes the contact" by opposing party's lawyer); Carter v. Kamaras, 430 A.2d 1058 (R.I. 1981) (preserving proper functioning of judicial system).

[218] United States v. Lopez, 4 F.3d 1455, 1462 (9th Cir. 1993).

[219] 51 B.R. 432 (Bankr. Utah 1988).

[220] *Id.* at 433.

[221] *Id.*

statement was distributed by any party, Mr. Snyder and his attorney disseminated a communication to creditors proposing five alternative plans and invited creditors to attend a meeting to discuss the proposals.[222] The court addressed the matter as a potential solicitation violation under the Bankruptcy Code[223] and then questioned whether the contact was also an impermissible contact with an opposing party represented by counsel.[224]

Recognizing that the Code of Professional Conduct applies to bankruptcy cases and proceedings,[225] the court cited to the then appropriate Utah rule on attorney contact with clients.[226] It provided, in relevant part, that a lawyer is prohibited from negotiating a settlement directly with another party unless the lawyer has consent of the opposing lawyer or is authorized by law to do so.[227] Applying the rule to bankruptcy cases generally, the court stated that it believed communication with creditors regarding a proposed plan of reorganization was analogous to "communicating with an adverse party regarding settlement [as in] . . . each case, the ethical canons require the prior consent from the communicant's attorney."[228] The court noted that distribution of an *approved* disclosure statement, plan, or ballots were excepted from this limitation because they were "authorized by law."[229]

In the action before it, the court found that it was "clear that the debtor's attorney did make direct contact with one or more creditors whom the debtor's attorney knew or should have known were represented by counsel" and that no exception applied.[230] Accordingly, the court reprimanded the attorney for his actions.[231]

In the second case, *In re Media Central, Inc.*,[232] the debtor received disclosure statement approval but, in mailing the disclosure statement, also included an unapproved insert which provided two alternative plans which could be voted on in the enclosed ballot.[233] Like the *Snyder* court, the bankruptcy court in this case focused mainly on Bankruptcy Code solicitation issues.[234] In a long footnote, however, the court recognized that the distribution of unapproved solicitation

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[222] *Id.* at 434–35.
[223] *Id.*; *see also supra* Part I.A.4.a (reviewing *Snyder* case).
[224] *In re Snyder*, 51 B.R. at 436–37.
[225] *Id.* at 437–39.
[226] *Id.*at 437–38. Utah Disciplinary Rule 7-104 provided:

> During the course of his representation of a client a lawyer shall not: (1) Communicate or cause another to communicate on the subject of the representation with a party he knows to be represented by a lawyer in that matter unless he has the prior consent of the lawyer representing such other party or is authorized by law to do so.

[227] *In re Snyder*, 51 B.R. at 437–38.
[228] *Id.* at 438–39.
[229] *Id*. 439 n.11.
[230] *Id.* at 437.
[231] *Id.*
[232] 89 B.R. 685 (Bankr. E.D. Tenn. 1988).
[233] *Id.* at 687.
[234] *Id.* at 688–90.

materials could very well be a violation of the applicable ethical canon.[235] After noting the general rule prohibiting attorney contact with represented opposing parties, the court recognized that while the communication in this case "was intended to be a vote solicitation under the Code, the solicitation was not proper with respect to the unfiled plans and was more akin to pre-plan negotiation."[236] However, the court declined to rule on the issue of improper conduct because no evidence had been presented.[237]

Both *In re Snyder* and *In re Media Central* urge broad application of Rule 4.2 and do not seem to recognize any exception to the rule that might exist in the bankruptcy arena. These positions are tested below.

2. Contact by Agents

The bankruptcy cases cited above are worst case scenarios, with actual attorney involvement in the solicitation process. In a typical case, however, a bankruptcy attorney is likely to be the person who recognizes the benefit of solicitation and urges a client to take such action. It is undisputed that clients can directly contact a represented client.[238] However, is not circumvention of a rule by getting another to do the bidding of an attorney still a violation of the ethics rules?

The predecessor to Rule 4.2, DR 7-104, provided that a lawyer should not "[c]ommunicate or *cause another to communicate*" with a represented party regarding a matter the lawyer knows is the subject of representation.[239] Rule 4.2 does not directly address agent contact.[240] However, Rule 8.4 of the Model Rules of Professional Conduct provides that it is professional misconduct to "violate or attempt to violate the rules of professional conduct, knowingly assist or induce another to do so, or do so through the acts of another."[241] So the issue then is: when does a client become the instrumentality of his lawyer?

In *Miano v. AC&R Advertising, Inc.*,[242] the court found that a client could become an instrument of his attorney. According to the court, acting at the behest of an attorney includes:

> not just using the client as an agent or in the place of the lawyer for making the communication (i.e. where the lawyer directs, supervises or plans the substance of the communication) but also

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[235] *Id.* at 690 n.2.
[236] *Id.*
[237] *Id*. at 690.
[238] RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 99 (2000).
[239] MODEL CODE OF PROF'L RESPONSIBILITY DR 7-104(A)(1) (2001) (emphasis added).
[240] MODEL RULES OF PROF'L CONDUCT R. 4.2 (2001).
[241] MODEL RULES OF PROF'L CONDUCT R. 8.4; *see also* MODEL RULE OF PROF'L CONDUCT R. 5.3(c)(1) (prohibiting ordering or ratifying of conduct by non-lawyer assistant that would be violation if engaged in by lawyer); RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 99 (suggesting that no real distinction between DR 7-104 and ABA Model Rule 4.2 in light of other ABA Model Rules).
[242] 148 F.R.D. 68 (S.D.N.Y. 1993).

> the act of suggesting or recommending to the client that he or she engage in such communication, even though the lawyer has no further involvement in or knowledge of the substance of the communication that subsequently takes place, or the endorsement or encouragement of such a course of action, even when it is first raised or proposed by the client . . . . [T]he lawyer can still in fact "cause" the client to communicate by observing or advising that it might be desirable for the client to . . . speak to the adverse party, if the lawyer's action is a material factor in the client's final decision to engage in such a communication.[243]

The *Miano* court limited its broad statements somewhat by also stating that parties have the right to deal with each other without the consent of an attorney.[244]

In contrast to the *Miano* court, several authorities have convincingly found that the prohibition against encouraging a client to contact an opposing party is not all encompassing. For instance, a 1992 ABA Formal Ethics Opinion was required to determine whether a defendant's lawyer could encourage his client to contact the opposing plaintiff to determine whether a settlement offer made to plaintiff's counsel had been conveyed to plaintiff.[245] The Standing Committee on Ethics and Professional Responsibility found that while Rule 4.2 provides no exception:

> [the] lawyer for the offeror-party [should] advise that party with respect to the lawyer's belief as to whether the offers are in fact being communicated to the offeree-party. Likewise, the offeror-party's lawyer has a duty to that party to discuss not only limits on the lawyer's ability to communicate with the offeree-party, but also the freedom of the offeror-party to communicate with the opposing offeree-party.[246]

The Standing Committee found support in its position based on the fact that Rule 4.2 omits the phrase "or cause another to communicate," which appeared in its predecessor, DR 7-104(A)(1), and that the ABA House of Delegates rejected an amendment that would have restored that phrase in 1983.[247] While the Standing Committee also made certain to limit the applicability of its determination to cases

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[243] *Id*. at 82 (quoting N.Y.C. Bar Assoc. Comm. on Prof'l and Judicial Ethics, Formal Op. 2 (1991) at 7).

[244] *Id.*

[245] *See* ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 362 (1992) (allowing defendant's lawyer to encourage client to communicate with plaintiff to discover whether plaintiff knew of settlement offer); LAWYERS' MANUAL ON PROF'L CONDUCT (ABA/BNA) 243–44 (1992) (summarizing Formal Op. 362).

[246] LAWYERS' MANUAL ON PROF'L CONDUCT 244.

[247] *Id.*; *see also* RESTATEMENT OF THE LAW: THE LAW GOVERNING LAWYERS § 99 cmt. k (2000) (noting attempt to broaden anti-contact rule to prevent lawyer from advising client with respect to opponent contact was rejected during ABA Model Rule development process).

where the purpose of the communication is to ascertain whether a settlement offer has been shared with an opposing party, it rather broadly stated that Rule 8.4(a) "should not be read to prohibit a lawyer from fully and fairly advising a client of the lawyer's best professional judgment as to the exercise of the client's rights in furtherance of the representation."[248]

The Standing Committee appears to have simply recognized that an attorney cannot provide appropriate representation where the attorney cannot at least inform the client of his or her rights and cannot inform the client regarding restrictions that govern the attorney which the client may not be aware. Other authorities support this view. The recently published Restatement of the Law Governing Lawyers[249] provides that restrictions on non-client contact "[do] not prohibit the lawyer from assisting the client in otherwise proper communication by the lawyer's client with a represented nonclient."[250] And, according to the latest revision to the leading ethics treatise, Hazard & Hodes' *The Law of Lawyering*, "a lawyer should be able to advise a client to contact a third party—even a represented third party—directly, without running afoul of the prohibition in Rule 8.4(a) against violating a disciplinary rule through the acts of another."[251] Collectively, these authorities recognize that nothing restricts a client's right to have direct contact with an opposing party nor does anything require lawyers to prevent, attempt to discourage, or advise regarding such contact.[252] Additionally, a bankruptcy attorney may find additional support to assist in solicitations based on the "authorized by law" exception to Rule 4.2.

3. The "Authorized by Law" Exception

The bar against attorney contact with opposing parties who are represented applies to all communications relating to the subject matter of the representation except those that fall into the narrow category of being "authorized by law." The *Snyder*[253] and *In re Media*[254] courts assert, in *dicta*, that the mailing of the disclosure statement, plan, and ballot directly to a represented party is allowed because it is authorized by law. The "authorized by law" exception, however, is generally to be extended no further than reasonably necessary.[255]

As noted in the ABA Model Rules of Professional Conduct,[256] few non-criminal cases have had the occasion to address what "authorized by law" entails.[257] In a

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[248] LAWYERS' MANUAL ON PROF'L CONDUCT at 244.

[249] RESTATEMENT OF THE LAW: THE LAW GOVERNING LAWYERS (2000).

[250] *Id.* at § 99(2).

[251] GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, 2 THE LAW OF LAWYERING § 38.4 (3d ed. 2003).

[252] *See* MODEL RULES OF PROF'L CONDUCT, R. 4.2 cmt. 1 (1999) ("[P]arties to a matter may communicate directly with each other").

[253] *See In re* Snyder, 51 B.R. 432, 439 n.11 (Bankr. D. Utah 1985) (stating that dissemination of disclosure statement, plan of reorganization or ballots to represented party is authorized by law).

[254] *See In re* Media, 89 B.R. 685, 690 n.2 (Bankr. E.D. Tenn. 1988) (crediting reasoning of *Snyder*).

[255] RESTATEMENT OF THE LAW: THE LAW GOVERNING LAWYERS § 99, cmt. g.

[256] *See* MODEL RULES OF PROF'L CONDUCT, R. 4.2 ("[M]ost case law construing the exception for communications 'authorized by law' involves criminal prosecutions . . . .").

bankruptcy case that did not involve solicitation, *In re Grand Union Co.*,[258] the court was asked to decide whether a notice of a bar date sent directly to claimants was a communication from an attorney that was subject to Rule 4.2.[259] Although the court did not identify its analysis as such, it focused on whether any bankruptcy rule allowed the debtor to be "authorized by law" to perform such acts.[260] It found that the answer was no.[261] The bankruptcy rules, concluded the court, should be interpreted consistent with the "prevailing ethical standards that require dealings with counsel where an opposing party is known to be represented."[262] The court provided no further guidance.

Several cases involving the Federal Employers' Liability Act ("FELA") have also addressed the scope of the "authorized by law" exception. FELA was designed to ensure that railroad employees obtained necessary information from their employers when accidents occurred on the job.[263] In each of the FELA cases, an employee of the railroad was questioned by the injured worker's attorney.[264] The railroad claimed that such contact was prohibited by Rule 4.2.[265] The plaintiff's attorney claimed that it was "authorized by law" to contact the employee because section 60 of FELA so allowed.[266] Section 60 provides, in relevant part: "Any contract, rule, regulation, or device whatsoever, the purpose, intent, or effect of which shall be to prevent employees of any common carrier from furnishing voluntarily information to a person in interest as to the facts incident to the injury or death of any employee, shall be void . . . ."[267]

The courts addressing the issue split as to whether the FELA section authorized *ex parte* contact.[268] About half the cases recognized that while the text of FELA did not explicitly allow *ex parte* communication with represented clients, the statute's broad protection against any prohibition on the free flow of information authorized the communication.[269] The other half of cases found that the provision did not authorize *ex parte* contact.[270] These latter cases read the section narrowly, finding that the purpose of the FELA statute is to allow injured railroad workers to obtain needed information about accidents from their co-workers and to protect those co-

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[257] *Id.*
[258] 204 B.R. 864 (Bankr. D. Del. 1997).
[259] *Id.* at 875–76.
[260] *Id*.
[261] *Id.* at 877.
[262] *Id.* (quoting Graham v. United States, 96 F.3d 446, 449 (9th Cir.1996)).
[263] *See, e.g.*, Blasena v. Consol. Rail Corp., 898 F. Supp. 282, 284–85 (D.N.J. 1995) (reviewing intent of FELA).
[264] *See* MODEL RULES OF PROF'L CONDUCT R. 4.2 cmt. at 412–13 (1999) (reviewing line of FELA cases).
[265] *Id.*
[266] *Id.*
[267] 45 U.S.C. § 60 (1986).
[268] *See* Pratt v. Nat'l R.R. Passenger Corp., 54 F. Supp. 2d 78, 80–81 (D. Mass. 1999) (reviewing split in cases on whether FELA provision authorized *ex parte* contact); MODEL RULES OF PROF'L CONDUCT, R. 4.2 (same).
[269] *See Pratt*, 54 F. Supp. 2d at 81 (citing cases in support of broad view of FELA statute).
[270] *See id.* at 80–81 (citing cases in support of narrow view of FELA statute).

workers from retaliation. "The section is not meant to be an excuse for attorneys representing railroad workers to sidestep their ethical responsibilities . . . ."[271]

In bankruptcy cases, the relevant statute, section 1125(b) provides:

> An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement . . . .

As noted by the two relevant bankruptcy cases, the latter portion of section 1125(b) cited above appears to allow transmission of the plan and a written disclosure statement to a "holder of a claim or interest," therefore providing the necessary "authorized by law" exception to Rule 4.2. It simply authorizes the transmission of the plan and a written disclosure statement to claimants.

Section 1125(b) also authorizes the solicitation of acceptances or rejections "from a holder of a claim or interest" after a disclosure statement has been mailed. This part of the statute mirrors the language regarding transmissions of disclosure statements and yet was ignored by the *In re Snyder* and *In re Media Courts*. A correct interpretation of section 1125(b) requires that solicitation of acceptances or rejections from a "holder of a claim" be authorized by law just as the mailing of the plan and a disclosure statement to a "holder of a claim" is authorized by law. Cases holding differently have simply not examined the statute closely.

4. Application to Bankruptcy Cases

On its face, Rule 4.2 of the Mode Rules appears to restrict even recommending to a client that he or she contact an opposing party to solicit their vote. Two cases, in fact, have so suggested.[272] However, these cases seem to be incorrect. Recent authorities provide that Rule 4.2 and Rule 8.4 should not be construed by attorneys in a manner which restricts an attorney's ability to inform the client of his or her rights and inform the client regarding relevant restrictions that govern the attorney's direct contact with opposing parties.[273] Most importantly, a close reading of section 1125(b) suggests " authorized by law" provides protection not only to the mailing of disclosure statements and plans but also to any post-disclosure statement solicitation.[274]

In summary, while attorneys may want to pay careful attention to the Model Rules in pre-disclosure statements solicitation cases,[275] post-disclosure statement

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[271] *Id.* (citing White v. Illinois Cent. R.R. Co., 162 F.R.D. 118, 120 (S.D. Miss. 1995)).
[272] *See supra* discussion in Part I.C.1.
[273] *See supra* discussion in Part I.C.2.
[274] *See supra* discussion in Part I.C.3.
[275] In such instances, the "authorized by law" exception could apply. *See supra* discussion in Part I.C.3.

solicitations should be without ethical restriction. To the extent an attorney is particularly troubled by a particular solicitation contact, it may wish to garner court pre-approval as it is clear that a tribunal may authorize *ex parte* contact in particular instances.[276]

D. Securities Regulations

While securities laws may occasionally be cited for guidance, the Bankruptcy Code and legislative history makes clear that such laws are not normally binding in the bankruptcy process.[277] Section 1125(e) provides that a proper solicitation under the Bankruptcy Code will provide the solicitor with protection from any applicable law.[278] One exception to this rule is stated in Bankruptcy Code section 1125(b). It provides, in relevant part, that an acceptance or rejection may not be solicited "after the commencement of the case" without a disclosure statement.[279] Therefore, pre-packaged plan solicitation, plans solicited before the commencement of the case, must comport with applicable securities laws. Another exception to the non-applicability of securities laws is found in 1125(e). It provides that a plan that is not solicited "in good faith and in compliance with the applicable provisions of this title" is not protected from violations of securities law or any other law.[280]

Although this Article is not intended to be a primer on securities law, it is important to note that the loss of the 1125(e) safe harbor can have serious consequences. Failure to abide by section 5 of the Securities Act can lead to civil and criminal liability. Moreover, Rule 10b-5 may also provide creditors with a private remedy for fraud.

The only reported bankruptcy case that appears to have addressed the loss of the section 1125(e)'s safe harbor was *In re Tucker Freight Lines, Inc*.[281] Although not a securities case *per se*, its teachings are instructive.

In *Tucker*, the creditors' committee sent out a post-disclosure statement letter soliciting rejections of a proposed plan which, the debtor later claimed, the committee knew or should have known contained false and misleading statements.[282] Following the conversion of the case to chapter 7, a subsequent lawsuit was filed against the creditors' committee by the successor of the debtor.[283] The creditors' committee, citing to the section 1125(e) protections, moved for summary judgment.[284] The court denied the motion, finding that if the allegations

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[276] *See, e.g.*, RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 99 (2000).
[277] *See* 11 U.S.C. § 1125(d) (2000); *see also In re* Dow Corning, 227 B.R. 111, 120 (Bankr. E.D. Mich. 1998).
[278] 11 U.S.C. § 1126(b) (2000).
[279] *Id*.
[280] *Id*. § 1126(e).
[281] 62 B.R. 213 (Bankr. W.D. Mich. 1986).
[282] *Id.* at 215.
[283] *Id.* at 215–16.
[284] *Id.* at 216.

were correct, the creditors' committee was not acting in "good faith" and thus was not protected by section 1125(e).[285] The creditors' committee was thus potentially liable under securities law, RICO, and state law tort claims.[286]

This analysis appears correct. Failure to abide by title 11, and failure to act in "good faith," make one subject to all applicable non-bankruptcy law. While the SEC has apparently never brought such an action (and neither has a private cause of action been brought under Rule 10b-5), the potential is there.

II. PENALTIES FOR "BAD" SOLICITATION

There are two provisions in the Code that relate explicitly to the penalty for violating solicitation rules. One, found at section 1126(e), allows a court to "designate" a vote that is solicited in good faith or in accordance with the provisions of the Bankruptcy Code.[287] The other, found at section 1125(e), contains both a carrot and a stick.[288] It provides safe harbor protection from any other applicable law (including securities laws) when a party solicits a vote in good faith or in accordance with the provisions of the Bankruptcy Code.[289] On its face, failure to strictly comply with the latter "safe harbor" provision would seem to lead to potentially devastating results, including securities laws violations[290] and potential Racketeer Influence and Corrupt Organization Act ("RICO") violations.[291]

Interestingly, courts rarely seem to penalize parties under the two explicit provisions when solicitation violations arise.[292] Although several courts have even noted that these provisions are seemingly the exclusive provisions for solicitation violations,[293] courts appear to be even more likely to hold a party in contempt, shift attorneys' fees, or restrict future communications with creditors than to designate a vote or explicitly remove the protections of the "safe harbor" provision.[294] Perhaps the courts are recognizing that some of the remedies could be harsh[295] or perhaps judges simply have no desire to read unfamiliar bankruptcy provisions. Whatever the case, a review of the reported decisions suggests that the penalties can be placed

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[285] *Id*.
[286] *Id.*
[287] 11 U.S.C. § 1126(e) (2000).
[288] *Id*. § 1125(e).
[289] *Id.*
[290] *See supra* discussion in Part I.D.
[291] 18 U.S.C. §§ 1961–1968 (2000).
[292] *See infra* discussion Parts II.A and II.B.
[293] Two courts explicitly found that disregarding votes under § 1126(e) appears to be the sole remedy for solicitation violations. *See In re* Aspen Limousine Serv., Inc., 198 B.R. 334, 340 (Bankr. D. Co. 1995) ("Violation of the solicitation provisions of 11 U.S.C. § 1125 appear to have no specific enforcement or remedial provisions in the Code, except, perhaps, 11 U.S.C. § 1126(e)."); *In re* Texaco Inc., 81 B.R. 813, 816 (Bankr. S.D.N.Y. 1988) (finding "exclusive relief afforded under the Code is to have such improperly solicited acceptance or rejection disregarded for purposes of computing the vote on the plan").
[294] *See generally* Part II.
[295] *See, e.g.*, 11 U.S.C. § 1126(e) (2000) (noting loss of safe harbor).

into explicit provision remedies and more general remedies and that, no matter which is applied, the result rarely seems truly painful to the "bad" solicitee.

A. Loss of the Safe Harbor (11 U.S.C. § 1125(e))

So long as the proponent provides "adequate information" in "good faith," the Code provides the proponent a "safe harbor" from all relevant non-bankruptcy laws. Specifically, section 1125(e) provides:

> A person that solicits acceptance or rejection of a plan, in good faith and in compliance with the applicable provisions of this title, or that participates, in good faith and in compliance with the applicable provisions of this title, in the offer, issuance, sale, or purchase of a security, offered or sold under the plan, of the debtor, of an affiliate participating in a joint plan with the debtor, or of a newly organized successor to the debtor under the plan, is not liable, on account of such solicitation or participation, for violation of any applicable law, rule, or regulation governing solicitation of acceptance or rejection of a plan or the offer, issuance, sale, or purchase of securities.[296]

While seemingly a potent tool, few courts have addressed this provision in cases, perhaps because the penalty is not self-executing. That is, an offender is not penalized for solicitation violations under this provision unless the offender is later sued on a securities regulations violations, other law violations, or in tort, and a court determines that the safe harbor does not apply. A court, after all, should not tell parties that an offender has lost the safe harbor protections unless someone is actually suing the offender and the offender points to section 1125(e) as a defense. As explored above, this is exactly what happened in *In re Tucker Freight Lines, Inc*.[297]

It is easy to see that this provision could be applicable in almost all cases where solicitation problems arise. Even if the solicitor acted in good faith, the solicitor may not have acted in "compliance with the applicable provisions of this title." Thus, in each and every case where the court finds solicitation problems, a potential tort claim, securities claim, or RICO claim could follow.

B. Vote Designation (11 U.S.C. § 1126(e))

The only other explicit Code solicitation provision can be found in section 1126(e). It provides that on request of a party in interest, and after notice and

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[296] *Id*. § 1125(e).
[297] 62 B.R. 213 (Bankr. W.D. Mich. 1986); *see also supra* discussion in Part I.D.

hearing, the court may "designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title."[298] In a typical case, courts simply designate rejections or acceptances cast in bad faith and do not count them.[299] Several courts have suggested that this provision is the exclusive remedy for improper solicitations.[300]

Interestingly, even while a court might designate votes as being solicited in bad faith,[301] few courts or commentators say much about what constitutes such bad faith solicitation.[302] This apparently requires a case-by-case review. Use of this remedy is also apparently subject to certain temporal restrictions. For instance, one court noted that where no votes had yet been cast, designation was not the appropriate remedy because it is far from certain that the designation will ameliorate the harm caused by the bad solicitation.[303]

C. Denial of Confirmation (11 U.S.C. § 1129(a)(2))

The court cannot confirm a plan if, among others, a plan proponent does not comply with the applicable provisions of title 11.[304] A plan proponent must, therefore, comply with disclosure and solicitation requirements of sections 1125 and 1126 to confirm a plan.[305] In practice then, a plan proponent who solicits votes before providing a disclosure statement in violation of section 1125(b) could potentially be denied confirmation on that basis.[306]

While numerous courts have recognized their ability to deny a plan on this basis, no court appears to have actually done so. The closest a court has come is to suggest that the improper solicitation of an unapproved disclosure statement made it unlikely that a confirmable competing plan could ever be submitted by that

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[298] 11 U.S.C. § 1126(e) (2000).

[299] *See In re* Texas Extrusion Corp., 68 B.R. 712, 718–19 (N.D. Tex. 1986) (designating rejections sought with "hustle letter" in bad faith and thus ruled that rejections so solicited would not be counted); *see also* 11 U.S.C. § 1126(c) (providing court shall count all acceptances and rejections for confirmation purposes other than those designated under § 1126(e)).

[300] *See, e.g., In re* Texaco, 81 B.R. 813, 816 (Bankr. S.D.N.Y. 1988) ("[E]xclusive relief afforded under the Code is to have . . . improperly solicited acceptance or rejection disregarded for purposes of computing the vote on the plan."); *In re* Media Central, Inc., 89 B.R. 685, 690 (Bankr. E.D. Tenn. 1988) (suggesting remedy for bad solicitation is disallowance of votes under 1126(e), and because debtor's attorney is at issue here, maybe denial of fees and expenses under 11 U.S.C. § 330).

[301] *See In re* Century Glove, 74 B.R. 952, 958 (Bankr. D. Del. 1987).

[302] *See, e.g.*, 7 COLLIER ON BANKRUPTCY ¶ 1126.06, at 1126-16 to 1126-18 (2003) (focusing on bad faith in terms of voting, not in terms of vote solicitation).

[303] *See In re* Clamp-All Corp., 233 B.R. 198, 210 (Bankr. D. Mass. 1999).

[304] *See* 11 U.S.C. § 1129 (2000).

[305] *See In re* Johns-Manville Corp., 68 B.R. 618, 630 (Bankr. S.D.N.Y. 1986); 7 COLLIER ON BANKRUPTCY ¶ 1129.03[2], at 1129-26; *see also In re* Cajun Elec. Power Coop., Inc., 150 F.3d 503, 512 n.3 (5th Cir. 1998) (assuming district court's reliance on § 1125 to bar confirmation implicated § 1129(a)(2)'s requirement that proponent complies with applicable provisions of title 11).

[306] *See In re* Aspen Limousine Serv., Inc. 193 B.R. 325, 341 (Bankr. D. Colo. 1996) (finding claim of § 1125(b) solicitation violation was not well grounded and therefore confirmation would not be denied).

proponent.[307] Other courts have not offered this penalty as an option perhaps because the punishment is so severe[308] and may effectively punish other creditors in the case. Alternatively, perhaps the penalty is not considered because it is unclear what to do when another provision (1126(e)) already provides an alternative sanction in the form of vote designation. Whatever the case, the tool is available but rarely applied by judges.

D. Refusal to Allow Further Participation (B.R. 2019(b))

Bankruptcy Rule 2019(b) provides that failure to comply with Bankruptcy Rule 2019(a) of "with any other applicable law regulating the activities and personnel of any entity, committee, or indenture trustee or *any other impropriety in connection with a solicitation* and, if it so determines, the court may refuse to permit that entity, committee, or indenture trustee to be heard further or to intervene in the case . . . ."[309] On its face then, Bankruptcy Rule 2019(b) seems to allow a court to curb a solicitation impropriety by denying the offending party the right to participate further in the case. The *Century Glove* bankruptcy court decision interpreted the provision in exactly that manner.[310]

Finding that creditor First American Bank's solicitation had violated sections 1125(b) and 1121(b), the *Century Glove* court recognized that it could prohibit First American from participating further in the case pursuant to Bankruptcy Rule 2019(b). It found that such a remedy, however, was "too harsh even though BR 2019(b)(1) so permits," and imposed monetary sanctions instead.[311] Although cited by *Collier*,[312] seemingly with approval, it is not clear that the *Century Glove* application of the rule is correct.

Bankruptcy Rule 2019 is titled "Representation of Creditors and Equity Security Holders in Chapter 9 Municipality and Chapter 11 Reorganization Cases." As the title suggests, rule 2019 provides, in section (a), that certain data must be supplied by representatives of more than one creditor or equity holder in a case and, in section (b), penalties for failure to comply with the section (a) requirements. At its heart then, the rule appears to require disclosure to ensure that the court (and everyone else for that matter) is not confused as to on whose behalf an attorney or other representative is acting. *Collier*, in fact, explicitly finds Rule 2019 to cover "entities which act in a fiduciary capacity that are not otherwise subject to the control of the court."[313]

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[307] *See In re Clamp*, 233 B.R. at 211.

[308] *See In re* General Homes Corp., FGMC, 134 B.R. 853, 861 (Bankr. S.D. Tex. 1991) (recognizing severity of provision). Even if it found a solicitation violation, the court stated, the conduct at issue in the case was not "so egregious as to require denial of confirmation of the plan." *Id.*

[309] FED. R. BANKR. P. 2019(b) (emphasis added).

[310] *See In re* Century Glove, 74 B.R. 952, 958 (Bankr. D. Del. 1987).

[311] *See id.* at 958.

[312] *See* 7 COLLIER ON BANKRUPTCY ¶ 2019.05[1], at 2019-7, n.2 (2003).

[313] *See id.* ¶ 2019.02 at 2019-3.

The obvious question then is: why would such a rule on representation disclosures make reference to improper solicitation? While it is simply not clear, it appears that the rule is really intended to address parties who act in a representative capacity. Most importantly, while Congress has granted the Supreme Court authority to issue rules for bankruptcy cases, such rules cannot "abridge, enlarge, or modify any substantive right."[314] As Congress has issued express provisions for solicitation violations,[315] the bankruptcy rules cannot legitimately add additional limitations as are simply deemed necessary. It is questionable, therefore, whether Bankruptcy Rule 2019 can be invoked to limit a party's participation in a case or to invoke a "lesser" penalty.[316]

E. Contempt

As explored in an old Act case, *In re Portland Electric Co.*,[317] contempt is not easy to use as a penalty for faulty solicitation. There, the court railed against the actions of an attorney who solicited votes against a plan approved by the court, blaming much of the alleged vice on the attorney's "eastern money" client.[318] Yet even in that case, the court found, in essence, that some sort of direct "bad faith" violation of an order was needed to hold a party in contempt, not mere inferences that a party may have intentionally disregarded the seemingly obvious (yet unstated) mandates of the court.[319]

A much more recent case, *In re Aspen Limousine Services, Inc.*,[320] held that what the court considered "soliciting an alternative plan," and thus a violation of 1125(b), was contemptuous.[321] There the court seemed to turn to contempt as its only potential remedy, noting that:

> [v]iolation of the solicitation provisions of 11 U.S.C. § 1125 appear to have no specific enforcement or remedial provisions in the Code, except, perhaps, 11 U.S.C. § 1126(e). This putative "remedy"–disqualification of affected ballots–is essentially no remedy at all, particularly under the within circumstances where the Debtor's primary Plan was confirmed quickly and early in the Chapter 11 process . . . .[322]

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[314] *See* 28 U.S.C. § 2075 (2000).

[315] *See* 11 U.S.C. §§ 1126(e), 1125(e) (2000).

[316] It is also far from certain that the imposition of monetary sanctions is a "lesser" penalty than participation in the case.

[317] 97 F. Supp. 903 (D. Oregon 1947); *see also supra* Part I.A.1. (regarding solicitation under the Act).

[318] *In re Portland Elec.*, 97 F. Supp at 910.

[319] *Id.* at 917; *see also* Dufenhorst v. Aitkin (*In re* Sixth & Wisconsin Tower, Inc.), 108 F.2d 538, 539 (7th Cir. 1939) (finding needed violation of order to find creditor who sent solicitation letter to other creditors in contempt).

[320] 198 B.R. 334 (Bankr. D. Colo. 1995).

[321] *See id.* at 337–40.

[322] *Id.* at 340.

Therefore, after discussing the differences between civil and criminal contempt and the authority conveyed on bankruptcy courts in the Tenth Circuit to use that power, the court sanctioned the alternative plan proponent $1000 and reimbursement of debtor's attorney's fees and costs.[323]

Interestingly, since one could dispute whether the actions of the alternative plan proponent should have been considered a solicitation at all, it is far from clear that contempt, a lethal tool in the judge's arsenal, should have been considered. The court, however, may have felt it necessary to take this route because, while not cited to for support, the alternative plan proponent appears to have violated the judge's oral instruction[324] in addition to the alleged violation of section 1125. In summary, contempt is not and should not be used in typical solicitation cases. A more recent bankruptcy case correctly criticizes the *Aspen* court decision, noting that contempt is a remedy "which should be used sparingly" and only when there exists "a direct relationship between a specific order focused on an alleged contemnor and the suggested violation."[325]

F. Restraints on Future Contact with Creditors

Typically, a prohibition on contact with creditors will enjoin future contact altogether[326] or simply require the bad solicitor to submit future proposed communications with creditors to the court for review.[327] Whatever the exact method, and from wherever that authority comes, the sanction is the same: no contact with creditors to seek votes (in favor of or against a plan) unless and until the court first approves the communication. Failure to abide by the court's order will obviously allow a court to exercise its contempt power. The exact source of the power to issue the order to restrict contact in the first place is, however, unclear. The seemingly broad ability of the court to restrict communications is also subject to criticism.

Creditors restricted by this means have occasionally raised First Amendment concerns.[328] While the opinions are not well supported, the parties may be recognizing the Supreme Court's shift in recent years to favor some protections of commercial speech.[329]

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[323] *Id.*
[324] *Id.* at 336–37.
[325] *In re* Clamp-All Corp., 233 B.R. 198, 210 (Bankr. D. Mass 1999).
[326] Read v. Schroeder Hotel Co. (*In re* Schroeder Hotel Co.), 86 F.2d 491 (7th Cir. 1936). *See generally In re* Grant, 6 B.R. 762 (Bankr. S.D.N.Y. 1980).
[327] *See, e.g., In re* Petroleum Prod., Inc., 99 B.R. 451, 453 (Bankr. D. Kan. 1989); *In re* Gulph Woods Corp., 83 B.R. 339 (Bankr. E.D. Pa. 1988).
[328] *See, e.g., In re Gulph Woods*, 83 B.R. at 342–43.
[329] *See id.*

G. Fee Shifting

In the United States, it is recognized that the prevailing litigant is ordinarily not entitled to collect attorneys fees from the losing party.[330] "The American rule governs the award of attorney fees and provides that each party in a civil litigation bears its own professional fees."[331] This means, according to the Supreme Court, "attorney's fees generally are not a recoverable cost of litigation 'absent explicit congressional authorization.'"[332] The American rule is, noted the Supreme Court in a different opinion, "deeply rooted in our history and in congressional policy; and it is not for us to invade the legislature's province by redistributing litigation costs." [333] It is clear that the American rule applies to bankruptcy proceedings. [334]

Absent a contract, statute, or extraordinary circumstances, exceptions to the American rule are "narrowly circumscribed." [335] One district court authoritatively found:

> [it was not even] plausible that the bankruptcy court has inherent authority to make exceptions to the American Rule, except in the three classes of cases explicitly recognized by the Supreme Court decisions . . . , for Congress has not 'extended any roving authority to the Judiciary to allow counsel fees and costs or otherwise whenever the courts deem them warranted.'[336]

The three recognized exceptions are fees related to recovering costs incurred in "preserving or recovering a fund for the benefit of others in addition to himself . . . for the 'willful disobedience of a court order . . .' or when the losing party 'acted in bad faith.'"[337]

Despite the impediments to fee shifting, bankruptcy courts have shifted fees when solicitation violations have been found. Such courts fail to recognize the existence of the American rule or even to suggest what exception they might be proceeding under.[338] Instead, courts simply authorize fee shifting based on a court's inherent authority,[339] based on Bankruptcy Rule 2019,[340] or without citing any

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[330] *See* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 247 (1975).
[331] *See In re* County of Orange, 179 B.R. 195, 202 (Bankr. C.D. Cal. 1995).
[332] Key Tronic Corp v. United States, 511 U.S. 809, 814 (1994).
[333] *Alyeska Pipeline*, 421 U.S. at 271.
[334] *See In re County of Orange*, 179 B.R. at 202 (citing Acequia, Inc. v. Clinton (*In re* Acequia, Inc.), 34 F.3d 800, 819 (9th Cir. 1994)).
[335] *See* Richardson v. Alaska Airlines, Inc., 750 F.2d 763, 765 (9th Cir. 1984).
[336] *See In re* Pro-Snax, 212 B.R. 834, 839 (N.D. Tex. 1997) (citation omitted), *aff'd*, 157 F.3d 414 (5th Cir. 1997).
[337] *Alyeska Pipeline*, 421 U.S. at 257–58.
[338] *See, e.g., In re* Clamp-All Corp., 233 B.R. 198, 211 (Bankr. D. Mass. 1999); *In re* Rook Broad., Inc., 154 B.R. 970 (Bankr. D. Idaho 1993); *In re* Century Glove, Inc., 74 B.R. 958, 958 (Bankr. D. Del. 1987) (shifting attorney fees of opponent debtor).
[339] *See* Duff v. United States Trustee (*In re* California Fid., Inc.), 198 B.R. 567, 573 (B.A.P. 9th Cir. 1996).
[340] *See supra* discussion at Part II.D.

authority at all.[341] Poor analysis by bankruptcy courts thus leaves little guidance to determine whether fee shifting is a viable "bad" solicitation penalty. If a party is truly ignorant of the rules, though, it appears that it could not be acting in "willful disobedience of a court order" or have "acted in bad faith." Thus, a good heart should provide a party with a defense to judges who wish to shift fees.

H. Non-Reimbursement of Debtor's Attorney Fees

While multi-volume ethic treatises could be written on whether it is proper for a court to restrict the zealous advocacy of an attorney through the use of a fee approval statute, it is abundantly clear that bankruptcy judges wield (and will use) such authority. So long as the debtor's attorney, the creditors' committee's attorney or any other attorney paid by the court is involved, 11 U.S.C. § 330 provides the explicit tool for judges to penalize attorneys involved in any improper activities, including improper solicitations. It provides that the court may award to a professional "reasonable compensation for *actual, necessary services* rendered by" the professional.[342] Subsection 330(a)(3) instructs a court, somewhat repetitively, to take into account "whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title."[343] Where solicitation is improper then, so the argument goes, the activities involved in rendering related legal services are likely to be deemed unnecessary.[344]

While section 330 is always a potential danger to any court retained "professional person,"[345] it has rarely been used in the solicitation context. *In re Media Central, Inc.*,[346] in fact, is apparently the only reported case where the court wanted to "await further developments" in the case to decide whether a debtor's attorney fees associated with an improper solicitation were "necessary, actual and reasonable."[347]

I. Subordination

The recent case of *In re Clamp-All Corp.*[348] demonstrates perhaps the most dangerous weapon judges have at their disposal to combat improper solicitations. In *Clamp-All*, two creditors of the debtor filed objections to the debtor's plan and

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[341] *See In re Clamp-All*, 233 B.R. at 211; *In re Rook Broad.,Inc.*, 154 B.R. at 976.
[342] 11 U.S.C. § 330(a)(1)(A) (2000) (emphasis added).
[343] *Id.* § 330(a)(3)(C).
[344] *See* 3 COLLIER ON BANKRUPTCY ¶ 330.04[1][b], at 330-30 (2003) (explaining professional fees associated with assisting an officer exceed his or her authority are services "unauthorized by the law" and "are likely to be deemed unnecessary at best").
[345] *See* 11 U.S.C. § 327 (defining, poorly, "professional person").
[346] 89 B.R. 685, 690 (Bankr. E.D. Tenn. 1988).
[347] *Id.*
[348] 233 B.R. 198 (Bankr. D. Mass. 1999).

attached thereto their own proposed plan and unapproved disclosure statement.[349] They served their objection and the attached disclosure statement on the entire creditor body.[350] The court found that this action was in fact a prohibited solicitation and thus violated sections 1125(b)[351] and 1121[352] and Bankruptcy Rule 3017.[353]

Because contempt required a specific court order violation, and it was not clear whether vote designation would right the perceived solicitation abuse, the court *sua sponte* raised the possibility of subordination.[354] Equitable subordination allows a court to "subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest."[355] According to the court, it required the establishment of three requirements: "(1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors or the debtor or conferred an unfair advantage on the claimant; (3) equitable subordination of the claim must not be consistent with the provisions of the Bankruptcy Code."[356]

The court concluded that such requirements were clearly met.[357] The creditors violated two sections of the Bankruptcy Code and one Bankruptcy Rule.[358] The violations provided the creditors with unfair advantages that were precisely the type the Bankruptcy Code was intended to prevent and subordination was consistent with Congress' goals.[359] Accordingly, the court subordinated the creditors' claims to all other non-insider claims.[360] By so doing, the court recognized that it assisted the debtor in being able to improve it own offer to creditors and, as an apparent threat, suggested that the confirmation requirements make it unlikely that these creditors could ever submit a confirmable alternative.

The *Clamp-All* court's penalties—subordination, potential non-confirmability of plan, and fee shifting—were particularly harsh. In fact, equitable subordination of a claim in itself, typically used when a party has elevated its claim by some device[361] rather than by actions unrelated to the claim, is an unusually harsh remedy. Whether this potentially dangerous weapon will be used by judges in future cases is questionable.

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[349] *Id*. at 202.
[350] *Id*.
[351] 11 U.S.C. § 1125(b) (2000) (requiring adequate information be disseminated before solicitation).
[352] *Id*. § 1121 (providing exclusivity period of 120 days for debtor).
[353] FED. R. BANKR. P. 3017(a) (providing plan and disclosure statement shall be mailed "only to the debtor, any trustee or committee appointed under the Code, . . . and any party in interest who requests" a copy in writing).
[354] *In re* Clamp-All Corp., 233 B.R. 198, 210–11 (Bankr. D. Mass. 1999).
[355] *Id*. at 210 n.11 (quoting 11 U.S.C. § 510(c)).
[356] *Id*. at 211 (citing Benjamin v. Diamond (*In re Mobile Steel Co*.), 563 F.2d 692 (5th Cir. 1977)).
[357] *In re Clamp-All Corp.*, 233 B.R. at 211.
[358] *Id*.
[359] *Id*.
[360] *Id*.
[361] *See, e.g.*, Summit Coffee Co. v. Herby's Foods (*In re* Herby's Foods), 2 F.3d 128 (5th Cir. 1993).

III. APPLYING THE RULES TO SOLICITATION PROBLEMS

The general rule for bankruptcy solicitations is that one cannot solicit votes to accept or reject a plan until a disclosure statement is provided.[362] As provided in Part I, Congress intended that solicitations should be interpreted to encourage negotiation, protect the public from misinformation and protect a debtor's right to exclusivity.[363] Most cases, including the leading case of *Century Glove*, recognize these considerations.[364] Application, however, is often difficult. This Part analyzes particular situations in light of the language of the statute, the Congressional intent, the competing considerations, and relevant case law to determine which solicitation devices or methodologies are appropriate and which are not. This Part also considers whether the First Amendment and attorney ethical restrictions may play a role in a particular solicitation case.

A. Pre-Disclosure Statement Voting Agreements

Soliciting an "acceptance or rejection of a plan" after a bankruptcy case is filed and before disclosure statement approval is granted is prohibited.[365] Yet, a survey of bankruptcy attorneys would likely suggest that voting agreements are often used and are certainly allowed. The correctness of such survey results is questionable.

At heart, the propriety of voting agreements is a true Bankruptcy Code issue. The question is simply whether a voting agreement is a solicitation of "an acceptance or rejection of a plan" in violation of section 1125(b)? When so framed, the answer appears obvious. Why else would one seek agreement other than to lock a party into a specified vote? Perhaps the only instance where a solicitation agreement could arguably be considered almost proper was in the case *In re Texaco*.[366]

As a result of a $10.3 billion judgment in favor of Pennzoil, Texaco entered bankruptcy.[367] During the bankruptcy, Pennzoil and Texaco negotiated a settlement whereby Pennzoil and Texaco agreed: to use their best efforts to obtain confirmation of a plan that settled the judgment for $3 billion; not vote for any modification of the plan without the support of the other party; and to not vote for, consent to, or support any other plan of reorganization.[368]

In determining whether the agreement was proper or not, the bankruptcy court first recognized that such an agreement had to be binding before Texaco would submit its plan or reorganization.[369] Otherwise, hypothesized the court, Pennzoil

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[362] 11 U.S.C. § 1125(b) (2000).
[363] *See supra generally* Part I.A.4 (discussing competing solicitation considerations).
[364] *See supra* Part I.A.3 (discussing *Century Glove*).
[365] 11 U.S.C. § 1125(b).
[366] 81 B.R. 813, 816 (Bankr. S.D.N.Y. 1988).
[367] *Id*. at 816.
[368] *Id*. 814–15.
[369] *Id*. at 815.

could support another plan and the prior negotiations would have been useless.[370] Then the court found that the agreement at issue was not a solicitation of "Pennzoil's acceptance or rejection of Texaco's plan" because it did not agree to vote to accept the plan at issue nor did it agree to do anything in regard to any filed plan.

> Section 1125(b) relates to the voting process with respect to filed plans. A disclosure statement must be approved by the court as to any plan before acceptances or rejections of such plan may be solicited. If a plan has not been filed, no disclosure statement is called for under 11 U.S.C. § 1125. Therefore, an agreement not to support any other plans in the future does not amount to the solicitation of a rejection of a plan which must be accompanied by a court approved disclosure statement. Such a *carte blanche* agreement as to future unfiled plans does not offend 11 U.S.C. § 1125(b).[371]

The court's reliance on the fact that a solicitation had only taken place with respect to an unfiled plan does not appear to be justified. As the Code was designed to ensure that votes could only be solicited—either to accept or reject a plan—after a claimant had received a copy of the disclosure statement, the fact that the reference is to a currently non-existing plan is irrelevant. On its face, section 1125(b) only allows solicitation of votes for a plan which has an approved disclosure statement.

The court in this case simply went around section 1125(b) and justified its interpretation by relying on the (unstated) doctrine of necessity. Where an otherwise prohibited agreement is important then, finds the court, linguistic maneuvering will be accepted. Such an interpretation is not consistent with the Supreme Court's instructions regarding statutory interpretation in recent years. Voting agreement are prohibited by section 1125(b), and, short of Congressional action, should be so construed by courts.

This view appears to have been adopted by Delaware courts in two recent bench rulings.[372] According to these rulings, the bright line rule on lock-up agreements is not whether an unfiled plan exists, but is instead dependent on the timing of the agreement. If the agreement were entered into prior to the commencement of the chapter 11 case, the agreement is valid on the grounds that section 1126(b) provides an exception for pre-petition solicitations. In contrast, if the agreement were entered into post-petition, the agreement violates section 1125(b)'s prohibition on

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[370] *Id*.
[371] *Id*. at 816.
[372] *See* Daniel J. DeFranceschi, *Delaware Court Announces Bright-Line Rule for Use of Lock-Up Agreements in Chapter 11 Cases*, 22 AM. BANKR. INST. J. 16 (2003).

post-petition solicitations that occur prior to the distribution of a disclosure statement.

B. Pre-Disclosure Statement Approval Solicitations

While the First Amendment might be raised as an issue, the Bankruptcy Code is the prime issue to address in pre-disclosure statement solicitation cases. It should be remembered that Congress wanted parties to make their own informed judgment about a plan rather than leave that determination to the SEC or the court.[373] Thus, section 1125(b) was enacted. In post-petition cases, it requires a party to distribute a disclosure statement before soliciting votes. Alternatively, if the party is requesting votes pre-petition, section 1125(b) requires that parties comply with applicable non-bankruptcy law. The latter situation is rather simple to analyze: comply with non-bankruptcy law if you want to seek votes pre-petition.

Parties interested in soliciting pre-disclosure statement approval should also be aware that they will lose the "authorized by law" exception in the Model Rules of Professional Responsibility and will therefore be required to rely on a court's interpretation of the general applicability of Rule 4.2.[374]

C. Mailing an Unapproved Disclosure Statement

In cases where an unapproved disclosure statement is mailed, the primary consideration is also the Bankruptcy Code. Section 1125(b) requires that only approved disclosure statements be solicited. The issue then is, once again, a matter of fact: is the intent of the party to negotiate or solicit? Where a creditor requests the drafter to provide a copy of the unapproved plan, for instance, no solicitation is involved.[375] Where, however, a party unilaterally mails an unapproved disclosure statement to *all* creditors, a certain violation of section 1125(b) should follow.[376]

D. Soliciting Acceptances Post-Disclosure Statement Approval

Several legal sources are potentially relevant to post-disclosure approval solicitations. The first, and obviously most important, is the Bankruptcy Code. It determines whether such solicitations can be restricted in content. The second is the First Amendment. It suggests that solicitations should be minimally restricted. The third and final source is applicable ethics rules. Part I.C. should be reviewed for an analysis of these rules.

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[373] *See supra* Part I.A.2.

[374] *See supra* Part I.C.

[375] *See, e.g.*, Century Glove, Inc. v. First Am. Bank, 860 F.2d 94 (3d Cir. 1988); *see also supra* discussion in Part I.A.3 & 4.

[376] *See, e.g., In re* Clamp-All Corp., 233 B.R. 198 (Bankr. D. Mass. 1999).

The Bankruptcy Code's section 1125(b) only restricts the solicitation of an "acceptance or rejection of a plan" until an approved disclosure statement has been provided. The leading bankruptcy solicitation case, *Century Glove*, has persuasively argued that this means that section 1125(b) "never limits the facts which creditors may receive, but only the time when a creditor may be solicited." Congressional history appears to support such a view.[377] Thus, taking the statute on its face, and in light of Congress' intent, it appears that solicitation should always be allowed unless an alternative unapproved plan is expressly solicited. (The latter problem is discussed separately below).

It should be recognized that while this narrow reading of the statute is almost universally adopted,[378] some commentators and judges have suggested a more careful approach to the statute be taken. The court in *In re Media Central, Inc.*, for example, noted that pitfalls may await parties who solicit outside the disclosure statement and have not first garnered court approval.[379] "Failure to obtain beforehand a judicial ruling on the propriety of statements or information sent in conjunction with a vote solicitation may lead to a vote disqualification after the fact if it is later determined that the statements or information were improper and the solicitation in bad faith."[380] The court concluded that the solicitee "can avoid potential problems by incorporating into its disclosure statement such additional information it intends to disseminate to creditors and equity security holders in connection with its vote solicitation." Another court instructed that only information which is truthful and absent of false or misleading statements, presented in good faith, and which does not propose an alternative unapproved plan need seek court approval.[381] In a similarly uninstructive fashion, one leading bankruptcy treatise suggests that when solicitations other than the actual plan and disclosure statement are to be sent, such communications should not be offensive to the court.[382]

Putting aside the matter of an alternative plan, the above expansions on the rule say nothing other than the obvious: if you plan on intentionally misleading voters in the case by soliciting with lies, potential pitfalls abound. If, however, you attempt in good faith to ensure the veracity of the statements you intend to state or distribute, the communication cannot be viewed by the court as improper. The general rule, again, is that once a disclosure statement is provided, solicitation is allowed under the Bankruptcy Code.

While it is not clear what the exact parameters of First Amendment protection might provide, *see* discussion Part I.B, it is clear that the narrow view of solicitation encouraged by courts' interpretation of the Bankruptcy Code is consistent with the Supreme Court's limited recognition of commercial speech. Citing the First

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[377] *See supra* Parts I.A.1 & 2.

[378] *See, e.g., In re* Kellogg Square P'ship, 160 B.R. 336 (Bankr. D. Minn. 1993); *In re* Media Central, Inc., 89 B.R. 685, 691 (Bankr. E.D. Tenn. 1988).

[379] 89 B.R. at 691.

[380] *Id.*

[381] *In re* Apex Oil Co., 111 B.R. 245, 249 (Bankr. E.D. Mo. 1990).

[382] DANIEL R. COWANS, 5 BANKRUPTCY LAW & PRACTICE ¶ 20.24, at 253 (7th ed. 1999).

Amendment, therefore, may encourage a court to rule in favor of a narrow view of solicitation restrictions in close call situations. Again, however, the First Amendment is of limited application in most solicitation cases.

E. Soliciting Rejections Post-Disclosure Statement

The analysis for soliciting rejections of votes post-disclosure statement approval is largely the same as soliciting acceptances.[383] As reviewed above, the Bankruptcy Code, the First Amendment and ethical restrictions on contacting persons must be considered.[384] In addition, parties soliciting rejections must also recognize that restrictions exist on referencing potential alternatives. This problem is addressed in the next section.

F. Referencing an Unapproved Alternative Plan

Referencing an unapproved alternative plan is a Bankruptcy Code issue and a First Amendment issue.[385] As reviewed in Part I.A.4.c, determining where to draw the line between soliciting rejections of one plan and soliciting acceptances of a second unapproved plan is the most difficult of determinations to make. Section 1121(b) provides the debtor a 120 day exclusivity period to propose a plan.[386] And yet, as Part I.A.4.a. addresses, negotiation and discussion of a plan are to be encouraged.

The leading bankruptcy case, *Century Glove*,[387] endorses free negotiation and recognizes that the "ability of a creditor to compare the debtor's proposals against other possibilities is a powerful tool by which to judge the reasonableness of the proposals."[388] In contrast, the leading bankruptcy treatise, *Collier on Bankruptcy*, summarily finds that the receipt of an approved disclosure statement is a prerequisite to solicitation of votes on a plan, and while a soliciting party *may not*

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[383] Some might disagree that solicitation of post-disclosure statement approval rejections is the same as solicitation of acceptances. According to an older version of *Collier*, the leading bankruptcy treatise:

> If the opponents of the plan intend to solicit rejections of the plan simultaneously with the proponents' solicitation of acceptances, the plan opponents should obtain from the court an affirmative finding that rejections may be solicited on the basis of the information contained in the disclosure statement filed by the proponents of the plan and approved by the court.

In re Gulph Woods, 83 B.R. 339, 341 (Bankr. E.D. Pa. 1988) (citing 5 COLLIER ON BANKRUPTCY ¶ 1125.03, at 1125-39 (15th ed. 1987)). While this might be a wise road to take to mollify an interested bankruptcy judge or to protect solicitations that might be questionable on other grounds or to determine whether you are in fact "soliciting" for a second unapproved plan, *see* text *infra*, there is nothing inherent in the solicitation of rejections that requires judge approval.

[384] *See supra* Parts I.B–I.C.

[385] COLLIER ON BANKRUPTCY ¶ 1125.03[1][a], at 1125-18 (citing *In re Apex Oil*, 111 B.R. 245).

[386] 11 U.S.C. § 1121(b) (2000).

[387] 860 F.2d 94; *see also supra* Part I.A.3.

[388] *Id.* at 702.

suggest an alternative unapproved plan, it may react to and present contrary views regarding the plan reflected in the approved disclosure statement.[389]

A recent case, *Clamp-All Corp.*,[390] adopts *Collier's* view and criticizes *Century Glove*. According to that court, Congress intended to provide a chapter 11 debtor the "unqualified opportunity to negotiate a settlement and propose a plan of reorganization without interference from creditors and other interests."[391] Part I.A.4 suggests why *Clamp-All* and *Collier* are incorrect. A narrow reading of the statute is also consistent with the recognition that even commercial speech is provided some level of protection by the First Amendment.

Soliciting rejections of a plan in a communication that suggests alternatives must be carefully drafted, however. Providing an entire copy of a proposal, providing options on a ballot for an unapproved plan, or otherwise suggesting an alternative plan is "on the table," are all examples of soliciting a second unapproved plan. Suggesting in a letter that the debtor appears able to propose a different plan, subject to the review and approval of the Bankruptcy Court, that would provide a greater return to all creditors should be allowed.

G. Using Pre-marked Ballots

In several cases, parties have mailed ballots pre-marked with either an acceptance or a rejection. The use of mailing pre-marked ballots to creditors seems to involve only Bankruptcy Code issues.

Although no specific provision has been cited by the courts addressing the issue, it appears clear that the issue is one of good faith[392] and that pre-marked ballots are not allowed.[393] One court explained: "We would consider it the equivalent of a plan's proponent pre-marking a ballot with an acceptance. We have never known any plan proponent to be so presumptuous as to have not instinctively perceived the impropriety of so doing."[394] If but one thing is clear in solicitation cases, it is that thou shall not send pre-marked ballots to creditors.

H. Using Pleadings as a Method to Solicit Votes

Several courts have been asked to address whether a pleading was filed with the intent to solicit an acceptance or rejection of a plan. Each has properly addressed

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[389] COLLIER ON BANKRUPTCY ¶ 1125.03[1][a], at 1125-18 (citing Apex Oil, 111 B.R. 245) (emphasis added).

[390] 233 B.R. 198; *see also supra* discussion Part I.A.4.c.

[391] *In re* Clamp-All, 233 B.R. 198, 207 (Bankr. D. Mass. 1999).

[392] *See* 11 U.S.C. § 1125(e) (2000) (providing safe harbor to those who act in "good faith"); *id*. § 1126(e) (allowing court to designate votes that are not procured in "good faith").

[393] *See In re* Petroleum Prod., 99 B.R. 451 (Bankr. D. Kan. 1989); *In re* Gulph Woods Corp., 83 B.R. 339 (Bankr. E.D. Pa. 1988); *see also* 7 COLLIER ON BANKRUPTCY ¶ 1125.03[1][a][i] ("Predictably, it has been held that it is improper to send a letter seeking rejecting votes with a pre-marked ballot.") (footnote omitted).

[394] *In re* Gulph Woods, 83 B.R. at 343.

the issue as largely one for the Bankruptcy Code, with reference to the First Amendment.

In one case, *In re Reliable Investors Corp.*,[395] the court was asked to enjoin a creditor from circulating a motion to convert a case to chapter 7 because the circulation allegedly violated section 1125.[396] The court resoundingly said no. It found, among other things, that no plan was yet even on the table, the Bankruptcy Code provided for public access to court documents, and free speech was guarantied by the First Amendment.[397]

A second opinion, *Clamp-All Corp.*,[398] reached a different result but the decision was not inconsistent with *Reliable Investors*. In *Clamp-All Corp.*, a creditor filed an objection to the debtor's disclosure statement and attached thereto a full copy of their own (unapproved) alternative plan of reorganization.[399] The motion was then served on the entire creditor body.[400] The court found the creditor was soliciting and held him in contempt for his actions.[401]

The obvious moral on the propriety of distributing pleadings then is that a court will look to intent when it is claimed that a pleading is being used as a solicitation. Where an exhibit is attached that should not be attached or, even simpler, a pleading is distributed to parties who should not be served with the pleading, the court can easily determine that a solicitation has been made. Such interpretations are proper.

I. Publicity about Plan or Debtor

Can the debtor issue a press release stating that it will soon submit its disclosure statement? Can you post a billboard that says that the debtor will release a plan of reorganization that won't submit enough money to creditors because the debtor's officers were (or are) cheats? Answers to these questions require careful consideration of the First Amendment and Bankruptcy Code solicitation rules.

As noted in Part I.B., the clash between the First Amendment comes about where the Code attempts to restrict solicitations. Parties cannot solicit "acceptances or rejections of a plan" before a disclosure statement is provided to creditors. If you are seeking "acceptance or rejections," therefore, the Bankruptcy Code seems to govern that behavior, but the First Amendment would be considered. If, however, you are outside the clear solicitation rules by, for instance, seeking to state bad things about the debtor, courts will have to determine the purpose behind the comments. Are you for instance, trying to collect on a claim or are you trying to procure a vote for an unapproved plan? The appropriate analysis and cases to review are set forth above in the First Amendment section of this Article, Part I.B.

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[395] 44 B.R. 904 (Bankr. W.D. Wis. 1984).
[396] *Id.* at 905.
[397] *Id.* at 906.
[398] 233 B.R. 198 (Bankr. D. Mass. 1999).
[399] *Id.* at 202.
[400] *Id*.
[401] *Id.* at 212.

CONCLUSION

This Article has argued that a broad solicitation interpretation is mandated by the legislative history, by the competing considerations, and by case law. Taking into account bankruptcy law, the First Amendment, and attorney ethical obligations, it has also defined what is proper solicitation, such as the mere reference to an alternative plan, and what is not, such as the use of pre-marked ballots. In the event a solicitation violation is found, the Article argues that courts do not legitimately have the vast arsenal of penalties at their disposal that many solicitation opinions suggest are available. Instead, this Article argues that a court's arsenal is limited and would be legitimately challenged in most cases.