CONTROLLING THE MARKET FOR INFORMATION IN REORGANIZATION

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ABSTRACT

After cash, perhaps the most valuable asset in a chapter 11 case will be information—about the debtor, its prospects, its demise, and its stakeholders, among other things. Not surprisingly, parties in large corporate cases increasingly fight about information across a variety of fronts, from the use of examiners to the presence and behavior of voting blocks. Avenues to resolve corporate distress, in chapter 11 and otherwise, increasingly resemble unregulated securities markets.

One might think that the Securities and Exchange Commission ("SEC") would be a logical regulator of information in this context. Indeed, at least as a statutory matter, it had a large role in reorganization from 1938 to 1978. Under current law, by contrast, the SEC plays a much more modest part. We might therefore think that reinvigorating the SEC's role in reorganization would solve growing problems of information asymmetry in this context.

This paper argues that before we can make any serious claim about the role the SEC should (or should not) play in reorganization, we must answer a more basic question: What policy should inform the rules that control the flow of information in reorganization? Merely dilating the SEC's status, without understanding what it is supposed to do, is unlikely to benefit anyone.

We explain that reorganization's information policy—to the extent it has one—derives haphazardly from the federal securities laws. Yet, today, the two systems have different goals and functions; the policy aspirations of one hardly fit the other. We may learn from the SEC's successes and failures. But, like the legal regime of which it is a part, that agency serves different purposes and constituencies than does the reorganization system. We thus argue that reorganization law needs its own information policy, and suggest some things that such a policy should consider.

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INTRODUCTION

> *Reports that say that something hasn't happened are always interesting to me, because as we know, there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns—the ones we don't know we don't know. And if one looks throughout the history of our country and other free countries, it is the latter category that tend to be the difficult ones.*[1]

> *All warfare is based on deception. Hence, when able to attack, we must seem unable; when using our forces, we must seem inactive; when we are near, we must make the enemy believe that we are away; when far away, we must make him believe we are near. Hold out baits to entice the enemy. Feign disorder, and crush him.*[2]

The past two and a half years have, by most measures, been a financial and economic disaster. At least anecdotally, it appears that more and larger firms have

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[1] Donald Rumsfeld, U.S. Sec'y of Def., Dep't of Def. News Briefing (Feb. 12, 2002), *available at* http://www.defense.gov/transcripts/transcript.aspx?transcriptid=2636.

[2] SUN TZU, THE ART OF WAR 42 (Lionel Giles trans., Wilder Publ'ns 2008) (1910).

collapsed than at any time since the Great Depression. And it is not just firms that have failed. In significant part, today's economic crisis is the product of massive regulatory failures.

The Securities and Exchange Commission has been especially, perhaps uniquely, embarrassed by today's crisis. It opened enormous loopholes that appear to have led to overleveraging and arbitrage from which we have yet to recover.[3] The Madoff and Stanford scandals—among others—suggest a regulator either indolent or indifferent.[4] While it may be that the SEC was neutered by political forces

[3] For example, in 2004, the SEC loosened the "net capital" rule, which required that securities broker-dealers limit their debt-to-net-capital ratio to 12 to 1. *See* Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities, 69 Fed. Reg. 34428, 34430–31 (June. 21, 2004) (codified at 17 C.F.R. § 240.15c3-1 (2010)) (describing broker-dealer's ability to include unsecured receivables in net capital); *see also* 3 COLLIER ON BANKRUPTCY, ¶ 741.08, at 741-46 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009) (discussing broker-dealers limited ability to maintain debt greater than 1500% of net capital). The five investment banks that qualified for an alternative rule—Bear Stearns, Lehman Brothers, Merrill Lynch, Goldman Sachs, and Morgan Stanley—were allowed to increase their leverage ratios, sometimes—as in the case of Merrill Lynch—to as high as 40 to 1. *See* Julie Satow, *Ex-SEC Official Blames Agency for Blow-Up of Broker-Dealers*, N.Y. SUN, September 18, 2008, *available at* http://www.nysun.com/business/ex-sec-official-blames-agency-for-blow-up/86130; *see also* Jon Hilsenrath et al., *Goldman, Morgan Scrap Wall Street Model, Become Banks in Bid to Ride Out Crisis; End of Traditional Investment Banking, as Storied Firms Face Closer Supervision and Stringent New Capital Requirements,* WALL ST. J., Sept. 22, 2008, at A1 (noting leverage ratios of Merrill Lynch, Morgan Stanley, and Goldman Sachs). Today, only two of these—Goldman and Morgan—appear to have survived. *See* Aaron Lucchetti & Robin Sidel, *Dow Industrials Take a 504.48-Point Dive; Goldman, Morgan Now Stand Alone; Fight On or Fold?,* WALL ST. J., Sept. 16, 2008, at C1 (reporting Morgan Stanley and Goldman Sachs as two remaining investment banks).

Similarly, the SEC repealed the so-called "up-tick" rule, which permitted the selling of borrowed shares only after an increase (or "uptick") in the share price. *See* Regulation SHO & Rule 10a–1, 72 Fed. Reg. 36348, 36358 (July 3, 2007) (codified at 17 C.F.R. §§ 240.200–240.201 (2010)) ("[The SEC] is removing Rule 10a-1, [17 C.F.R.] § 240.10a-1, and amending Regulation SHO, [17 C.F.R.] §§ 242.200 and 201."); Scott Patterson, *Foes Take On 'Uptick' Rule for Stocks,* WALL ST. J., Sept. 29, 2009, at C3 (discussing political pressure and SEC's proposal for a modified up-tick rule). This rule had placed an important limit on the destructive capacity of a short, and is generally thought to have reduced market volatility–until its repeal. Today, there is evidence that "the repeal of the uptick rule makes markets highly vulnerable to manipulation resulting in severe under valuations and market instability." Yaneer Bar-Yam, *Market Instability and the Uptick Rule*, NEW ENG. COMPLEX SYS. INST. (2008), *available at* http://www.necsi.edu/headlines/uptick.html; *see also* Patterson, *supra,* at C3 (describing investor blame on uptick rule for financial crisis); Dion Harmon & Yaneer Bar-Yam, *Technical Report on SEC Uptick Repeal Pilot*, NEW ENG. COMPLEX SYS. INST. (2008), *available at* http://www.necsi.edu/research/UptickTechReport.pdf (analyzing effects of SEC's repeal on "rapid decline of value of individual corporations and the stock market as a whole in 2008").

[4] *See, e.g.*, Joseph Giannone, *Spitzer: S.E.C. Still Asleep at the Switch*, REUTERS, Mar. 18, 2010, *available at* http://blogs.reuters.com/reuters-dealzone/2010/03/18/spitzer-s-e-c-still-asleep-at-the-switch ("[T]he SEC has been asleep at the switch for a decade."); Martha Graybow, *Stanford Had Been on SEC's Radar for Some Time*, REUTERS, Feb. 18, 2009, *available at* http://www.reuters.com/article/idUSTRE51H4CX20090218 ("Has the SEC been asleep at the switch?"); Janet Morrissey, *After Its Madoff Report, Can Victims Sue the SEC?*, TIME, Sep. 3, 2009, *available at* http://www.time.com/time/business/article/0,8599,1920323,00.html ("The SEC internal-investigation report released on Wednesday points a clear finger of blame at the agency, stating that SEC investigators missed multiple opportunities to discover Bernard Madoff's criminal activities."); Brian Ross, Joseph Rhee & Justin Rood, *Manhunt: Accused Financier Scammer Stanford Missing*, ABC NEWS, Feb. 18, 2009, *available at* http://abcnews.go.com/print?id=6903014 ("Once again, this could be another case of the SEC asleep at the switch. Allegations of fraud and possible drug money

opposed to its core mission,[5] that simply tells us that we should be wary of allowing the political process to police capital markets.

Yet, it is entirely understandable why we might think that a regulator like the SEC should have a new (preferably improved) role in reorganization. From 1938 until 1978, the SEC had, at least nominally, a fairly intrusive role in resolving business failures, commenting on plans, vetting debtors and trustees, and so forth.[6] William O. Douglas, a chief architect of both the SEC and the 1938 Chandler Act, not surprisingly saw affinities between the two regimes.[7] His logic—and that of

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laundering have been made against Stanford in the past ten years, but the SEC took action only after two former employees filed a lawsuit in civil court."); Jesse Westbrook & Robert Schmidt, *Cox 'Asleep at Switch' as Paulson, Bernanke Encroach*, BLOOMBERG, Sept. 22, 2008, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aoM0mju1ARQo ("On the night of March 15, when Fed and Treasury officials were hammering out the terms of JPMorgan's takeover of Bear Stearns, an SEC official looking for [then-Chairman] Cox found him at a birthday party for Mark Olson, head of the Public Company Accounting Oversight Board."). Perhaps most telling is the SEC's program of "voluntary regulation":

> "The last six months have made it abundantly clear that voluntary regulation does not work," [former SEC Chairman Cox] said in a statement. The program "was fundamentally flawed from the beginning, because investment banks could opt in or out of supervision voluntarily. The fact that investment bank holding companies could withdraw from this voluntary supervision at their discretion diminished the perceived mandate" of the program, and "weakened its effectiveness," he added.

Stephen Labaton, *S.E.C. Concedes Oversight Flaws Fueled Collapse*, N.Y. TIMES, Sept. 27, 2008, at A1.

5 *See, e.g.*, Joel Seligman, *The SEC and Politics* 1, 3 (Jan. 18, 2006) (text of statement at 33d Annual Securities Regulation Institute), *available at* http://www.law.northwestern.edu/professionaled/documents/SECpolitics.pdf. ("It has always been a myth that the Commission was above politics . . . .").

6 *See* Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840 (1938) (repealed 1978); Clifford J. White III & Walter W. Theus, Jr, *Chapter 11 Trustees and Examiners After BAPCPA*, 80 AM. BANKR. L.J. 289, 291–92 (2006) ("The SEC's efforts culminated in a reorganization statute which furnished much needed protection and shifted control of the reorganization process away from management and the reorganizers."); *see also* William Blair, *Classification of Unsecured Claims In Chapter 11 Reorganization*, 58 AM. BANKR. L.J. 197, 197 n.3 (1984) (noting SEC's significant role in rehabilitation proceedings between 1938 and 1978). Under chapter X of the Bankruptcy Act, the SEC had standing to act as a party in interest during the entire bankruptcy proceeding. *See* Chandler Act §§ 156-80, 52 Stat. at 888–92; Jonathan C. Lipson, *The Shadow Bankruptcy System*, 89 B.U. L. REV. 1609, 1638 n.117 (2009) [hereinafter Lipson, *Shadow Bankruptcy*]; Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 AM. BANKR. L.J. 1, 11 (2010) [hereinafter Lipson, *Understanding Failure*]. Any plan of reorganization for a debtor with more than three million dollars in debt had to be submitted to the SEC for comment prior to confirmation. *See* Chandler Act § 172, 52 Stat. at 890–91 ("[T]he judge . . . shall, if such indebtedness exceeds $3,000,000, submit to the Securities and Exchange Commission for examination and report the plan . . . which the judge regards as worthy of consideration."); *see also, e.g.*, Thomas G. Kelch, *Shareholder Control Rights in Bankruptcy: Disassembling the Withering Mirage of Corporate Democracy*, 52 MD. L. REV. 264, 270 (1993) (noting safety provided to investors through SEC giving advice and providing detailed review of plans involving debt over three million dollars); David A. Skeel, Jr., *The Rise and Fall of the SEC in Bankruptcy* 31–32 (Univ. of Pa. Law Sch. Inst. for Law & Econ., Working Paper No. 267, 1999), *available at* http://ssrn.com/abstract=172030 (discussing SEC's reports on reorganization plans).

7 *See In re* Premier Int'l Holdings, Inc., 423 B.R. 58, 69 (Bankr. D. Del. 2010) (acknowledging Douglas's involvement with Chandler Act); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1633, 1637–38, 1678 n.305, 1683 (explaining Douglas's impact on bankruptcy reformation); *see also* Grayson-Robinson Stores, Inc. v.

both systems as he proposed them—was fairly simple: large reorganizations affected public investors, who had just as much need for protection when a firm reorganized as when it had its initial public offering.

The SEC's actual role in reorganization, however, was brief. Shortly after enactment, debtors found ways to circumvent some of the securities market protections envisioned by the Chandler Act.[8] An interview by one of the authors with attorneys practicing in the 1970s indicated that, by 1978, the SEC was little more than an irritant.[9] Not surprisingly, the 1978 Code significantly reduced the role of the SEC in chapter 11.[10]

Why, then, would we think there is a new role for the SEC in chapter 11? As discussed below, many features of the modern reorganization system have come to resemble an unregulated securities market. Because the SEC has historically regulated securities markets, it may be easy to think that the SEC's role should be commensurately reinvigorated.

We disagree. While it is true that the SEC has regulatory expertise from which the reorganization system can learn, that is not the same as arguing that the SEC's role in reorganization should be expanded. Rather, before we can make any decisions about the role of the SEC—or any information regulator—in bankruptcy, we need to understand what information policy in reorganization should be.

To that end, this paper makes three claims:

First, while we may be wary of the SEC *qua* regulator, we have no illusions about the fact that its subject of regulation—the control of financial information—is more important in reorganization than ever before. As discussed in Part II, fights about the control of information increasingly dominate reorganizations and restructurings, both before and during chapter 11. These fights impose transaction and agency costs that do little to advance any plausible policy goal we might have for the reorganization of troubled firms.

SEC, 320 F.2d 940, 952–53 (2d Cir. 1963) (Clark, J., dissenting) (noting Douglas's influence on SEC and Chander Act).

[8] *See* Skeel, *supra* note 6, at 2 ("[L]ittle more than a decade later, the SEC's authority in bankruptcy started eroding. Troubled firms began to evade SEC oversight by invoking bankruptcy provisions designed for small firms, rather than the chapter for publicly held debtors."); *see also* Gen. Stores Corp. v. Shlensky, 350 U.S. 462, 465–66 (1956) (discarding strict rule that large corporate debtors must use chapter X and stating new rule as whichever chapter would better serve public and private interests); William Hildbold, *Will Section 1141(d)(6) of the Bankruptcy Code Destroy Corporate Chapter 11 Reorganizations by Rendering SEC Claims Non-dischargeable?*, 17 AM. BANKR. INST. L. REV. 551, 560 (2009) (describing "death knell" of SEC bankruptcy power as large firms able to use chapter XI, originally thought reserved for smaller firms).

[9] *See* Lipson, *Understanding Failure*, *supra* note 6, at 14 n.73 (citation omitted) (describing inclusion of mandatory examiner provision as a "sop to the SEC").

[10] The Bankruptcy Code provides a much more modest role for the SEC. *See* 11 U.S.C. § 1109(a) (1978), *amended by* 11 U.S.C. § 1109(a) (2006) ("The Securities and Exchange Commission may raise and may appear and be heard on any issue in a case under this chapter, but the Securities and Exchange Commission may not appeal from any judgment, order, or decree entered in the case."); Hildbold, *supra* note 8, at 561 (positing Congress chose to significantly reduce SEC's role in bankruptcy in 1978).

Second, these fights are in important part the product of a conceptual gap: although "transparency" usually is claimed to be a high regulatory value in reorganization, we have given little thought to what this means or how it should work. True, there are information-forcing rules in reorganization, most notoriously Federal Rule of Bankruptcy Procedure 2019. But these rules are increasingly the locus of trench warfare over transgressions and interpretation: they produce legal fees, not transparency. In any case, compliance under the existing regime is unlikely to accomplish even the crudest version of transparency, because the information that matters must be produced on bankruptcy court dockets (and the pleadings logged there), and obtained through the Electronic Case Filing system. These systems are, however, slow, clunky, and inefficient. They were designed to help courts and parties manage cases—not mine financial information.

Third, while the SEC may or may not be the appropriate regulator in reorganization, its successes—and failures—offer valuable lessons about how we can develop more fair and efficient information-control rules that match legitimate bankruptcy policy goals to current and evolving market trends. We suggest some of the considerations that should go into developing better information policy in bankruptcy. We also offer tentative thoughts about how such policies might be implemented.

Fights about information in reorganization are not new, but they are increasingly important. Despite a vast literature on the propriety and growth of market forces in bankruptcy reorganization, scholars and practitioners have paid scant attention to bankruptcy's information functions, or the policies that should address those functions.[11] Rather, they assume, with little analysis, that the information needed to make intelligent market and social decisions in the bankruptcy tournament will miraculously work its way into the right hands. But they are wrong. If information is an asset, it will be hoarded and fought for as surely as oil or gold. Thus, unless and until we have some idea what the rules about information in reorganization should do, we will make little progress in managing those fights.

This paper proceeds in three parts. Part I describes the general contours of information fights in reorganization. Part II describes four classes of such fights.

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[11] There are some exceptions. *See, e.g.*, Ziad Raymond Azar, *Bankruptcy Policy, Legal Heritage, and Financial Development: An Agenda for Further Research*, 24 EMORY BANKR. DEV. J., 379, 461–62 (2008) (identifying information availability as "major variable" governments should consider); Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1954 (2006) ("The junior investor may find it impossible to borrow the full amount from a third party because the third party does not know as much about the business and will therefore lend only a fraction of the business's value. The private information problem that makes a sale of the business unattractive also makes it difficult for the junior investor to borrow the funds needed to buy out the senior investor."); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1619 (addressing importance of "systemic transparency" of information in bankruptcy).

Part III explains how and why we should rethink information (disclosure) policy in reorganization.

I. WHAT WE FIGHT ABOUT WHEN WE FIGHT ABOUT FAILURE

We typically think that bankruptcy reorganization is about fights over money: Who can grab the largest slice of an economic pie that is too small to feed all of a corporate debtor's hungry creditors and shareholders? Increasingly, however, these fights focus on information or information rules: Who will control information about the debtor and its stakeholders? Data, not dollars, are rapidly becoming the contested currency in corporate failure.

Why? Because business failure increasingly is a problem markets purport to solve. "Today," Professor Baird writes, "creditors of insolvent businesses . . . no longer need a substitute for a market sale. Instead of providing a substitute for a market sale, chapter 11 [bankruptcy reorganization] now serves as the forum where such sales are conducted."[12] Reorganization under chapter 11 of the Bankruptcy

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[12] Douglas G. Baird, *The New Face of Chapter 11*, 12 AM. BANKR. INST. L. REV. 69, 71 (2004) [hereinafter Baird, *New Face*]. Indeed, Professor Baird (along with Dean Rasmussen) claims that the success of market forces has resulted in the death of traditional forms of reorganization. Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 699 (2003); Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 752 (2002) [hereinafter Baird & Rasmussen, *End of Bankruptcy*]. The Supreme Court would appear to concur with the aspiration, if not the empirical claim. "[T]he best way to determine [a reorganizing debtor's] value is exposure to a market." Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 457 (1999).

Others are not so sanguine, and argue that bankruptcy reorganization is not, and cannot be, managed effectively by market forces alone. Professors LoPucki and Doherty argue that asset sales were, at least for a time, increasing in frequency, although producing lower valuations than a traditional reorganization. *See, e.g.*, Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 14 (2007) ("In the 1990s, section 363 sales of large public companies grew from a trickle to a flood. Sales under confirmed plans were also on the increase."). Even Baird and Rasmussen would appear to be rethinking their position, arguing that chapter 11 has become "anti-bankruptcy" because

> [t]he current environment is one in which there are no natural leaders (or followers) among the creditors to perform the shuttle diplomacy required to build a consensus. Without familiar benchmarks, there is no shared understanding of what form a plan should take. Coalition formation is harder. Worse yet, in some cases there may be no stable equilibrium at all. To use the language of cooperative game theory, the core may be empty.

Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L.J. 648, 652 (2010) (footnotes omitted).

Code[13] "has morphed into a branch of the law governing mergers and acquisitions."[14]

The marketization of business failure has been driven largely by two phenomena: (1) the growth of secondary markets for claims against distressed firms,[15] and (2) the growth of large, private pools of capital that purchase these claims, or other interests in, or assets of, troubled companies. Although we now call these investors "hedge funds"[16] or "private equity funds," in earlier days they

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[13] The current version of the Bankruptcy Code was originally enacted in 1978 (Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, *reprinted in* 1978 U.S.C.C.A.N 5787–6573 (codified as amended at 11 U.S.C. §§ 101–1330 (1978))) and has been amended several times, most recently in 2005. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

[14] Baird, *New Face*, *supra* note 12, at 75. *See also* Baird & Rasmussen, *End of Bankruptcy*, *supra* note 12, at 751–53 (arguing companies use chapter 11 to sell assets rather than reorganize); David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 918 (2003) ("The endless negotiations and mind-numbingly bureaucratic process that seemed to characterize bankruptcy in the 1980s have been replaced by transactions that look more like the market for corporate control.").

[15] For discussions of the development of this market, see Hon. Robert D. Drain & Elizabeth J. Schwartz, *Are Bankruptcy Claims Subject to the Federal Securities Laws?*, 10 AM. BANKR. INST. L. REV. 569, 576 (2002) (describing market for distressed debt, particularly trade debt, but noting liquidity of debentures and bonds); Chaim J. Fortgang & Thomas M. Mayer, *Trading Claims and Taking Control of Corporations in Chapter 11*, 12 CARDOZO L. REV. 1, 2 (1990) (explaining hedge fund involvement with bankruptcy reorganization); Paul M. Goldschmid, Note, *More Phoenix Than Vulture: The Case for Distressed Investor Presence in the Bankruptcy Reorganization Process*, 2005 COLUM. BUS. L. REV. 191, 193 n.6 (2005) (noting term "distressed-debt investors . . . refers to a class of investors who purchase the assets or claims of firms once their debt or operations become 'distressed'"); Michelle M. Harner, *Trends in Distressed Debt Investing: An Empirical Study of Investors' Objectives*, 16 AM. BANKR. INST. L. REV. 69, 75 (2008) (observing market for distressed debt has expanded significantly); Adam J. Levitin, *Finding Nemo: Rediscovering the Virtues of Negotiability in the Wake of Enron*, 2007 COLUM. BUS. L. REV. 83, 86 (2007) (noting hedge funds and investment banks are major players in trading of creditor claims against bankruptcy debtor); Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 181 (2004) ("[D]istressed debt trading has grown to proportions never contemplated at the time of the enactment of the Bankruptcy Reform Act."); Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. INST. L. REV. 85, 101–04 (1995) (analyzing claims trading in bankruptcy reorganization); Glenn E. Siegel, *Introduction: ABI Guide to Trading Claims in Bankruptcy: Part 2 ABI Committee on Public Companies and Trading Claims*, 11 AM. BANKR. INST. L. REV. 177, 177 (2003) ("Perhaps nothing has changed the face of bankruptcy in the last decade as much as the newfound liquidity in claims . . . . Now, in almost every size case, there is an opportunity for creditors to exit the bankruptcy in exchange for a payment from a distressed debt trader . . . ."); David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARDOZO L. REV. 1905, 1906 (2004) (arguing DIP financers have been encouraged to lend to "cash-starved debtors"); Frederick Tung, *Confirmation and Claims Trading*, 90 NW. U. L. REV. 1684, 1685 (1996) (regarding trends in claims trading as "a Wall Street staple").

[16] The term "hedge fund" has "no uniformly accepted meaning, but commonly refers to a professionally managed pool of assets used to invest and trade in equity securities, fixed income securities, derivatives, futures and other financial instruments." DOUGLAS HAMMER, ET AL., U.S. REGULATION OF HEDGE FUNDS 1 (Am. Bar Ass'n 2005). Discussions of the role of hedge funds in bankruptcy appear in, for example, Mark Berman & Jo Ann J. Brighton, *Will the Sunlight of Disclosure Chill Hedge Funds? The Tale of Northwest Airlines*, 26 AM. BANKR. INST. J. 24, 24 (2007) ("[H]edge funds are not confined to a single type of investment and might acquire an interest at any one or more places in a company's capital structure."); Mark S. Lichtenstein & Matthew W. Cheney, *Riding the Fulcrum Seesaw: How Hedge Funds Will Change the*

went by the less charitable name "vulture funds."[17] Today, while amounts are difficult to determine, it appears that private investors play an increasingly important role in bankruptcy reorganization[18] because of their access to capital, nimbleness, and expertise. Even before the collapse of *Lehman Brothers,* their investments in distressed firms were said to run to the billions of dollars.[19]

Like all markets, the market for control of distressed firms depends on two things: money and information. Because private investors are sophisticated and well-funded, it is not surprising that they would aggressively pursue every informational advantage. This zeal can result in costly fights. Yet, most major participants in reorganization—from the debtor-in-possession to the creditors' committee—increasingly find themselves in fights that are, at bottom, about the application or effect of information-control rules. In the absence of such rules (*e.g.*, before bankruptcy) the best informed likely will win, even if winning comes at the expense of a reorganizing firm and its other stakeholders.

II. FOUR INFORMATIONAL BATTLEGROUNDS

Fights in four contexts show that controlling the flow of information is increasingly important in reorganization: (1) the appointment of examiners under section 1104 of the Bankruptcy Code; (2) disclosures under Federal Rules of

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Dynamics of Future Bankruptcies, 191 N.J. L.J. 102 (2008) (stating hedge funds can provide funds to help stabilize distressed companies); James M. Shea, Jr., Note, *Who Is at the Table? Interpreting Disclosure Requirements for Ad Hoc Groups of Institutional Investors under Federal Rule of Bankruptcy Procedure 2019*, 76 FORDHAM L. REV. 2561, 2589 (2008) (footnote omitted) ("Distress[] investors participate in Chapter 11 reorganizations in several ways, in both debt and equity positions. Hedge funds, in particular, often invest in first- or second-lien secured debt and join lender groups; frequently they invest in unsecured subordinated notes, bonds and other debentures, and equity securities.").

[17] *See* Richard Lieb, *Vultures Beware: Risks of Purchasing Claims Against a Chapter 11 Debtor*, 48 BUS. LAW. 915, 915–19 (1993) (discussing nature and behavior of "vulture" funds); *The Vultures Take Wing; Investing in Distress*, THE ECONOMIST, Mar. 31, 2007, at 96 (describing hedge fund investments in "distressed-securities groups"); *Rich Pickings*, FUND STRATEGY, Apr. 3, 2006, *available at* http://www.fundstrategy.co.uk/features/rich-pickings/120260.article ("Vultures are basically value investors, trying to buy an asset for a price well below its intrinsic or fair value.").

[18] *See, e.g.*, Transcript of Hearing at 23:4–23:5, *In re* Proposed Amendments to the Fed. Rules of Bankr. & Criminal Procedure (Feb. 5, 2010) [hereinafter Gerber Testimony], *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK_Hearing_Feb_5_2010.pdf ("[M]ost of the creditors in my cases now are [distress investors]."); *see also* Bo J. Howell, *Hedge Funds: A New Dimension in Chapter 11 Bankruptcy Proceedings*, 7 DEPAUL BUS. & COMM. L.J. 35, 35 (2008) (noting role hedge funds are playing in bankruptcy proceedings); Neil King Jr. & Jeffrey McCracken, *Chrysler Chapter 11 is Imminent*, WALL ST. J., Apr. 30, 2009, at A1 (describing hedge funds' involvement in Chrysler's reorganization plan).

[19] *See, e.g.*, Jay Krasoff & John O'Neill, *The Role of Distressed Investing and Hedge Funds in Turnarounds and Buyouts and How This Affects Middle-Market Companies*, 9 J. OF PRIVATE EQUITY 17, 17 (2006) (describing how hedge funds spend hundreds of billions of dollars on buyouts and lending); *see also* Tung, *supra* note 15, at 1685 (stating claims trading market in late 1980s and early 1990s ran as high as $300 billion); Louise Story, *Investors Stalk the Wounded of Wall Street*, N.Y. TIMES, Apr. 4, 2008, at A1 (discussing how "bankers, traders, hedge fund gurus and takeover artists" have purchased assets of distressed companies).

Bankruptcy Procedure 2019 and 3001; (3) requests to seal documents under section 107 of the Bankruptcy Code; and (4) disputes during the "gap" period after a covenant default and before a company files for bankruptcy (if it does so at all).

A. Examiners

One informational battleground involves the appointment of examiners under section 1104 of the Bankruptcy Code.[20]

> Examiners are private individuals appointed by the United States Trustee at the direction of a bankruptcy court to investigate and report on alleged acts of pre-bankruptcy mal- or misfeasance when a company seeks protection under chapter 11. Congress created examiners to provide "special protection for the large cases having great public interest . . . to determine fraud or wrongdoing on the part of present management." Examiners have played important, often controversial, roles in many of our most recent, high-profile bankruptcy cases, including *Enron*, *Worldcom*, *Refco*, *Mirant*, *New Century*, *Lyondell Chemical*, and *Lehman Brothers*. Their investigations on occasion have cost millions of dollars and resulted in major lawsuits or settlements.[21]

Although examiners perform an obvious informational function, their appointments tend to be both rare and controversial. In *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, we describe an empirical study of requests for and appointments of examiners in large chapter 11 cases.[22] We reviewed dockets and pleadings from 576 of the largest chapter 11 cases commenced between 1991 and 2007, and from those dockets extracted data about the cases.[23] One of us also interviewed attorneys, judges, examiners and other participants in large cases that might have involved examiners.[24]

Our data show that parties rarely want examiners, even in the largest cases, and even where the case might have been precipitated by fraud, the paradigmatic form

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[20] *See* 11 U.S.C. § 1104(c) (2006) (authorizing appointment of examiner in chapter 11 case); Lipson, *Understanding Failure*, *supra* note. 6, at 14 n.73 (referring to comments by attorney describing examiner as "sop to the SEC"); Lawrence K. Snider, *The Examiner in the Reorganization Process: A Need to Modify*, 45 BUS. LAW. 35, 36 (1989) (reviewing cases analyzing "appointment, role, powers, and duties" of examiners).

[21] Lipson, *Understanding Failure*, *supra* note 6, at 2 (footnotes omitted).

[22] *See generally id*.

[23] *See id*. at 19–22. The cases were all cases for the subject years appearing in the Bankruptcy Research Database, which is available at http://lopucki.law.ucla.edu/. *See* Lipson, *Understanding Failure*, *supra* note 6, at 19 (describing methodology).

[24] *See* Lipson, *Understanding Failure*, *supra* note 6, at 23 (reporting nineteen interviews taken in total).

of information failure.[25] Examiners were requested in only 87 of the 576 cases we studied (about 15%),[26] and the request was opposed in 59 of those 87 cases (about 68%).[27] Of the 31 cases in our sample that allegedly involved fraud, examiners were sought in only 9, and were appointed in only 5.[28]

Our study revealed that management was by far the most likely party to oppose appointment of an examiner, objecting in 68% of cases we studied.[29] In the recent, high-profile *New Century* case, for example, the United States Trustee sought the appointment of a chapter 11 trustee or, in the alternative, an examiner, shortly after the case was commenced.[30] The bankruptcy court declined to appoint a trustee, which would have displaced management, but did appoint an examiner to determine, among other things, how and why this major subprime lender had misstated its financials so seriously.[31]

According to the examiner's report, management fought the investigation.[32] "The [e]xaminer's investigation was made much more challenging, lengthy, inefficient and expensive due to some troubling failures of New Century and others to cooperate," the examiner explained.[33] The company "unreasonably withheld for many months the production to the [e]xaminer of hundreds of thousands of important documents."[34] This may not be surprising, given that the examiner's investigation determined that the debtors' estates had causes of action against executives to recover bonuses and other compensation paid based on alleged misstatements of financial performance.[35]

Managers are not the only stakeholders likely to object to the use of an examiner. While management was the most likely participant to oppose an

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[25] *See id.* at 40 ("[E]ven though there is a correlation between fraud and examiner motions, examiners were rarely sought (and thus rarely appointed) in fraud cases.").

[26] *See id.* at 4.

[27] *See id.* at 30–31.

[28] *See id.* at 6.

[29] *See id.* at 31.

[30] *See* Motion of the United States Trustee for an Order Directing the Appointment of a Chapter 11 Trustee or, in the Alternative, an Examiner, at 1–2, *In re* New Century TRS Holdings, Inc., No. 07-10416 (Bankr. D. Del. 2007), ECF No. 278 (citing failures of current management as reason for seeking appointment of chapter 11 trustee).

[31] *See* Final Report of Michael J. Missal Bankruptcy Court Examiner, at 11, *In re New Century*, No. 07-10416 (Bankr. D. Del. Feb. 29, 2008) [hereinafter New Century Final Report], *available at* http://www.klgates.com/FCWSite/Final_Report_New_Century.pdf (providing examiner would "investigate any and all accounting and financial statement irregularities, errors or misstatements" (quoting Order Denying in Part and Granting in Part Motion of the United States Trustee for an Order Directing the Appointment of a Chapter 11 Trustee, or in the alternative, an Examiner, *In re New Century*, No. 07-10416 (Bankr. D. Del. June 1, 2007), ECF No. 1023)).

[32] *See id.* at 18.

[33] *Id.*

[34] *Id.*

[35] *See id.* at 513–19 (discussing potential causes of action available to debtor's estates, including professional negligence, negligent misrepresentation, and recovery of bonuses and other forms of compensation).

examiner request (opposing 40 of 87 requests), the official committee of unsecured creditors (the "UCC") was a close second, opposing 30 of 87 requests.[36] Like debtors-in-possession, who may oppose examiner appointments in an attempt to prevent the disclosure of certain information, committees may also resist examiner appointments in an effort to protect their own interests (or at least the interests of the committee's professionals). Since examiners and UCCs perform some of the same investigative functions, UCCs likely will want to be the ones performing the investigation so that they can control the flow of information.[37] In both instances, there is a battle for control of information.[38]

The lack of requests and frequency of opposition does not mean that parties—or the system as a whole—do not want the information an examiner might produce. But the high level of opposition does indicate that parties are willing to fight its production, fights which, in themselves, can be costly. Indeed, in the 39 cases in which examiners were appointed on a motion, they were appointed notwithstanding an objection in 29 of them (about 75%).[39]

Fights involving examiners extend beyond their appointment. Sometimes—as in the *FiberMark* and *Tribune* cases—parties whose activities are discussed will ask that the examiner's report be filed under seal.[40] Sometimes courts agree; sometimes they do not.[41] Similarly, examiners can become involved in protracted fights about the scope and contours of their investigations. In *Refco*, for example, parties disputed the examiner's authority to obtain documents and to take discovery.[42] Perhaps sensitive to this, Anton Valukas, the examiner in *Lehman Brothers*, worked under an extremely broad retention order, yet also chose not to take formal

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[36] *See* Lipson, *Understanding Failure*, *supra* note 6, at 30–31.

[37] *See id.* at 30.

[38] *Cf.* New Century Final Report, *supra* note 31, at 22 (highlighting how lack of cooperation examiner received made examiner's investigation more time-consuming, expensive, and inefficient, possibly obscuring information or issues that may have confirmed, changed, or supplemented findings).

[39] *See* Lipson, *Understanding Failure, supra* note 6, at 31.

[40] *See In re* FiberMark, Inc., 330 B.R. 480, 489 (Bankr. D. Vt. 2005) (holding attorney-client privilege and work product doctrine as appropriate reasons to seal examiner's report); Bill Rochelle, *Esmerian, St. Vincent, Mesa Air, Petters, Chemtura, Madoff: Bankruptcy*, BLOOMBERG, July 27, 2010, http://www.bloomberg.com/news/2010-07-27/esmerian-st-vincent-mesa-air-petters-chemtura-madoff-bankruptcy.html (noting examiner in Tribune case filed most of his report under seal).

[41] *See, e.g., In re FiberMark*, 330 B.R. at 510–11 (granting debtor's motion to unseal examiner's report); Amended Order Supplementing Order Directing the Appointment of an Examiner, Etc. Dated April 19, 2005, at 2, *In re FiberMark*, No. 04-10463 (Bankr. D. Vt. May 13, 2005), ECF No. 1470 (directing examiner's report to be confidential and filed under seal); *see also* Order (1) Authorizing Court-Appointed Examiner, Kenneth N. Klee, Esq., to Temporarily File His Entire Report Under Seal; and (2) Unsealing the Entire Report, the Exhibits and Related Transcripts, at 2–3, *In re* Tribune Co., No. 08-13141 (Bankr. D. Del. Aug. 3, 2010), ECF No. 5252 [hereinafter Tribune Order] (approving examiner's temporary filing of entire report under seal but requiring parties-in-interest be given access to report, exhibits, and transcripts).

[42] *See In re* Refco, Inc., 336 B.R. 187, 201 (Bankr. S.D.N.Y. 2006) (holding any information received in connection with discovery be governed by court order).

discovery in the form of depositions and the like.[43] But as Kenneth Klee, the examiner in the *Tribune* case learned, the cooperative approach does not always work.[44]

Fights about examiners, like all fights about information-control rules, may really be about other matters. We found that 17% of requests for examiners were probably made for strategic reasons that had little to do with producing information about the debtor's failure.[45] We make this (tentative) inference based on the fact that these motions were withdrawn before judicial consideration.[46] Presumably, at least some of these movants were given something in exchange for withdrawing the motions.

While there are doubtless many reasons why participants in a large case may be reluctant to have an examiner appointed, the important point is that they are perfectly willing to fight about examiners at every turn.

B. Bankruptcy Disclosure Rules

Managers and official committees are not the only parties who fight over information in bankruptcy. Equally important are private investors, whose strategies also increasingly appear to involve the control of information.

Private investors may acquire any number of positions against a debtor before or during bankruptcy. One private investor may, for example, acquire secured and

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[43] *See, e.g.*, Order Directing Appointment of an Examiner Pursuant to Section 1104(c) of the Bankruptcy Code, at 2–4, *In re* Lehman Brothers Holdings, Inc., No. 08-13555 (Bankr. S.D.N.Y. Jan. 16, 2009), ECF No. 2569 (outlining examiner's duties); Matt Phillips, *Lehman's Accidental Historian*, WALL ST. J., Sept. 18, 2010, http://online.wsj.com/article/SB10001424052748704858304575498261847641000.html ("He had the power to subpoena, but he knew that subpoenas wouldn't be the way to get the investigation done quickly and efficiently. 'If the lawyers from the other side wanted to make this a long drawn-out affair, we would still be working on the report for five years,' he said. One strategic decision he made was to conduct the 250 interviews without witnesses being under oath and without a court reporter present.").

[44] *See* Motion of Court-Appointed Examiner, Kenneth N. Klee, Esq., for Order (1) Temporarily Authorizing the Filing of the Examiner's Entire Report and Certain Documents Under Seal; and (2) Overruling the Claims of Confidentiality with Respect to the Report and its Exhibits, *In re Tribune*, No. 08-13141 (Bankr. D. Del. July 23, 2010), ECF No. 5114. Klee sought an order simultaneously (1) authorizing him to file his entire report under seal and (2) overruling all claims of confidentiality and unsealing the entire report. *Id.* ¶ 1. How did the case get to the point where the examiner filed his report subject to claims of confidentiality by the examinees? The appointment order told him to "preserve claims of confidentiality" and to "file a public Report." *Id.* ¶ 20. So, from the outset, Klee told the parties to provide what they had, and to indicate what they wanted to keep secret. *Id.* ¶ 22. What happened next is no surprise. "The claims of confidentiality are so broad, and cover so may documents and subjects relevant to the Investigation and the Report, that it is impossible for the Examiner to redact all of this information from the Report without rendering the Report difficult to follow or understand." *Id.* ¶ 28. "The Examiner does not believe that all claims of confidentiality are well-founded or asserted in good faith." *Id.* ¶ 31. Judge Carey gave the parties five days to read the report and work it out and then summarily denied all unresolved claims of confidentiality. Tribune Order, *supra* note 41, at 3.

[45] *See* Lipson, *Understanding Failure*, *supra* note 6, at 6.

[46] *See id.*

unsecured claims, as well as preferred stock, or even common stock.[47] The economic goal may be to reach the "fulcrum" position, the point in the capital structure that achieves maximum control for minimum investment.[48] The tactical key for these private investors will be information arbitrage: they want to obtain as much information as possible about the debtor—and the debtor's other stakeholders—while revealing as little information about themselves as possible. Two sets of rules—those regarding collective representation and those regarding claims trading—affect private investors' ability to arbitrage information in this way, and thus form a second information battleground in bankruptcy reorganization.

1. Rule 2019 and Ad Hoc Committees

The importance of information is underscored by litigation in several recent large bankruptcy cases surrounding "the simplest questions of identity: who are you, and whom do you represent?"[49] The specific issue is whether ad hoc committees of investors (*e.g.*, hedge funds) must comply with Rule 2019,[50] which

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[47] *See, e.g.*, Berman & Brighton, supra note 16, at 24 (noting hedge funds may acquire interest in company's capital structure); Lichtenstein & Cheney, *supra* note 16 (observing distressed debt investors willing to accept junior positions or equity stake); Shea, *supra* note 16, at 2589 (describing ways in which distress investors participate in chapter 11 cases).

[48] *See, e.g.*, Lichtenstein & Cheney, *supra* note 16 (explaining how hedge funds advance strategies by acquiring "fulcrum" position); Robert J. Rosenberg & Michael J. Riela, *Hedge Funds: The New Masters of the Bankruptcy Universe*, 17 NORTON J. BANKR. L. & PRAC. 701, 703 (2008) (discussing investment in distressed companies as component of hedge fund strategy).

[49] Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1639. Indeed, bankruptcy practitioners consider Rule 2019 compliance to pose a threat strong enough to be used strategically in negotiations. *See* Evan D. Flaschen & Kurt A. Mayr, *Bankruptcy Rule 2019 and the Unwarranted Attack on Hedge Funds*, 26 AM. BANKR. INST. J. 16, 49 (2007) (noting debtors assert Rule 2019 against owners of their debt); Michael DeMarino, Comment, *Rule 2019: The Debtor's New Weapon*, 42 J. MARSHALL L. REV. 165, 169 (2008) ("Non-compliance with Rule 2019 carries grave consequences, and may result in a court refusing to hear from the ad hoc committee and denying the committee the right to speak for its members.").

[50] *See, e.g.*, FED. R. BANKR. P. 2019(b) (stating court may, for failure to comply with rule, enjoin any entity, committee, or indenture trustee from being heard in case); *see also In re* Phila. Newspapers, LLC ("*Phila. Newspapers*"), 422 B.R. 553 (Bankr. E.D. Pa. 2010); *In re* Premier Int'l Holdings, Inc. ("*Six Flags*"), 423 B.R. 58, 60 (Bankr. D. Del. 2010) (determining "informal committee" not subject to Rule 2019); *In re* Wash. Mut., Inc. ("*Wash. Mut.*"), 419 B.R. 271, 272, 275 (Bankr. D. Del. 2009) (finding noteholders group to be "ad hoc committee" and granting creditor's motion for group to comply with Rule 2019); *In re* Northwest Airlines Corp. ("*Northwest Airlines II*"), 363 B.R. 704, 709 (Bankr. S.D.N.Y. 2007) (denying ad hoc committee's motion to seal Rule 2019 statement); *In re* Northwest Airlines Corp. ("*Northwest Airlines I*"), 363 B.R. 701, 701 (Bankr. S.D.N.Y. 2007) (finding ad hoc committee's Rule 2019 statement to be inadequate). Two other courts recently have considered the issue—and are evenly split—but those opinions do not contain much detail about the courts' reasoning and thus are not discussed here. *See, e.g.*, Order (A) Compelling The Ad Hoc Noteholder Group To Comply with Fed. R. Bankr. P. 2019; (B) Prohibiting Further Participation in These Cases by the Ad Hoc Noteholder Group Pending Compliance with Fed. R. Bankr. P. 2019; and (C) Directing the Debtors to Withhold Further Payments to or on Behalf of Such Group Pending Compliance with Fed. R. Bankr. P. 2019, *In re Accuride Corp.*, No. 09-13449 (Bankr. D. Del. Jan. 22, 2010), ECF No. 632, *available at* http://accurideinfo.com/pdflib/633_13449.pdf (compelling ad hoc noteholder group's compliance with Rule 2019(a)); Order Denying Scotia Pacific Co. LLC's Motion for an Order Compelling the Ad Hoc Noteholder Group to Fully Comply with Bankruptcy Rule 2019(a) By Filing

would (depending on how you read the rule) require them to disclose the identities of and positions held by their members.[51] Bankruptcy courts have held that Rule 2019 requires ad hoc committee disclosures in two recent cases;[52] they have declined to do so in two others.[53]

The doctrinal issue is whether Rule 2019 applies to any grouping of stakeholders, or only to a group whose representative is formally an "agent."[54]

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a Complete and Proper Verified Statement Disclosing Its Membership and Their Interests, at 2, *In re* Scotia Dev. LLC, No. 07-20027-C-11 (Bankr. S.D. Tex. Apr. 18, 2007), ECF. No. 658, *available at* http://www.akingump.com/docs/publication/972.pdf (denying motion to compel ad hoc noteholder group's compliance with Rule 2019(a)); *see also* Andy Winchell, *How Can We Sleep When Rule 2019 Is Burning?*, BANKR. LITIG. COMM. NEWSLETTER, (Am. Bankr. Inst., Alexandria, Va.), Apr. 2010, http://www.abiworld.org/committees/newsletters/litigation/vol7num5/sleep.html (discussing split of authority regarding application of Rule 2019 and summarizing *Northwest Airlines*, *Scotia*, *Wash. Mutual*, *Six Flags*, *Accuride*, and *Phila. Newspapers*). The issue was also litigated, but ultimately settled, in *In re* Mirant Corp. *See, e.g.*, Notice of Hearing on the Motion of New Mirant Entities to Compel Certain Holders of Class 3 Claims to Comply with Rule 2109 of the Federal Rules of Bankruptcy Procedure, at 1, *In re* Mirant Corp., No. 03-46590 (Bankr. N.D. Tex. May 16, 2007); Press Release, Mirant Corp., Mirant to Complete Settlement with Pepco (Aug. 7, 2007), *available at* http://files.shareholder.com/downloads/MIR/1045464794x0x254457/02990991-24cb-4a50-a4c1-cf9c247a347e/MIR_News_2007_8_9_General.pdf (announcing settlement).

[51] Rule 2019 requires "every entity or committee representing more than one creditor or equity security holder" to file a statement disclosing:

> (1) the name and address of the creditor or equity security holder; (2) the nature and amount of the claim or interest and the time of acquisition thereof . . . ; (3) a recital of the pertinent facts and circumstances in connection with the employment of the entity . . . [and] the name or names of the entity or entities at whose instance, directly or indirectly, the employment was arranged or the committee was organized or agreed to act; and (4) . . . the amounts of claims or interests owned by the entity, the members of the committee or the indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.

FED. R. BANKR. P. 2019(a). The term "entity" is defined in the Bankruptcy Code as any "person, estate, trust, governmental unit, [or] United States trustee." 11 U.S.C. § 101(15) (2006) (defining Code terms). Rule 2019 also requires the prompt filing of supplemental statements upon the occurrence of "any material changes" to the original Rule 2019 statement. FED. R. BANKR. P. 2019(a).

[52] *See Wash. Mut.*, 419 B.R. at 272; *Northwest Airlines I*, 363 B.R. at 709; *see also* Berman & Brighton, supra note 16, at 24.

[53] *See Phila. Newspapers*, 422 B.R. at 567–68; *Six Flags*, 423 B.R. at 60; *see also* Shea, *supra* note 16, at 2615–18 (examining legal history of Rule 2019 and concluding detailed disclosure requirement of Rule 2019 does not apply to ad hoc committees).

[54] *Compare Six Flags*, 423 B.R. at 65 ("[T]he plain meaning of 'represent' contemplates an active appointment of an agent to assert deputed rights."), *and Phila. Newspapers*, 422 B.R. at 567 ("The Court agrees with the reasoning of the [*Six Flags*] Court on this point . . . ."), *with Northwest Airlines I*, 363 B.R. at 703 (dismissing argument Rule 2019 did not apply to ad hoc committee because no committee member represented any other party), *and Wash. Mut.*, 419 B.R. at 274–75 (dismissing argument Rule 2019 did not apply because ad hoc committee could not bind individual members without consent). The *Six Flags* and *Phila. Newspapers* courts also found that a group cannot be a "committee" within the meaning of Rule 2019 unless it is appointed by some larger group. *See Phila. Newspapers*, 422 B.R. at 566 (adopting definition of committee used by court in *Six Flags* case); *Six Flags*, 423 B.R. at 64–65 (defining committee as "a 'body of two or more people *appointed* for some special function by, and usu. out of a (usu. larger) body[]'" (quoting I OXFORD SHORTER DICTIONARY 464 (6th ed. 2007))). But, under the *Six Flags* and *Phila. Newspapers*

While each recent decision purports to be based on the "plain language" of Rule 2019, the real issues seem to be: Who was Rule 2019 intended to protect, and from what?[55] To resolve this, most courts have considered the work of William O. Douglas and his seminal report on the reorganization system.[56]

When Congress passed the Securities Exchange Act of 1934, it instructed the Securities and Exchange Commission to investigate and report on what it perceived to be the failures of the reorganization system of the day.[57] The SEC chose one of the leading bankruptcy scholars of the time, and later Supreme Court justice, William O. Douglas to conduct the investigation and author the report.[58] This report,[59] comprising eight volumes published over several years, became a

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approach, this appointment requirement would be subsumed by the agency requirement of the term "represents." If there is an agency representation, the agent by definition would have been appointed; but if there is no agency representation, the question of appointment would be irrelevant.

[55] *Compare Six Flags*, 423 B.R. at 65–71 (focusing on protecting creditors and shareholders from insider dominance), *and Phila. Newspapers*, 422 B.R. at 567 (adopting *Six Flags* analysis), *with Northwest Airlines I*, 363 B.R. at 703 (focusing on ensuring information availability for court and system participants and noting ad hoc committees "implicitly ask the court and other parties to give their positions a degree of credibility appropriate to a unified group with large holdings"), *and Wash. Mut.*, 419 B.R. at 276 (citing *Northwest Airlines I*). While each court ostensibly based its decision on the plain meaning of Rule 2019, they reach opposite conclusions on both the plain meaning and legislative history analyses. *See, e.g., Phila. Newspapers*, 422 B.R. at 565 ("In four decisions courts have expressly based their ruling on the 'plain meaning' of the text of Rule 2019 but have evenly split on that 'plain meaning.' Further, the two Courts to have most recently and extensively reviewed legislative history (as a fallback) have reached diametrically opposite conclusions as to the import of such extrinsic evidence."). *Compare Six Flags*, 423 B.R. at 72–73 (interpreting legislative history of Rule 2019 to not require disclosure by ad hoc committee), *with Wash. Mut.*, 419 B.R. at 277–79 (requiring disclosure by ad hoc committees after examining legislative history of Rule 2019).

[56] *See, e.g., Six Flags*, 423 B.R. at 68–69 (providing history and thorough analysis of Douglas's SEC report); *Wash. Mut.*, 419 B.R. at 277 (asserting direct predecessor to Rule 2019 was Rule 10-211 under former chapter X of Bankruptcy Act, which was adopted following William O. Douglas's SEC report); *Northwest Airlines I*, 363 B.R. at 704 (citing SEC report as leading directly to adoption Rule 10–211, predecessor to Rule 2019); SEC, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, PART I – STRATEGIES AND TECHNIQUES OF PROTECTIVE AND REORGANIZATION COMMS. 902 (1937) [hereinafter DOUGLAS REPORT] (recommending any person representing twelve or more creditors be required to disclose amount of claims owed, dates of acquisitions, amounts paid for securities, and any sales or transfer of securities).

[57] *See* Daniel J. Bussel, *Coalition-Building Through Bankruptcy Creditors' Committees*, 43 UCLA L. REV. 1547, 1556–57 (1996) (analyzing problem of "insider" creditor committees in receivership reorganization and discussing Douglas Report's criticisms and recommendations for reorganization practices); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1633–38 (recognizing flaws in pre-Chandler Act reorganization and asserting Douglas Report was heavily influential in laying foundation for modern reorganization); Richard E. Mendales, *Intensive Care for the Public Corporation: Securities Law, Corporate Governance, and the Reorganization Process*, 91 MARQ. L. REV. 979, 985–88 (2008) (citing procedural and substantive problems with pre-Chandler Act receivership reorganizations and describing SEC's role in correcting reorganization problems and creating modern reorganization).

[58] *See Six Flags*, 423 B.R. at 68 (citing Douglas's discontent with equity receivership practice as influential on his SEC report); Bussel, *supra* note 57, at 1556 (noting Douglas's "frontal assault" on receivership reorganization practices through Douglas Report); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1633 (asserting SEC chose Douglas to write reorganization report based on Douglas's status as a prominent bankruptcy scholar).

[59] DOUGLAS REPORT, *supra* note 56 (consisting of eight volumes and spanning time frame of eight years).

significant driving force behind the sweeping bankruptcy reforms embodied in the Chandler Act of 1938.[60] "The [Douglas Report] led directly to the adoption of Chapter X [of the Chandler Act] and Rule 10-211 thereunder, which provided for disclosure of the 'personnel and activities of those acting in a representative capacity' in order to help foster fair and equitable plans free from deception and overreaching."[61] With the enactment of the Bankruptcy Reform Act of 1978, Rule 10-211 was replaced by Federal Rule of Bankruptcy Procedure 2019.[62] As the *Six Flags* court noted, it is "readily apparent [that] there is not a single substantive difference between Rule 10-211 and Rule 2019."[63]

The Douglas Report supports both interpretations. On the one hand, Douglas was appalled by the behavior of insiders and their treatment of holdout creditors and shareholders,[64] who essentially faced coercive tender offers in early reorganizations.[65] In the *Six Flags* court's view, Rule 2019 solves a problem that no longer exists,[66] and so is superfluous.[67] On the other hand, Douglas was a proponent

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[60] *See In re* Jeppson, 66 B.R. 269, 278 (Bankr. D. Utah 1986) (asserting chapter X was work of Justice William Douglas and was based on Douglas Report's recommendations); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1637–38 (recognizing Justice Douglas's insight into securities and bankruptcy law as crucial to creation of Chandler Act of 1938); Jessica Wang, *Neo-Brandeisianism and the New Deal: Adolf A. Berle, Jr., William O. Douglas, and the Problem of Corporate Finance in the 1930s*, 33 SEATTLE U. L. REV. 1221, 1236 (2010) (providing detailed analysis of how Douglas Report led to creation of Chandler Act of 1938 and chapter X reorganization).

[61] *Northwest Airlines I*, 363 B.R. at 704 (quoting 13A COLLIER ON BANKRUPTCY, ¶ 10-211.04 (Lawrence P. King et al. eds., 14th ed. 1976)).

[62] *See Six Flags*, 423 B.R. at 71 (indicating "old" Rule 10-211 was adopted as Fed. R. Bankr. P. 2019); *Northwest Airlines I*, 363 B.R. at 704 (finding Rule 2019 under 1978 Bankruptcy Code retained substance of Rule 10-211); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1637 (stating Rule 10-211 was forerunner to Rule 2019).

[63] *Six Flags*, 423 B.R. at 72.

[64] *See* DOUGLAS REPORT, *supra* note 56, at 1–2 (arguing reorganizers sought to serve own interests rather than those of investors); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1635–36 ("Although these reorganizations had the trappings of creditor democracy, Douglas complained that 'not infrequently these devices have been abused in such a way as to cause their functions to be perverted to serve the interests of reorganizers as distinguished from the interests of investors.'" (quoting DOUGLAS REPORT, *supra* note 56, at 1)).

[65] *See, e.g., Six Flags*, 423 B.R. at 67–68 (noting unequal treatment of holdouts, as dissenting creditors and stockholders could not participate in process and received inferior returns than consenting creditors); *In re* Phila. Newspapers, LLC ("*Phila. Newspapers*"), 422 B.R. 553, 561 (Bankr. E.D. Pa. 2010) (citing *In re* Wash. Mut., Inc. ("*Wash. Mut.*"), 419 B.R. 271, 277 (Bankr. D. Del. 2009)) (discussing argument Rule 10-211 was adopted to remedy abuses by "protective committees" that solicited deposits from creditors, who thereby gave up rights in reorganization case to such committees); *Northwest Airlines I*, 363 B.R. at 704 (asserting abuses in equity receiverships and corporate reorganizations led to passage of Rule 10-211 to prevent deception and overreaching).

[66] *See, e.g., Six Flags*, 423 B.R. at 65–71 (discussing legislative history of Rule 2019 as successor to Rule 10-211, which was adopted to implement and enforce strict limitations imposed on protective committees by Chandler Act of 1938, as it was concerned with elimination of dominating and self-serving insider groups).

[67] *See id.* at 73 ("[T]he Chandler Act so effectively curbed the power of protective committees that they virtually ceased to exist within a few years of the Act's passage. Rule 10-211 was, for all intents and purposes, superfluous almost immediately after its passage. There was nothing left to regulate."). Similarly,

of disclosure for the sake of disclosure, and transparency is a major theme in the Douglas Report.[68] The *Northwest Airlines* and *Washington Mutual* courts considered transparency to be paramount and, in this respect, Rule 2019 to be an important tool for protecting the integrity of the system.[69]

The battle to define the scope of Rule 2019 has spilled over from bankruptcy litigation to the federal judicial rulemaking process.[70] Roughly six months after the *Northwest Airlines* decisions, two trade associations that represent claims traders, the Securities Industry and Financial Markets Association ("SIFMA") and the Loan Syndications and Trading Association ("LSTA"), wrote to the Judicial Conference of the United States Courts seeking to repeal Rule 2019 to prevent a repeat of *Northwest Airlines*.[71] They argued that price information is irrelevant to the treatment of bankruptcy claims and could compromise confidential and proprietary trading strategies,[72] and also that the risk of having trading strategies "reverse

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the *Six Flags* court concluded that "Rule 2019 is also, for all intents and purpose, superfluous," and that "the problem it was designed to address by requiring certain disclosures simply no longer exists." *Id.*

[68] *See, e.g.*, Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1676 n.301 (noting Douglas Report "[found] secrecy 'inimical to the interests of investors and creditors as a whole'" (quoting DOUGLAS REPORT, *supra* note 56, at 693–94)).

[69] *See, e.g., Wash. Mut.*, 419 B.R. at 278 ("The predecessor of Rule 2019 was designed to 'provide a routine method of advising the court and all parties in interest of the actual economic interest of all persons participating in the proceedings.'" (quoting DOUGLAS REPORT, *supra* note 56, at 902)); *In re* Northwest Airlines Corp. ("*Northwest Airlines II*"), 363 B.R. 704, 709 (Bankr. S.D.N.Y. 2007) ("Rule 2019 protects other members of the group—here, the shareholders—and informs them where a committee is coming from by requiring full disclosure of the securities held by members of the committee and the respective purchases and sales. . . . Rule 2019 is based on the premise that the other shareholders have a right to information as to Committee member purchases and sales so that they make an informed decision whether this Committee will represent their interests or whether they should consider forming a more broadly-based committee of their own. It also gives all parties a better ability to gauge the credibility of an important group that has chosen to appear in a bankruptcy case and play a major role.").

[70] *See* Hon. Laura Taylor Swain, REPORT OF THE ADVISORY COMMITTEE ON BANKRUPTCY RULES, 6 (May 27, 2010) [hereinafter ADVISORY COMM. REPORT], *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/jc09-2010/2010-09-Appendix-B.pdf (discussing debate over amendments to Rule 2019); *see also Phila. Newspapers,* 422 B.R. at 568 (declining comment but noting upcoming congressional decision on proposed amendments to Rule 2019); *Wash. Mut.*, 419 B.R. at 279 (discussing proposed amendment of Rule 2019).

[71] *See* Letter from Elliot Ganz, General Counsel and Executive Vice President, The Loan Syndications and Trading Ass'n and Sean C. Davy, Managing Director, Corporate Credit Markets Division, Sec. Indus. and Fin. Mkts. Ass'n, to Peter G. McCabe, Sec'y, Comm. on Rules of Practice and Procedure of the Judicial Conference of the United States, Admin. Office of the United States Courts, at 8–9 (Feb. 1, 2010) [hereinafter SIFMA/LSTA Comment Letter], *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/2009%20Comments%20Committee%20Folders/BK%20Comments%202009/09-BK-026-Comment-Ganz%20and%20Davy.pdf (describing disclosure issues implicated by *Northwest Airlines II*); Letter from The Loan Syndications and Trading Ass'n and the Sec. Indus. and Fin. Mkts. Ass'n, to Peter G. McCabe, Sec'y, Comm. on Rules of Practice and Procedure of the Judicial Conference of the United States, Admin. Office of the United States Courts, at 5–6 (Nov. 30, 2007) [hereinafter SIFMA/LSTA Repeal Letter], *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Suggestions%202007/07-BK-G-.pdf (discussing potential harmful impact of Rule 2019 after *Northwest Airlines I*).

[72] *See* SIFMA/LSTA Comment Letter, *supra* note 71, at 2–3; SIFMA/LSTA Repeal Letter, *supra* note 71, at 7. The information was legally irrelevant, they claimed, because the price paid for a claim has no bearing

engineered" would drive distressed debt investors from the market or at least create a deterrent to negotiating with debtors in bankruptcy.[73]

The SIFMA/LSTA call to repeal Rule 2019 drew criticism from Judges Drain and Gerber,[74] who have presided over some of the nation's largest and most complex recent chapter 11 cases.[75] Judges Drain and Gerber both argued that Rule 2019 should be expanded and clarified, not repealed.[76] The Committee of Rules of Practice and Procedure of the Judicial Conference of the United States Courts (the "Rules Committee") seemed to agree, ultimately proposing revisions to Rule 2019 (the "Proposed Rule 2019 Revisions"), which featured an expanded and clarified, rather than a repealed, Rule 2019.[77]

Judge Gerber also requested the opportunity to testify before the Rules Committee regarding the Proposed Rule 2019 Revisions.[78] In his testimony, he agreed partially with SIFMA/LSTA that price information *sometimes* was irrelevant, and indicated that mandatory disclosure of only a general timeframe of acquisition could be acceptable.[79] He cautioned however, that this information sometimes is very important and that the bankruptcy courts should have the

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on how it will be treated under a reorganization plan. *See* SIFMA/LSTA Repeal Letter, *supra* note 71, at 8 (citing *In re* Fairfield Exec. Assocs., 161 B.R. 595, 602–03 (D.N.J. 1993)).

[73] *See* SIFMA/LSTA Comment Letter, *supra* note 71, at 12–14 ("Given the choice between disclosing their highly confidential and proprietary investment strategies, on the one hand, and not participating in the bankruptcy process via membership in an *ad hoc* group, on the other, many may choose either to remain completely silent or, for large holders, to speak only on their own behalf."); SIFMA/LSTA Repeal Letter, *supra* note 71, at 22–24.

[74] *See* Letter from Hon. Robert E. Gerber to Advisory Comm. on Bankr. Rules, c/o Peter G. McCabe, Sec'y, Comm. on Rules of Practice and Procedure, Admin. Office of theUnited States Courts (Jan. 9, 2009), at 4 [hereinafter Gerber Letter], *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Suggestions%202008/08-BK-M-Suggestion-Gerber.pdf (arguing for amendment, rather than repeal, of Rule 2019); Letter from Hon. Robert D. Drain to Advisory Comm. on Bankr. Rules, c/o Peter G. McCabe, Sec'y, Comm. on Rules of Practice and Procedure, Admin. Office of the United States Courts (Jan. 13, 2009), at 1 [hereinafter Drain Letter], *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Suggestions%202008/08-BK-N-Suggestion-Drain.pdf (agreeing with Judge Gerber's Rule 2019 analysis).

[75] Judge Drain has presided over, among others, the *Refco* and *Delphi* cases. *See In re* Delphi Corp., No. 05-44481, 2009 WL 483215 (Bankr. S.D.N.Y. Feb. 25, 2009); *In re* Refco Inc., 336 B.R. 187 (Bankr. S.D.N.Y. 2006). Judge Gerber has presided over, among others, the *General Motors*, *Adelphia*, and *Lyondell Chemical* cases. *See In re* Gen. Motors Corp., 409 B.R. 24 (Bankr. S.D.N.Y. 2009); *In re* Lyondell Chem. Co., 402 B.R. 596 (Bankr. S.D.N.Y. 2009); *In re* Adelphia Commc'ns Corp., 365 B.R. 24 (Bankr. S.D.N.Y. 2007).

[76] *See* Drain Letter, *supra* note 74, at 1 ("Rule 2019 should not be repealed but should, rather, be amended to clarify and . . . broaden its scope."); Gerber Letter, *supra* note 74, at 1 ("I write to urge the Advisory Committee on Bankruptcy Rules to update Bankruptcy Rule 2019—but not to repeal it.").

[77] *See* Hon. Laura Taylor Swain, REPORT OF THE ADVISORY COMMITTEE ON BANKRUPTCY RULES 2 (May 11, 2009), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/proposed0809/BK5-2009.pdf ("Rule 2019 is amended to expand the scope of the rule's coverage and the content of its disclosure requirements.").

[78] E-mail from Hon. Robert E. Gerber, U.S. Bankr. J., S.D.N.Y., (Jan. 7, 2010, 03:57 EST), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/2009%20Comments%20Committee%20Folders/BK%20Comments%202009/09-BK-019-Testify-Gerber.pdf.

[79] *See* Gerber Testimony, *supra* note 18, at 24:15–25:14.

authority to order its disclosure,[80] even if disclosure were limited to cases where proponents made a "strong showing of relevance" to guard against abusive requests under the rule.[81]

Judge Gerber offered this anecdote to explain his view of the utility of Rule 2019 in both deterring and investigating questionable representations by unofficial committees:

> In the *General Motors* case on my watch, a committee that called itself the Unofficial Committee of Family and Dissident ["F & D"] GM Bondholders asked me to appoint them as an official committee, or, more technically, asked me to direct the U.S. trustee to do it. And they opposed the 363 sale of GM that I think many of us know about.
>
> In no less than four pleadings before me, they said in these exact words or very similar words, that they represented over 1500 bondholders with whom the F & D committee has been communicating, with bond holdings believed to exceed $400 million at face value. They went on to say, and please note this, a substantial number of these bondholders invested in GM bonds at or near par values with their pensions and life savings.
>
> Well, especially with statements like those, and consistent with the practice of my district, most recently by Judge Gonzalez in *Chrysler*, who had similarly required compliance with 2019, I required an amended 2019 in compliance clients with the rule.
>
> When that was done, it provided the required information not for 1500 people or a hundred people, but for three people, of whom only one of the three had bought at par, and the 2019 showed that one of the other two had bought at prices from a penny to a dime on the dollar, more than half of which was within two weeks of the GM filing, and that the other guy had bought more than 80 percent of his bonds at 12 cents on the dollar in the month just before the filing.
>
> Well, the contrast between what was said and applied to me in those pleadings and what the 2019 revealed was dramatic. Disclosure of the truth didn't affect the allowability of their claims. . . . But it painted a very different picture of the message that they were trying to communicate to me.[82]

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[80] *See id.* at 25:14–25:22.
[81] *Id.* at 25:24–26:5.
[82] *Id.* at 21:3–22:10.

While the Rule 2019 disclosure in *General Motors* allowed the parties to know with whom they were dealing, it did not affect the actual positions of the parties or prevent any action by the ad hoc committee.

Judge Gerber's discussion of *General Motors* exposes the gap between our reorganization system's information policy and its information rules. Rule 2019 has remained virtually unchanged since its predecessor, Rule 10-211, was adopted.[83] Yet, the reorganization system today is radically different from the system Douglas found in the 1930s.[84] The *Six Flags* court may well be correct that the specific problem the original rule solved—coercive tender offers by corporate insiders—no longer exists in that form. Yet, examples like Judge Gerber's *General Motors* anecdote indicate that there remains a real need for meaningful disclosure. If nothing else, today's fights about Rule 2019 are, in a sense, evidence that there is a mismatch between information policy as embedded in existing rules and the current needs of the system. If the Rule worked, most would comply with it, and courts would have little trouble policing transgressions. That, of course, has not been the case.[85]

To be sure, there has been some progress. After consideration of the comments submitted and testimony given at two hearings, the Rules Committee amended the Proposed Rule 2019 Revisions (the "Amended Rule 2019 Revisions") and unanimously recommended their approval by the Judicial Conference.[86] The Amended Rule 2019 Revisions modernize Rule 2019 insofar as they remove the purported agency requirement and extend coverage to interests not contemplated by the original drafters, such as derivatives and short positions.[87]

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[83] *See* FED. R. BANKR. P. 2019; *In re* Phila. Newspapers, LLC ("*Phila. Newspapers*"), 422 B.R. 553, 559 (Bankr. E.D. Pa. 2010) (noting 1978 Bankruptcy Code and rules thereunder did not substantively change Rule 10-211 in Rule 2019); *In re* Premier Int'l Holdings, Inc. ("*Six Flags*"), 423 B.R. 58, 72 (Bankr. D. Del. 2010) ("[It is] readily apparent [that] there is not a single substantive difference between Rule 10-211 and Rule 2019.").

[84] *See Six Flags*, 423 B.R. at 71 (describing changes in bankruptcy reorganization after adoption of Chandler Act); *In re* Northwest Airlines Corp. ("*Northwest Airlines II*"), 363 B.R. 704, 708 (Bankr. S.D.N.Y. 2007) ("Much has changed in reorganization practice since the 1930's, but the disclosure required by what is now Bankruptcy Rule 2019 is substantially the same. The facts of this case illustrate why public disclosure is still needed.").

[85] *See, e.g.*, *In re* Wash. Mut., Inc. ("*Wash. Mut.*"), 419 B.R. 271, 273 (Bankr. D. Del. 2009) (providing background to dispute over interpretation of Rule 2019); Christopher J. Updike & Michael A. Stevens, *Rule 2019 and Its Applicability to Ad Hoc Committees*, RESTRUCTURING REVIEW (Cadwalader, Wickersham & Taft LLP, New York, N.Y.), Apr. 2010, at 14, http://www.cadwalader.com/assets/newsletter/RR_April_2010.pdf ("Rule 2019 is now frequently raised by parties seeking to use the threat of compliance with Rule 2019 as a strategic tool in bankruptcy negotiations."); *see also* Gerber Testimony, *supra* note 18, at 20:3-20:7 ("[I]n *Six Flags*, litigants tried to enforce [Rule] 2019 against a constituency that they were negotiating against or litigating against, but they conveniently forgot to do the same thing vis-a-vis their allies.").

[86] *See* ADVISORY COMM. REPORT, *supra* note 70, at 6–7 (describing proposed amendments to Rule 2019 and recommending approval by Judicial Conference).

[87] *See Phila. Newspapers*, 422 B.R. at 555 (noting expansion of coverage embodied in proposed amendments to Rule 2019); *Wash. Mut.*, 419 B.R. at 279 (acknowledging importance of amended Rule 2019

But the Amended Rule 2019 Revisions fail to address the deeper question: What policy goal—if any—do they advance? Since, as Judge Gerber noted, the information obtained through Rule 2019 disclosures often will not affect the allowability of claims, system participants in many cases either will not need this disclosure at all, or will need different information in a different form (*e.g.*, through on-line trading and reporting platforms). As long as Rule 2019 requires disclosure of information that is potentially useless to its recipients but is inherently costly to disclosing parties, strategic litigation surrounding Rule 2019 will continue.

2. Rule 3001 and Claims Trading

If fights over Rule 2019 are trench warfare, battles over Rule 3001 are a cold war. This is because Rule 3001 historically has been an administrative-efficiency rule, not an information-forcing rule, even though it might have both effects. "Rule 3001(e) is largely designed to aid a debtor in determining who should receive distributions under a plan (or otherwise). It is not designed to tell the debtor or its other stakeholders information that would aid negotiations or prevent misconduct."[88] Prior to the amendment of Rule 3001 in 1991,[89] approval of the bankruptcy court was required before a claim could be traded after its proof of claim was filed.[90] "Now, claims trade without notice, disclosure of the purchase

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in face of short-selling and derivative positions); ADVISORY COMM. REPORT, *supra* note 70, at 25, 30, 31 (describing proposed amendments to Rule 2019).

[88] Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1647–48; *see* Resurgent Capital Servs. v. Burnett (*In re* Burnett), 306 B.R. 313, 319 (B.A.P. 9th Cir. 2004), *aff'd*, 435 F.3d 971 (9th Cir. 2006) (noting amended Rule 3001(e) does not require disclosure of information such as consideration for transfer); *In re* Crosscreek Apartments, Ltd., 211 B.R. 641, 646 n.7 (Bankr. E.D. Tenn. 1997) ("Compliance with Rule 3001(e) appears designed primarily to meet the due process requirement that a creditor be given notice and an opportunity to object to any purported transfer of its claims against the estate.").

[89] Rule 3001(e) provides that, "[i]f a claim other than one based on a publicly traded note, bond, or debenture has been transferred . . . after the proof of claim has been filed, evidence of the transfer shall be filed by the transferee." FED. R. BANKR. P. 3001(e).

[90] The pre-1991 amendment version of Bankruptcy Rule 3001(e) provided, in relevant part:

> Transferred Claim.
> (1) Unconditional Transfer Before Proof Filed. If a claim other than one based on a bond or debenture has been unconditionally transferred before proof of the claim has been filed, the proof of claim may be filed only by the transferee. If the claim has been transferred after the filing of the petition, the proof of claim shall be supported by (A) a statement of the transferor acknowledging the transfer and stating the consideration therefor or (B) a statement of the transferee setting forth the consideration for the transfer and why the transferee is unable to obtain the statement from the transferor.
> (2) Unconditional Transfer After Proof Filed. If a claim other than one based on a bond or debenture has been unconditionally transferred after the proof of claim has been filed, evidence of the terms of the transfer shall be filed by the transferee. The clerk shall immediately notify the original claimant by mail of the filing of the evidence of transfer and that objection thereto, if any, must be filed with the clerk within 20 days of the mailing of the notice or within any additional time allowed by the court. If the court finds, after a hearing on notice, that the claim has been unconditionally transferred, it

price, or any judicial oversight at all, except when there is a challenge to the authenticity of the transfer."[91] More accurately, then, there are no battles over Rule 3001, as there are over Rule 2019; in the context of claims trading, the important information just slips past, unnoticed.

The 1991 amendment to Rule 3001 is not entirely to blame, but it is a contributing factor. For instance, Rule 3001 requires notice of transfers of the economic rights of a claim—who gets the money—but not the control rights—who gets to vote.[92] Thus, if the voting rights and economic rights are decoupled, either a Rule 3001 disclosure will not be required (if only the voting rights are transferred), or the Rule 3001 disclosure that is filed might be meaningless beyond mere administrative convenience for the debtor (if only the economic rights are transferred).[93] If it were still in effect today, the pre-amendment Rule 3001 would not require the substantive disclosure to catch this, but it would at least give the courts—being familiar with modern practices—the *ex ante* opportunity to inquire.

Recent proposed amendments to Rule 3001 will do nothing about this issue, as they apply only in cases of "individual" debtors.[94] At any rate, the proposed amendments still have an administrative focus; they primarily introduce stricter

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> shall enter an order substituting the transferee for the original claimant, otherwise the court shall enter such order as may be appropriate.

FED. R. BANKR. P. 3001(e)(1)–(2), codified at 11 U.S.C. app. at 246 (1988), *amended by* 11 U.S.C. app. at 348 (2006).

[91] Lipson, *Shadow Bankruptcy*, *supra* note 6 at 1647 (citation omitted) (indicating courts have less control over claims trading after 1991 amendment because court approval is no longer necessary); *see* Geoffrey Groshong, *Trading Claims In Bankruptcy: Debtor Issues*, 10 AM. BANKR. INST. L. REV. 625, 642 (2002) (concluding debtors have viable options to gain control over claims-trading despite lack of judicial intervention); Michael H. Whitaker, Note, *Regulating Claims Trading In Chapter 11 Bankruptcies: A Proposal for Mandatory Disclosure*, 3 CORNELL J.L. & PUB. POL'Y 303, 319 (1994) (stating amended Rule 3001(e) reduced court oversight of claims trading).

[92] *See, e.g.*, FED. R. BANKR. P. 3001(e)(1)–(4) (requiring notice of certain claim transfers); *see also* Lipson, *Shadow Bankruptcy*, *supra* note 6 at 1648–49 (observing Rule 3001(e) does not seem to require creditors filing notice of transfer to indicate who holds right to vote); Whitaker, *supra* note 91, at 322 ("While Rule 3001(e) precludes courts from using it as a basis for regulation of claims trading, courts can still use other sections of the Bankruptcy Code to regulate claims trading.").

[93] *See, e.g.*, Kevin J. Coco, *Empty Manipulation: Bankruptcy Procedure Rule 2019 and Ownership Disclosure in Chapter 11 Cases*, 2008 COLUM. BUS. L. REV. 610, 620 (2008) (reasoning creditor's position under Rule 3001(e) may enable creditor to use voting power to reduce value of claims and realize return on net short position); Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 815–16 (2006) (remarking current rules require minimal disclosure, focusing on voting power rather than economic ownership); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1648–49 (arguing lead banks may obtain "empty voting" rights in excess of economic stake under Rule 3001(e)).

[94] *See* Proposed Amendments to the Federal Rules of Bankruptcy Procedure, Rule 3001(c)(2) (August 2009), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/proposed0809/BK_Rules_Forms_Amendments.pdf (suggesting procedural requirements for claims against individual debtors). The only change to Rule 3001 to be approved by the Rules Committee and forwarded to the Judicial Conference is the addition of Rule 3001(c)(2), which is entitled "Additional Requirements in an Individual Debtor Case; Sanctions for Failure to Comply." *Id.*

requirements for proving ownership and amounts of claims,[95] proposed to protect individual debtors in the wake of perceived abuses and sloppy record keeping by the consumer lending industry.

C. Motions to Seal

A third context in which we fight about information involves requests to seal documents under section 107 of the Bankruptcy Code. Section 107 provides that all filings in a bankruptcy case and the dockets themselves are public records.[96] The statute permits the court to seal a particular filing if it contains: (1) "a trade secret or confidential research, development, or commercial information;"[97] (2) "scandalous or defamatory matter[s];"[98] or (3) information, the disclosure of which would create an "undue risk of identity theft or other unlawful injury to the individual or the individual's property."[99] Sealing is mandatory in the first two cases if requested by a

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[95] *See, e.g.*, *id.* at Rule 3001(c)(1) (requiring proofs of claim for revolving consumer credit agreements to be accompanied by most recent account statement); *id.* at Rule 3001(c)(2) (requiring proofs of claim in individual debtor cases to be accompanied by itemized statements of interest, fees, expenses, if claim holder seeks to recover same in addition to principal).

[96] 11 U.S.C. § 107(a) (2006) ("Except as provided in subsections (b) and (c) of this section and subject to section 112, a paper filed in a case under this title and the dockets of a bankruptcy court are public records and open to examination by any entity at reasonable times without charge.").

[97] *Id.* § 107(b)(1). Commercial information has been defined as information that would cause "an unfair advantage to competitors by providing them information as to the commercial operations of the debtor." Video Software Dealers Ass'n. v. Orion Pictures Corp. (*In re* Orion Pictures Corp.), 21 F.3d 24, 27 (2d Cir. 1994) (quoting Ad Hoc Protective Comm. for 10 1/2% Debenture Holders v. Itel Corp. (*In re* Itel Corp.), 17 B.R. 942, 944 (B.A.P. 9th Cir. 1982)); *see also In re* 1031 Tax Group, LLC, No. 07-11448, 2007 WL 1836525 at *2 (Bankr. S.D.N.Y. June 22, 2007) (noting confidential commercial information under section 107(b) need not rise to level of trade secrets); *In re* Handy Andy Home Improvement Ctrs., Inc., 199 B.R. 376, 382 (Bankr. N.D. Ill. 1996) (stating commercial documents must provide unfair advantages to competitors, as mere commercial use is not grounds for exclusion under section 107(b)(1)). Examples of the types of information courts have sealed as commercial information include licensing and other agreements entered into by the debtor where disclosure would impair the debtor's ability to negotiate similar agreements with other parties, *In re Orion Pictures*, 21 F.3d at 28, and a physician contracting agency debtor's physician lists to prevent competitors from recruiting the physicians away from the debtor, *In re Frontier Group, LLC*, 256 B.R. 771, 773–74 (Bankr. E.D. Tenn. 2000).

[98] 11 U.S.C. § 107(b)(2). Courts have held that, to avail itself of the mandatory exception for defamatory material under section 107(b)(2), "an interested party must show (1) that the material at issue would alter his reputation in the eyes of a reasonable person, and (2) that the material is untrue or that it is potentially untrue and irrelevant or included for an improper end." *In re* Gitto Global Corp., 422 F.3d 1, 16 (1st Cir. 2005).

[99] 11 U.S.C. § 107(c). Congress introduced section 107(c) as part of the 2005 BAPCPA amendments. Bankruptcy Abuse Prevention and Consumer Prevention Act of 2005, Pub. L. No. 109-8, § 234, 119 Stat. 23, 74-75 (codified at 11 U.S.C. § 107(c)(1)). Being relatively new, there is very little, if any, case law applying the identity theft exception in section 107(c). Prior to the enactment of BAPCPA, however, the *Kaiser Aluminum* court restricted access to information relating to the representation of mass tort litigants with claims against the debtor by preventing electronic docket access. *In re* Kaiser Aluminum Corp., 327 B.R. 554, 560 (D. Del. 2005). The court based its decision on a balancing of the mass-tort litigants' privacy rights against the public's interest in access, *id.* at 559, but post-BAPCPA, this case probably would have fallen squarely within the bounds of section 107(c).

party in interest.[100] Sealing is discretionary in the third case (and if raised *sua sponte* in the first two cases).[101] Still, the interest in promoting open and accessible information is strong, and courts have unsealed filings where the grounds for the exception subsequently ceased to exist.[102]

As we further professionalize and privatize chapter 11 (through the use of turnaround professionals and incentive compensation programs), it is not surprising that fights will erupt about the disclosure of retention agreements and compensation structures. In several recent cases, for example, debtors have obtained orders sealing the pleadings used to establish retention bonus programs, even over the objections of creditors.[103] For instance, in *In re Georgetown Steel Co.*,[104] the court sealed the names of, and information about, the salaries and benefits packages of fourteen key employees that the debtor sought to retain through a key employee retention program ("KERP").[105] The United States Trustee opposed the debtor's motion to seal, but eventually conceded that disclosure of only a description of the key employees' duties and the total amounts allocated to each category of the KERP would be sufficient.[106] The court concluded that the remaining information about the KERP could be sealed as confidential commercial information under section 107(b)(1) because the evidence showed that:

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[100] *See* 11 U.S.C. § 107(b) ("On request of a party in interest, the bankruptcy court shall . . . [seal documents]."); *see also, e.g., In re* Barney's, Inc., 201 B.R. 703, 708–09 (Bankr. S.D.N.Y. 1996) (stating courts required to seal corporate information when requested by interested parties if information would afford competitors unfair advantages); *In re* Phar-Mor, Inc., 191 B.R. 675, 680 (Bankr. N.D. Ohio 1995) (granting plaintiff leave to withdraw complaint within thirty days or else it would be sealed because complaint contained scandalous and defamatory information).

[101] *See* 11 U.S.C. § 107(b) ("[O]n the bankruptcy court's own motion, the bankruptcy court may . . . [seal documents]."); *id.* § 107(c)(1) ("The bankruptcy court, for cause, may . . . [seal documents]."); *see also* 3 COLLIER ON BANKRUPTCY, ¶ 107.04, at 107-11 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009) ("Section 107(c) gives the court broad discretion to protect an individual with respect to any information . . . .").

[102] *See In re* Alterra Healthcare Corp., 353 B.R. 66, 76–77 (Bankr. D. Del. 2006) (unsealing documents filed in bankruptcy proceeding after motion to seal previously had been granted).

[103] *See, e.g., In re* Allied Holdings, Inc., 337 B.R. 716, 717 & n.1 (Bankr. N.D. Ga. 2005) (overruling objection of Teamsters Union and sealing names of KERP participants); *In re* Georgetown Steel Co., 306 B.R. 542, 548 (Bankr. D.S.C. 2004) (sealing names of key employees under KERP over objection by United States Trustee); *see also* Transcript of Proceedings at 4:11-14, 6:20-8:15, *In re* Nellson Nutraceutical, Inc., No. 06-10072 (Bankr. D. Del. July 21, 2006), ECF No. 495 (sealing hearing regarding management incentive plan); Order Approving Debtors' Motion, Pursuant to Bankruptcy Code Section 107(b) and Fed. R. Bankr. P. 9018, to Seal Record of Proceedings Relating to the Debtors' Motion for Entry of Order Authorizing Debtors to Honor Prepetition Incentive-Based Bonus Plan Pursuant to Sections 363 and 105 of the Bankruptcy Code, *In re* Werner Holding Co., No. 06-10578 (Bankr. D. Del. Aug. 8, 2006), ECF No. 297 (sealing record of proceedings regarding Incentive-Based Bonus Plan); Order Authorizing the Filing Under Seal of an Exhibit to the Motion of the Debtors for an Order Authorizing the Debtors to Make Certain Payments Pursuant to a Management Incentive Plan, *In re* Pliant Corp., No. 06-10001 (Bankr. D. Del. Mar. 8, 2006), ECF No. 307 (sealing exhibit relating to Buck Compensation Review).

[104] 306 B.R. 542 (Bankr. D.S.C. 2004).

[105] *Id.* at 544.

[106] *Id.* at 545, 548.

> disclosure . . . could (a) provide competitors an advantage in their efforts to recruit the [k]ey [e]mployees away from the Company; (b) place the [k]ey [e]mployees at risk for potential repercussions as has occurred in the past; and (c) disrupt the internal equity and cause extreme disharmony among the remaining employees.[107]

If the objective of chapter 11 is to promote the restructuring and preservation of going concerns, then preventing competitors from recruiting key employees may be a legitimate goal; but if we decide to treat bankruptcy like any other market, perhaps this type of recruiting should be allowed.

Some parties even try to seal their own mandatory disclosures. In *Northwest Airlines II*, after a failed attempt to avoid the disclosure requirements of Rule 2019,[108] an ad hoc committee filed a motion to seal its Rule 2019 disclosures, arguing that sealing was required under section 107(b)(1) to protect its members' commercial information—their "trading strategies."[109] The court rejected this "improbable contention," however, and it appears that counsel conceded in argument that trading strategies were not the real issue.[110] Rather, it appears that the committee's true concern was protecting its members' "bargaining position" by not giving "counterparties an unfair advantage [from knowing the members'] basis or acquisition cost of the assets [they] were trying to sell."[111] "Just as car dealers do not disclose to customers their actual acquisition cost of their cars," one committee member explained "and builders do not disclose to potential home buyers their actual cost to build homes, we do not disclose to potential counterparties our basis in our investments."[112]

Judge Gropper was unmoved. "The Committee members do not advance their position when they compare themselves to car or real estate salesmen," he wrote.[113] Since the trading strategies were not at issue, "[t]here [was] thus no basis for the contention that [section] 107(b)[(1)], as construed in *Orion*,[114] mandates that the information required by Rule 2019 be sealed on request."[115] Implicit in this

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[107] *Id.* at 546. It is difficult to imagine how placing key employees "at risk for potential repercussions" is relevant to the confidential commercial information determination. *Id.* Citing several prior acts of violence against the key employees and other management figures, the court noted that, "[w]hile potential harm to individuals is not one of the delineated factors under § 107(b), all parties agreed that the safety of the [k]ey [e]mployees is something that should be considered based on the facts and circumstances of this case." *Id.* at 548.

[108] *See supra* Part II.B.1.

[109] *In re* Northwest Airlines Corp. ("*Northwest Airlines II*"), 363 B.R. 704, 707 (Bankr. S.D.N.Y. 2007).

[110] *Id.*

[111] *Id.* at 708 (quoting Daniel Krueger Decl. at 3).

[112] *Id.*

[113] *Id.*

[114] See *supra* note 97 for a description of the *Orion* test. *In re* Orion Pictures Corp., 21 F.3d 24, 27 (2d Cir. 1994) (defining commercial information as causing "an unfair advantage to competitors by providing them information as to the commercial operations of the debtor").

[115] *Northwest Airlines II*, 363 B.R. at 707.

statement is the finding that damage to the ad hoc committee's bargaining position resulting from the disclosure of their acquisition costs did not constitute the unfair advantage to competitors required by the *Orion* test to make sealing mandatory under section 107(b)(1). Where the mandatory provisions of section 107(b) do not apply, "[t]he Court's duty instead is to enforce Bankruptcy Rule 2019 in a manner consistent with protecting the legitimate rights of the parties and the public interest, keeping in mind that [section] 107(b) provides a broader mandate in favor of sealing documents than applies in non-bankruptcy cases."[116]

Professionals also want to conceal their activities. In *Computer Learning Centers*, for example, counsel for the chapter 7 trustee "unilaterally" filed its fee application under seal, asserting that the time records were privileged.[117] The court explained that "[p]rivileged material is not usually included in original time records; however, if it is included in the firm's copy of the time records, it may be redacted from the filed document. Nonetheless, sufficient non-privileged information must be provided so that the court can evaluate the application."[118] The court then described the fundamental problem with filing a fee application under seal. "[F]iling it under seal deprived interested creditors from any meaningful review of the fee application. They, of course, are the very ones who are, effectively, paying [the trustee's counsel]."[119]

These are not the only creative motions to seal. Some have tried to seal information about the size of tort claim settlements, claiming that it is commercial information because other tort victims who knew the settlement terms would obtain an unfair advantage in settlement negotiations.[120] Others have tried to seal tort claim settlement information as defamatory or scandalous.[121] Still others have tried to seal allegations of fraud and mismanagement as defamatory or scandalous material.[122]

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[116] *Id.*

[117] *In re* Computer Learning Ctrs., Inc., 272 B.R. 897, 907 n.8 (Bankr. E.D. Va. 2001).

[118] *Id.*

[119] *Id.*

[120] *See, e.g.*, Geltzer v. Andersen Worldwide, No. 05-CV-3339, 2007 WL 273526, at *3 (S.D.N.Y. Jan. 30, 2007) (denying motion to seal settlement agreement claimed to be "confidential 'commercial information'"); *In re* Quigley Co., No. 04-15739, 2010 WL 3528818, at *36–38 (Bankr. S.D.N.Y. Sept 8, 2010) (denying motion to seal settlement claimed to be "commercial information"); *Northwest Airlines II*, 363 B.R. at 708 n.8 (noting preservation of leverage does not typically justify sealing of records).

[121] *See, e.g.*, Neal v. Kan. City Star, 461 F.3d 1048, 1053–54 (8th Cir. 2006) (holding list of creditors did not constitute scandalous material and was thus improperly sealed); Powers v. Odyssey Capital Group, LLC (*In re* Mesaba Aviation, Inc.), 418 B.R. 756, 763 (B.A.P. 8th Cir. 2009) (citation omitted) (denying claimant's motion to seal application for *in forma pauperis* status, as mere damage to reputation is insufficient to deny public access under scandalous or defamatory exception); *In re* Alterra Healthcare Corp., 353 B.R. 66, 77 (Bankr. D. Del. 2006) (granted but later vacated). The *Alterra* court originally granted the unopposed motion to seal settlement information. *Id.* at 69. More than a year later, a newspaper filed a motion to intervene in the case for the sole purpose of requesting that the settlement information be unsealed. *Id.* The court found that none of the section 107 exceptions applied and vacated its original sealing order. *Id.* at 75–77.

[122] *See, e.g., In re* Gitto Global Corp., 422 F.3d 1, 14–15 (1st Cir. 2005) (finding examiner's report containing allegations of fraud and mismanagement could not be filed under seal); *In re* Food Mgmt. Group,

These motions—whether successful or not—incite conflict which, in turn, bespeaks the value of the information and the cost of seeking and fighting its production.

D. The Gap Period

The most challenging informational conflicts are likely to occur before (or in lieu of) chapter 11, during the gap between the announcement of a debt covenant default (*e.g.*, on Form 8-K) and the filing of a bankruptcy petition (or other resolution of financial distress). None of the ordinary information-control mechanisms are useful during this post-default gap, so information asymmetry is likely greatest here.

Prior to the filing of a bankruptcy petition, the informational tools provided by the Bankruptcy Code are not available: Because no case is yet commenced, there are no examiners, no ad-hoc committee disclosures under Rule 2019, and no claim transfer disclosures under Rule 3001.[123] At the same time, while the change-of-control disclosure mechanisms provided by the Securities Exchange Act of 1934 (the "1934 Act")—sections 13(d), 14(d), and 14(e) and the rules enacted thereunder—technically do apply, they generally require only the disclosure of acquisitions of equity interests—stock.[124] But in the post-default gap, it is the

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LLC, 359 B.R. 543, 561 (Bankr. S.D.N.Y. 2007) (denying motion to seal because "mere embarrassment or harm caused to the party is insufficient to grant protection under [scandalous or defamatory exception of section] 107(b)(2)"); *In re* Hope, 38 B.R. 423, 425 (Bankr. M.D. Ga. 1984) (finding allegations of fraud in complaint to be insufficient grounds to seal record).

[123] *See* 11 U.S.C. § 1104 (2006) (authorizing court to order appointment of examiner "[a]t any time after the commencement of the case but before confirmation of a plan"); *In re* North Bay Gen. Hosp., 404 B.R. 443, 456 (Bankr. S.D. Tex. 2009) (footnote and citation omitted) (explaining goal of Rule 2019 is "complete disclosure during the business reorganization process"); *In re* Armstrong, 320 B.R. 97, 104–05 (Bankr. N.D. Tex. 2005) (asserting Rule 3001 allows debtor and chapter 13 Trustee to have information sufficient to determine validity of claims).

[124] *See* Securities Exchange Act of 1934, ch. 404, 48 Stat. 881, 894–95 (codified as amended at 15 U.S.C. §§ 78m–78n (2006)); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1630–31. There are two 1934 Act control-disclosure mechanisms that could apply but are ineffective during the post-default gap:

> . . . The first, section 13(d) of the 1934 Act, requires any person or group that becomes the owner of more than five percent of any class of publicly traded equity securities to file (within ten days) with the issuer and the SEC a statement setting forth the person's background, the source of funds used for the acquisition, the purpose of the acquisition, the number of shares owned, and any relevant contracts, arrangements or understandings. The purpose of Rule 13d-1 is fairly clear: it enables an equity issuer and its other shareholders to know whether someone is acquiring enough shares to influence the issuer's governance. The problem is that this rule does not apply to "straight" debt securities. Its application to derivative and short positions is uncertain.
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> Similarly, rules that require disclosure of tender offers are likely to have little force here. The Williams Act regulates tender offers at the federal level prescribing, among other things, filing, disclosure, and dissemination requirements, and is incorporated in sections 14(d) and (e) of the 1934 Act. While section 14(d) applies only to tender offers for equity securities registered under section 12 of the 1934 Act, section 14(e) applies to any tender offer, including those for debt securities. The net effect is

acquisition of debt that will deliver control of a distressed company. As one of us wrote in *Shadow Bankruptcy*:

> Thus, there is a gap: prior to bankruptcy, we require disclosure for those who seek to control a firm by obtaining its shares, but not if they seek to control a firm by obtaining its debt. When a firm is solvent, this gap does not matter, since creditors will not exercise the sort of control that concerns the securities laws: they are unlikely to affect the composition of a firm's board or management, make basic investment and strategic decisions for the firm, and so on.
>
> All of this changes, however, once a firm is in distress. As practitioners have long known – and as theoretical and empirical literature now confirm – once a firm is in financial trouble, creditors take control and equity holders take a back seat. This transfer of power tends to follow a conventional understanding of the priority that creditors generally have over shareholders in the repayment of firm obligations. . . . When a firm is in distress, creditors—not shareholders—call the shots.[125]

Disputes about the control of information in this context might not be litigated as frequently as Rule 2019 filings. But the stakes are extremely high here, and opportunities to abuse information asymmetries even higher.

Consider the case of Kellwood Co. In July 2009, Kellwood, a large U.S. apparel supplier, was nearly forced into bankruptcy apparently because its largest bondholder, Deutsche Bank, refused to participate in an exchange offer.[126] Although Deutsche initially had agreed to restructure Kellwood's debt, it unexpectedly withdrew its support for a debt restructuring, waiting until after the debt was in default for more than three days to agree to new debt repayment terms.[127]

Kellwood, which owns several clothing brands, including Phat Farm and Sag Harbor, said that bondholders including Deutsche Bank had agreed to exchange a

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> that a tender offer for debt securities need only comply with the anti-fraud rules of section 14(e) and not with the more fulsome registration and disclosure rules of section 14(d).

Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1630–31 (footnotes omitted).

[125] *Id.* at 1632 (footnotes omitted).

[126] *See* Karen Brettell, *CDS May Have Prompted Deutsche Delay on Kellwood-Traders*, REUTERS, July 24, 2009, *available at* http://www.reuters.com/article/idUSN2447969420090724; Peter Lattman, *Corporate News: Kellwood Faces Debt Deadline—Apparel Maker Considers Bankruptcy Filing in Blow to Buyout Firm*, WALL ST. J., July 11, 2009, at B5.

[127] *See* Brettell, *supra* note 126; Brad Dorfman & Caroline Humer, *Kellwood Could Face Bankruptcy – WSJ*, REUTERS, July 10, 2009, *available at* http://www.reuters.com/article/idUSN1033402820090710; Lattman, *supra* note 126.

$140 million bond that came due in early July 2009 for new senior secured debt maturing in 2014.[128] Although Kellwood representatives said they had "no idea" why the bank changed its mind, there was "widespread speculation" that Deutsche Bank owned credit default swaps linked to Kellwood debt.[129] The CDS apparently would pay after a three-day grace period lapsed.

> Traders have speculated that the bank may have held so-called negative basis trades, in which they owned the bonds and also owned CDS protection.
>
> In this case, the bank would have profited from payments from the CDS contracts, which are expected to stand at around 80 percent of the insurance bought.
>
> The company would also have gained from exchanging its bonds, which traded at 23 cents on the dollar on Thursday, for new debt that is expected to trade at its full value, traders said.[130]

In short, and as academics have observed with respect to other categories of lenders, this extreme form of information asymmetry may create or magnify perverse incentives to see pre–bankruptcy workouts fail.[131]

Private investors also might use inside information obtained in the gap period to short a debtor's shares. Recent research by Massoud et al. finds evidence that hedge funds as lenders may be short-selling borrower equity before the announcement of a hedge fund loan.[132] They will do this because they know that shares of borrowers decline in value when they announce a loan (or loan amendment) with a hedge fund. As lenders, they will be "privy to private information about the performance of borrower firms around both loan originations and loan renegotiations" and thus "quasi-insiders."[133] Armed with this information, they will short the borrower's equity before the announcement, betting in essence that the firm's share price will decline—which it will do on the announcement.[134]

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[128] *See* Brettell, *supra* note 126; Dorfman & Humer, *supra* note 127; Lattman, *supra* note 126.

[129] Dorfman & Humer, *supra* note 127; *see also* Brettell, *supra* note 126; Lattman, *supra* note 126.

[130] Brettell, *supra* note 126.

[131] *See* Viral V. Acharya & Timothy C. Johnson, *Insider Trading in Credit Derivatives*, 84 J. FIN. ECON. 110, 138 (2007) (summarizing concern over hedging by banks with access to privileged information). *See generally* Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1618 (discussing private investors' incentives to realize short-term value at the expense of debtor's reorganization); Marshall E. Tracht, *Insider Guaranties in Bankruptcy: A Framework for Analysis*, 54 U. MIAMI L. REV. 497, 520 (2000) (describing insider guaranty's mitigation of "perverse pre–bankruptcy incentives").

[132] Nadia Massoud et al., *Do Hedge Funds Trade on Private Information? Evidence From Syndicated Lending and Short-Selling*, J. FIN. ECON. (forthcoming), *available at* http://ssrn.com/abstract=1462561 (finding companies borrowing from hedge fund lenders experience aggressive short-selling of equity prior to public announcement of loans, suggesting abuses of insider information).

[133] *Id*. at 1.

[134] *See id.* at 2 ("Overall, our results are consistent with the notion that the equity of the hedge fund borrowers [is] short-sold *prior to* public announcements of loan originations."); *see also* Jenny Anderson, *As*

The problem with the opacity of the gap period is that there might not be a light at the end of the tunnel. The bankruptcy disclosure mechanisms will be of no use if a company that enters the gap period does not file for bankruptcy. Indeed, at least according to data predating the Great Credit Seizure of 2008,[135] most will not.[136] This may not always be a bad thing, as many "firms with covenant defaults often end up performing quite well" despite declining to file for bankruptcy.[137] Yet, the important question, especially in a world after the collapse of *Lehman Brothers,* and in which private investors remain largely unregulated in the reorganization context, is whether our information rules help or hinder reorganization policy.

III. CONTROLLING INFORMATION IN REORGANIZATION—TOWARD A COHERENT INFORMATION POLICY

The foregoing discussion shows that fights about information and information-forcing rules are increasingly common in reorganization. They are problematic for obvious reasons. From an economic perspective, they are evidence of agency and transaction costs without apparent benefit. Fights about the interpretation of information-forcing rules (*e.g.*, Rule 2019, section 107) impose costs on debtors and the judicial system. Concealing the conflict inherent in certain combinations of positions creates incentives to see reorganizations fail. These and similar information failures produce opportunities for rent seeking that is especially galling in the context of troubled firms, where one investor's opportunism may spell disaster for a debtor's many other stakeholders.

At a social level, such fights suggest an environment in which guile, suspicion and speed increasingly displace trust and confidence in the system. Reorganization depends heavily on negotiation to reallocate a debtor's losses. Negotiation, in turn,

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Lenders, Hedge Funds Draw Insider Scrutiny, N.Y. TIMES, Oct. 16, 2006, at A1 (discussing SEC scrutiny of hedge funds poised to exploit confidential insider information as debt holders); Gregory Zuckerman, *Hedge-Fund Lending Draws Scrutiny*, WALL. ST. J., July 3, 2010, at B1 ("Traders say a fund might seek short-term gains from a potential tumble [in share prices] when word emerges that a company has turned to hedge funds for a high-rate loan, even if the fund is comfortable extending a loan because the company is likely to survive over the long haul. It also could be that some hedge funds are offered the chance to lend to a company, turn down the opportunity and then short the company's shares."). Although activity of this sort might violate federal securities laws, the technical nature of the claims, and important questions about standing and privity of contract, make it an unlikely tool to police opportunism of this form.

[135] *See* Jonathan C. Lipson, *Auto Immune: The Detroit Bailout and the Shadow Bankruptcy System*, CONCURRING OPINIONS (Dec. 19, 2008, 3:03 PM), http://www.concurringopinions.com/archives/2008/12/jonathan_lipson.html (analyzing arguments supporting bailouts of automobile manufacturers).

[136] *See* Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1629 n.65 (citing Greg Nini et al., *Creditor Control Rights, Corporate Governance, and Firm Value* 10 (June 2009) (unpublished manuscript), *available at* http://ssrn.com/abstract=1344302.

[137] *Id*. at 1629 n.68; *see also* Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. REV. 115, 155–56 (arguing capital expenditure restrictions imposed on companies subsequent to covenant defaults may lead to increased market-to-book value and operating performance); Nini et al., *supra* note 136, at 4–5 (finding improved operating performance and equity-market valuation in months directly following covenant default).

requires some degree of trust. Obviously, reorganization has never been a game for the faint of heart, and so we should not pretend that trust can solve all problems. But the more we fight about the control of information in reorganization, the more we signal a lack of confidence in one another and the system. This ultimately serves no one with an interest in preserving a viable negotiated reorganization system.

An intuitive response to the foregoing problems is to say that "transparency" should be an overriding goal in reorganization. As fights over Rule 2019 indicate, transparency remains an important value in this process. The Second Circuit perhaps best captured bankruptcy's historic aspirations about transparency in its *Lionel* opinion:

> A fair analysis of the House bill [leading to the Bankruptcy Code] reveals that reorganization under the 1938 Chandler Act, though designed to protect creditors had, over the years, often worked to their detriment and to the detriment of shareholders as well. The primary reason reorganization under the Act had not served well was that disclosure was minimal and reorganization under the Act was designed to deal with trade debt, not secured or public debt or equity. The [current Bankruptcy Code], it was believed, provides some form of investor protection to make it a "fairer reorganization vehicle." The key to the reorganization Chapter, therefore, is disclosure. To make disclosure effective, a provision was included that there be a disclosure statement and a hearing on the adequacy of the information it contains. The essential purpose served by disclosure is to ensure that public investors are not left entirely at the mercy of the debtor and its creditors.[138]

Yet, to say that transparency is the goal begs important questions: To what end? About what? For whom? At what cost? And, perhaps most practically, who pays?

These, in turn, are questions that can be answered only by addressing two prior policy questions. First, what should information policy be in reorganization? Historically, it appears to have been rooted in the vision of transparency that animated the early federal securities laws. Yet, there is good reason to question whether this model of information policy makes sense generally, or with respect to distressed firms. Second, and perhaps more difficult, what relationship should any information policy in reorganization bear to larger bankruptcy policy goals? We know that bankruptcy is the subject of robust policy debates in general. How should those debates inform choices about information policy in reorganization?

[138] Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1070 (2d Cir. 1983) (citations omitted).

A. Information Models

This symposium considers the role that the SEC has played, or could play, in reorganization which, in turn, assumes that the securities law model of disclosure might provide policy guidance for those concerned with the control of information in reorganization. Yet, if we step back and think about the larger policy question—how do we manage problems arising from excessive information asymmetry—it should be obvious that the SEC's approach to controlling the flow of information is but one of several models we might use.

Conventional legal theory approaches problems of information asymmetry from one of three general perspectives, none of which fit bankruptcy reorganization very well. One, a "transactional" model, views information production and verification as the centerpiece of rational market behavior in capital asset transactions.[139] Capital market participants can be trusted to ask for—and receive—full and accurate information. If companies do not supply this information, they would have to "forego access to the capital markets."[140] Government has no meaningful role in addressing serious information asymmetries, on this view, because none should exist. If they do, the market will correct for them. In any case, fraud only happens to those too lazy or gullible to detect it. On this view, the costs of regulating to protect the weak exceed the social benefits of permitting the rest of us to order our affairs (including information sharing) privately.

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[139] *See* Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE. L.J. 239, 274-77 (1984) (examining nature of information production in capital asset transactions); *see also* Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1357–58 (1999) (discussing capital asset pricing model and social benefits of increased disclosure by securities issuers). This is generally referred to as "due diligence," and is rooted in federal securities law practice. "[D]ue diligence connotes the absence of negligence in the preparation of disclosure; in turn, lack of due diligence is often considered negligence." Donald C. Langevoort, *The Statutory Basis for Due Diligence Under the Federal Securities Laws*, at 11 (PLI Corp. L. and Prac. Course Handbook Series No. B0-00A4, 1999) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 208 (1975)); *see also* Monroe v. Hughes, 31 F.3d 772, 774 (9th Cir. 1994) (citation omitted) ("Although issuers are held strictly liable under [section] 11 for damages resulting from misrepresentations in a registration statement, an accountant has a due diligence defense; [section] 11 therefore imposes a negligence standard for an accountant's liability."); Rebenstock v. Deloitte & Touche, 907 F. Supp. 1059, 1068 (E.D. Mich. 1995) (acknowledging accountant's due diligence defense against section 11 liability).

[140] HOMER KRIPKE, THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE 119 (1979) ("A disclosure will be supplied voluntarily by issuers interested in the capital markets when there is a consensus among suppliers of capital or other transactors in the capital markets that this information is necessary to them for lending and investment decisions."); *see also* HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (1966) (arguing against prohibitions on insider trading). *See generally* George J. Benston, *The Value of the SEC's Accounting Disclosure Requirements*, 44 ACCT. REV. 515, 516 (1969) (discussing exchange of information between managers and stockholders); George J. Stigler, *Public Regulation of the Securities Markets*, 37 J. BUS. 117 (1964) (analyzing public regulation of securities markets).

A second model is adversarial and recognizes that, in litigation, parties have no common interest in sharing information.[141] Thus, nonwaivable rules of discovery and evidence force parties to share information, even if it is against their perceived self-interest.[142] The civil litigation system "often allow[s] extensive intrusion into the affairs of both litigants and third parties," the Supreme Court explained in *Seattle Times Co. v. Rhinehart*.[143] Because courts are public institutions, their work—and the pleadings of the parties—are presumptively public. Thus, in this adversarial model, there is much skirmishing about forced disclosure, whether to opponents or (through public pleadings) to the "world."

A third model—and the one that has awkwardly been tethered to the reorganization system for over 70 years—comes from the federal securities laws, whose "primary policy" has been "the remediation of information asymmetries"[144] through a disclosure system that "compels business corporations and other

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[141] *See generally* Ragge v. MCA/Universal Studios, 165 F.R.D. 601, 603–04 (C.D. Cal. 1995) ("[T]he purpose of discovery is to remove surprise from trial preparation so the parties obtain evidence necessary to evaluate and resolve their dispute. Toward this end, Rule 26(b) is liberally interpreted to permit wide-ranging discovery of all information reasonably calculated to lead to discovery of admissible evidence; but the discoverable information need not be admissible at the trial."); Hatfield v. Edward J. DeBartolo Corp., 676 N.E.2d 395, 399 (Ind. Ct. App. 1997) (noting how rules of discovery "are designed to allow a liberal discovery process, the purposes of which are to provide parties with information essential to litigation of the issues, to eliminate surprise, and to promote settlement"); Judith Resnik, *Uncovering, Disclosing, and Discovering How the Public Dimensions of Court-Based Processes Are at Risk*, 81 CHI.-KENT L. REV. 521, 538 (2006) ("[I]n the 1930s, the drafters of the Federal Rules of Civil Procedure invented an obligation—called 'discovery,' entailing the exchange of information (orally and in writing) and the production of records—that not only multiplied the information available to the parties but created the possibility for others to learn more details, in advance of trial, through the disputants' filings.").

[142] *See* SEC v. Samuel H. Sloan & Co., 369 F.Supp. 994, 995 (S.D.N.Y. 1973) ("The purpose of discovery is to enable a party to discover and inspect material information which by reason of an opponent's control, would otherwise be unavailable for judicial scrutiny. Rule 34 of the Federal Rules of Civil Procedure provides that relevant and non-privileged documents and objects in the possession of one party be made available to the other, thus, eliminating surprise and permitting the issues to be simplified and the trial to be expedited."); United States v. Procter & Gamble Co., 14 F.R.D. 230, 232 (D. N.J. 1953) (noting purpose of discovery "is to make relevant and nonprivileged documents in the possession of one party available to the other"); EEOC v. St. Francis Cmty. Hosp., 70 F.R.D. 592, 594 (D.S.C. 1976) (citation omitted) (recognizing Federal Discovery Rules construed liberally and "are intended to produce 'open disclosure of *all potentially relevant information*'"). A recent study found that discovery disputes were the second most common type of dispute in civil litigations conducted by U.S. District Courts, at least as measured by the number of orders entered by those courts. *See* David A. Hoffman, Alan J. Izenman & Jeffrey R. Lidicker, *Docketology, District Courts, and Doctrine*, 85 WASH. U. L. REV. 681, 714 (2007).

[143] 467 U.S. 20, 30 (1984).

[144] Joel Seligman, *No One Can Serve Two Masters: Corporate and Securities Law After Enron*, 80 WASH. U. L. Q. 449, 450 (2002) [hereinafter Seligman, *Two Masters*]; *see also* Troy A. Paredes, *Blinded by the Light: Information Overload and its* Consequences *for Securities Regulation*, 81 WASH. U. L. Q. 417, 422 (2003) (footnote omitted) ("As a regulatory matter, the mandatory disclosure debate has been settled for seventy years, since the Securities Act of 1933 was adopted. Our federal securities laws are designed to protect investors and the integrity of capital markets by mandating disclosure that enables informed investor decision making, boosts investor confidence, and reduces agency costs."). *See generally* 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 226–27 (3d ed. 1989) (discussing various disclosure mechanisms of Securities Exchange Act of 1934).

securities issuers to disseminate detailed, generally issuer-specific information when selling new securities to the public and requires specified issuers to file annual and other periodic reports containing similar information."[145] This is a mandatory disclosure system, but not one that is adversarial: no one has to issue securities to the public. But if you do, you must tell the public a great deal of information about the issuer, the transaction, and so forth.

This model has presented a number of problems, the most basic of which is: What purpose does it serve? "[D]isclosure, and still more disclosure," in the words of Loss & Seligman,[146] will protect the investing public at large: "The truth shall make you free."[147] Hypothetical widows and orphans will make better investment decisions if issuers or other important securities market participants (potential control acquirors) are forced to disclose "material" information.[148] The goal here is rooted in a belief that the requirement to tell the truth and the whole truth will in fact result in better behavior by those forced to make the disclosure.[149] It is, in a sense, a supply-side, deterrence-based theory of the regulatory power of information. We care less about the audience for the information than the fact that the information must be produced.

Unchecked, this model can be enormously costly, and for uncertain benefits. Complying with securities law disclosure rules *ex ante* can be exorbitantly expensive. While statutory changes such as the Private Securities Litigation Reform Act ("PSLRA") have expressed a Congressional desire to reduce the litigation costs associated with securities law violations, defending such suits can be very taxing on a company and its management.[150] And yet, it is not clear who is

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[145] Seligman, *Two Masters*, *supra* note 144, at 450 (footnote omitted); *see also* Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1675–76 (discussing "primary policy" of U.S. securities laws); Paredes, *supra* note 144, at 425–26 (observing elements of disclosure regime mandated by federal securities laws). The federal securities laws include the Securities Act of 1933, 15 U.S.C. § 77a (2000); the Securities Exchange Act of 1934, 15 U.S.C. § 78a (2000); the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 (2000); the Trust Indenture Act of 1939, 15 U.S.C. § 77bbb; the Investment Company Act of 1940, 15 U.S.C. § 80a-1 (2000); the Investment Advisers Act of 1940, 15 U.S.C. §80b-1; and the Securities Investor Protection Act of 1970, 15 U.S.C. § 78aaa.

[146] LOSS & SELIGMAN, *supra* note 144, at 29.

[147] *Id.*

[148] *See* Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051, 1102 (2000) (describing "rational choice theory," which predicts informed decision-makers can balance risks against benefits to make better decisions); Adam J. Levitin, *The Consumer Financial Protection Agency*, 28 AM. BANKR. INST. J. 10, 10 (2009) ("Markets rely on information. If all material information is readily available to consumers in a form they can easily process, then consumers will be able to make intelligent, informed decisions, which will presumably maximize consumer welfare and discipline product and practice offerings."); Paredes, *supra* note 144, at 431 (footnote omitted) ("The goal of the federal mandatory disclosure system is not disclosure. Disclosure is merely the chosen means to the end of informed investor decision making.").

[149] As William O. Douglas wrote, "[T]he requirement that the truth about securities be told will in and of itself prevent some fraudulent transactions which cannot stand the scrutiny of publicity . . . ." William O. Douglas, *Protecting the Investor*, 23 YALE L. REV. 522, 524 (1934).

[150] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.); *see* Merritt B. Fox, *Civil Liability and Mandatory*

influenced by the content of the disclosure. There is little evidence that "average investors" read much of what is disclosed, or understand it if they do.[151]

It is thus not surprising that some have called for a more nuanced approach. SEC Commissioner Troy Paredes, for example, has argued that we should look at not only the supply side of information production, but also the demand side. "[D]isclosure of information is not enough for a disclosure-based regulatory system to succeed," he has argued.[152] "Investors, analysts, and others need to use the disclosed information effectively for the disclosures to be useful."[153]

At least two aspects of human behavior pose obstacles to the effective use of disclosed information under the securities law model. First, people tend to simplify complex decisions by considering only a small subset of factors and excluding the rest.[154] Disclosures that relate to the excluded factors will not be considered and thus will have no effect on the decision-making process.[155] Second, even if all the relevant factors are considered, an individual's risk tolerance may vary depending on whether a decision is viewed as an opportunity to capture a gain or to avoid a loss.[156] Since risk tolerance generally is higher in loss-avoidance situations,[157]

Disclosure, 109 COLUM. L. REV. 237, 281 (2009) (noting "high transaction costs associated with securities litigation"); Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 278 (1998).

[151] *See, e.g.*, ABT SRBI, MANDATORY DISCLOSURE DOCUMENTS TELEPHONE SURVEY, Submitted to SEC Office of Investor Educ. and Advocacy 2008, *available at* http://www.sec.gov/pdf/disclosuredocs.pdf ("It is clear that many investors do not read disclosure documents for companies and funds in which they invest, and those that do spend relatively little time reviewing these documents considering the breadth of information they contain."); *see also* Donald C. Langevoort, *Commentary: Investors, IPOs, and the Internet*, 2 ENTREPRENEURIAL BUS. L.J. 767, 770 (2008) [hereinafter Langevoort, *Commentary*] ("The bottom line of all this is that making information available to investors does not mean that they will use it at all, much less use it well."); Paredes, *supra* note 144, at 431–32 (remarking typical individual investors are not expected to pay close attention to companies' disclosures).

[152] Paredes, *supra* note 144, at 432*; see also* Langevoort, *Commentary*, *supra* note 151, at 770 ("The bottom line of all this is that making information available to investors does not mean that they will use it at all, much less use it well.").

[153] Paredes, *supra* note 144, at 432.

[154] *See, e.g.*, Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1047 (2009) [hereinafter Langevoort, *The SEC*] (citing Daniel Read et al., *Choice Bracketing*, 19 J. RISK & UNCERT. 171, 171–73 (1999)) ("When faced with a complicated choice, for example, people often simplify by focusing entirely on two or three salient attributes of the decision. The less able they are to frame the decision in narrow terms, the more often the outcome is one of indecision or procrastination.").

[155] *See* Langevoort, *The SEC*, *supra* note 154, at 1050 ("Disclosure works in the sales practice area to the extent that it is salient enough be visible in the dense informational environment the investor is navigating. But recall that people simplify by narrowing the product attributes on which they will make their choice; if the disclosure relates to a non-preferred attribute, it will have no effect unless the style of disclosure is powerful enough to make it important.").

[156] *See* Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135, 146–47 (2002) (stating while overconfidence can lead to success, it may also lag behind passive, well-diversified trading strategy).

[157] *See id.* at 144 ("[I]f prompted to see the choice as one of trying to avoid a loss of that which is currently possessed, people tend to be more risk-seeking.").

investors downplay the significance of negative information regarding investments they already hold because selling the position would result in a recognition of the loss; this would lead the holder to retain the position (and increase its loss), even in the face of information that its value likely will decrease further.[158]

We do not know whether, or to what extent, these general observations about investor behavior apply to those who hold or trade in distressed debt claims, or to creditors of insolvent firms generally. It may be that a creditor's circumstances matter as much as the information itself. Thus, trade creditors are likely to have some information about a debtor—whether through gossip or more formal credit reporting channels—but this information may be less robust than information acquired by the hedge fund that has offered to purchase the trade creditor's claim against the debtor. The trade creditor may sell the claim—and thus book the loss now—because it prefers cash today, even if it may generally be risk-tolerant when facing a loss. Conversely, the hedge fund may want to purchase the debt because it believes in the long-term profitability of the debtor, or because it has unique arbitrage opportunities arising from other positions it holds against the debtor (*e.g.*, short positions). Whether observations about risk preferences of the larger population apply to these and other stakeholders of a distressed firm doubtless warrants further study. Yet, it is apparent that information policy in reorganization should result in disclosure tailored to the realistic needs and uses of system participants.

Perhaps equally important is a means for participants to search, filter, and process the information effectively.[159] The supply side of the information equation clearly matters,[160] but it is not the only—or necessarily the most important—focus

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[158] *Cf. id.* (citing Terrence Odean, *Are Investors Reluctant to Realize their Losses?*, 53 J. FIN. 1775 (1998); Hersh Shefrin & Meir Statman, *The Disposition to Sell Winners Too Early and Ride Losers Too Long: Theory and Evidence*, 40 J. FIN. 777 (1985)) ("We might expect people to hold on to their losing stocks too long, and sell their winners too readily.").

[159] *See* Conn. Bar Ass'n. v. United States, 394 B.R. 274, 291 (D. Conn. 2008) (inferring means of disclosure should "prevent at least some consumer deception"); Paredes, *supra* note 144, at 432 ("[F]or our mandatory disclosure system to work, securities market participants must not only have access to information, but must be able to search and process in an effective manner the information that is disclosed."); Laura S. Unger, Comm'r, SEC, Speech by SEC Comm'r: Rethinking Disclosure in the Information Age: Can There Be Too Much of a Good Thing? (June 26, 2000), *available at* http://www.sec.gov/news/speech/spch387.htm (concluding disclosed information can be useful to investors only if they are able to understand it and apply it effectively).

[160] But even in the investor-protection context, there is growing empirical evidence that disclosure for its own sake is a failed enterprise. *See, e.g.*, Troy A. Paredes, *Foreword*, 81 WASH. U. L. Q. 229, 237 (2003) (acknowledging "supply-side" of disclosure and asserting "financial reporting system of U.S. securities markets [is] to ensure that the financial information companies disclose is accurate"); Dan Stober, *Filings to Keep Officials from Unfairly Profiting*, SAN JOSE MERCURY NEWS, Apr. 30, 2005, at 1 ("Disclosure laws were designed to promote 'transparency,' not total revelation . . . ."); Sunita Sah, George Loewenstein & Daylian Cain, The Burden of Disclosure 1 (June 27, 2010) (unpublished manuscript), *available at* http://ssrn.com/abstract=1615025 ("We present 3 experiments that reveal a previously unrecognized perverse effect of disclosure: Disclosure of an advisor's conflict of interest can decrease advisees' trust in the

of information policy. By focusing on those who must disclose—rather than on those who receive and use the disclosures—we seem to produce enormous amounts of information. Yet, the increase in information may, paradoxically, produce less intelligent decision-making. Those expected to absorb the information may simply be overwhelmed.

As the debates about Rule 2019 show, the securities law and the law of reorganization were born sharing a supply-side view of information policy.[161] As one of us has argued elsewhere, William O. Douglas—a chief architect of both—embraced disclosure as an end in itself.[162] Thus, like the federal securities laws, chapter 11's attitude toward disclosure has focused on the obligations of debtors-in-possession (or plan proponents), making only nodding reference to the possible needs of actual stakeholders. While section 1125 may require that disclosure statements provide "adequate information" to "hypothetical investors," anyone who has ever tried to read the chapter 11 disclosure statement of any reasonably large company knows that the "kitchen sink" approach prevails. "Disclosure, and still more disclosure" is as much the mantra of reorganization as it is of the federal securities laws.

Although "transparency" is a goal of both the securities laws and reorganization law, the reality is that bankruptcy fits none of the conventional disclosure models—transactional, adversarial or mandatory—comfortably. It is not exactly (or exclusively) a "deal," a "litigation," or a securities transaction. On the one hand, Congress intended—and lawyers seem to believe—that reorganization will usually be a negotiated process.[163] The goal of reorganization is conventionally thought to

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advice while simultaneously increasing pressure to comply with that advice."). This, we believe, creates even greater pressure to figure out what the "correct" disclosure policy in reorganization should be.

[161] *See, e.g.*, Baron v. Smith, 380 F.3d 49, 56 (5th Cir. 2004) (illustrating applicability of Securities Exchange Act of 1934 to chapter 11 proceedings); Jacobson v. AEG Capital Corp., 50 F.3d 1493, 1496 (9th Cir. 1995) (discussing relationship between securities laws and Bankruptcy Code section 1125(e) in context of alleged fraudulent disclosure); Drain & Schwartz, *supra* note 15, at 622, 623 (2002) (discussing overlap of Bankruptcy Code with disclosure requirements of securities laws).

[162] *See* Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1633–68; *see also* DOUGLAS REPORT, *supra* note 56, at 3 ("From the investors' point of view no reorganization could be thoroughgoing unless the reorganizers adhered to these objectives of expedition, economy, fairness, and honesty."); William O. Douglas, *Protecting the Investor*, 23 YALE REV. 522, 523–24 (1934) ("[T]he requirement that the truth about securities be told will in and of itself prevent some fraudulent transactions which cannot stand the scrutiny of publicity . . . .").

[163] *See, e.g.*, Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 458 n.28 (1999) ("[T]he Chapter 11 process relies on creditors and equity holders to engage in negotiations toward resolution of their interests." (quoting G. Eric Brunstad, Jr., Mike Sigal & William H. Schorling, *Review of the Proposals of the National Bankruptcy Review Commission Pertaining to Business Bankruptcies: Part I*, 53 BUS. LAW. 1381, 1406 n.136 (1998))); Richard F. Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 BUS. LAW. 441, 441 (1984) (claiming cramdown power is used more frequently as leverage in settlement); Kenneth N. Klee, *Cram Down II*, 64 AM. BANKR. L.J. 229, 234 (1990) (noting bargaining aspect of bankruptcy case); Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 126 (1990) ("Current law provides a complex legal environment in which representatives of thousands

be the confirmation of a plan of reorganization, which is possible only if a sufficient number and amount of stakeholders agree to the plan.[164] On the other hand, reorganization can become adversarial at almost any point.[165] Bankruptcy courts are empowered to hear and decide a wide range of contests within a bankruptcy case that are governed largely by the Federal Rules of Civil Procedure and the Federal Rules of Evidence.[166] Even reorganization plans—which are generally viewed as a kind of a contract—can be "crammed down" over significant dissent.[167]

In any case, while reorganization may involve the issuance of new securities—or, more importantly, trading in the distressed securities of the troubled business—federal securities laws generally do not apply when a company is in bankruptcy.[168]

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of creditors and shareholders bargain over the disposition of billions of dollars in assets. Adjudication of cases within that environment is thought to be virtually impossible.").

[164] *See* 11 U.S.C. §§ 1126(a), (c), 1129(a)(10) (2006) (providing requirements for acceptance and confirmation of debtor's plan).

[165] *See* D-1 Enters., Inc. v. Commercial State Bank, 864 F.2d 36, 38 (5th Cir. 1989) (describing former debtor filing claim three years after court ordered sale and dismissal of reorganization petition); *In re* Fernwood Mkts., 73 B.R. 616, 618–19 (E.D. Pa. 1987) (describing creditor's challenge to validity of section 363(b) sale after affirmation of plan, settlement, and numerous subsequent adversary complaints); Elizabeth Warren, *Vanishing Trials: The New Age of American Law*, 79 AM. BANKR. L.J. 915, 924 (2005) (noting various stages at which adversarial proceedings may occur). That reorganization could become adversarial does not mean that it often does. Baird and Morrison show that litigation in bankruptcy is quite rare. *See* Douglas G. Baird & Edward R. Morrison, *Adversary Proceedings in Bankruptcy: A Sideshow*, 79 AM. BANKR. L.J. 951, 952 (2005) ("[A]dversary proceedings are rare in both business and consumer cases and, apart from taking less time, have changed little in recent years."); Warren, *supra*, at 926 ("[T]he proportion of adversary proceedings per case in the bankruptcy system has fallen rather sharply."). *But see* Donald S. Bernstein, *A Reorganization Lawyer's Perspective on Professor Warren's Vanishing Trials: The New Age of American Law*, 79 AM. BANKR. L.J. 943, 947 (2005) ("One can easily argue that the filing of a plan of reorganization should be considered the equivalent of commencing an adversary proceeding for Professor Warren's purposes. . . . If the filing of a plan amounts to the commencement of an 'adversary proceeding,' the initiation and trial of an additional 'adversary proceeding' would have to be added to Professor Warren's data base for every Chapter 11 case in which a plan is filed.").

[166] Although the Federal Rules of Evidence apply, the Federal Rules of Civil Procedure are modified somewhat and appear generally in Part VII of the Federal Rules of Bankruptcy Procedure. *See* Boone v. Barnes (*In re* Barnes), 266 B.R. 397, 403 (B.A.P. 8th Cir. 2001) (citation omitted) ("[E]ven when then bankruptcy court applies state law to resolve substantive issues, it must apply the Federal Rules of Evidence to resolve evidentiary questions."); *In re* Merritt Logan, Inc., 109 B.R. 140, 142–43 (Bankr. E.D. Pa. 1990) (noting portion of Federal Rules of Bankruptcy Procedure found in Part VII govern adversary proceedings and "are, in many respects, identical to the rules governing civil actions in district courts, [although] they do contain some differences").

[167] *See* 11 U.S.C. § 1129(b) (2006) (allowing courts to confirm a plan even if paragraph (8) of subsection (a) is not met, so long as plan "does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."); *see also* Broude, *supra* note 163, at 441–42 (discussing effects of cramdown provisions); Klee, *supra* note 163, at 229–31 (discussing codified and uncodified requirements for cramdown).

[168] For example, securities issued under a confirmed plan of reorganization are generally exempt from the registration process under Bankruptcy Code section 1145. *See* 11 U.S.C. § 1145 (enumerating exemptions from securities laws); *see also* H.R. REP. NO. 95-595, at 227–28 (1977) (noting section 1145 "permits the disclosure statement to be approved without the necessity for compliance with the very strict rules of Section 5 of the Securities Act of 1933 [because the cost of registration is often] prohibitive in a bankruptcy reorganization"); 8 COLLIER ON BANKRUPTCY, ¶ 1145.01, at 1145–5 (Alan N. Resnick & Hencry J. Sommer eds., 16th ed. 2009) (footnote omitted) ("The justification for a relaxation of securities law registration

Although claims against a debtor might be traded like securities, the consensus view is that these are not "securities" for most purposes of the federal securities laws.[169] As noted above, this is one reason the market for claims against debtors in bankruptcy increasingly resembles an unregulated securities market.[170]

While the federal securities laws and chapter 11 both require companies to produce and verify information, the larger systems they seek to manage differ in fundamental ways. The securities law disclosure system (usually) anticipates financially healthy companies, and seeks to protect individual investors (as well as the integrity of the markets in general) with mandatory disclosure.[171] It contemplates long-term investors, and is concerned only indirectly with problems of collective action.[172] It addresses a robust and enormously complex system of

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requirements in connection with chapter 11 stems in part from the protections of chapter 11 itself, as well as from the perceived unfairness of fettering participants in the chapter 11 process . . . with the added burdens of complying with securities law requirements.").

[169] *See* Stephen H. Case, *Trading in Claims*, 826 PRAC. L. INST. COMM. 75, 95 (2001) (citation omitted) ("[I]t is now fairly clear that trade claims are not ['securities']."); Drain & Schwartz, *supra* note 15, at 574 ("[T]he securities laws probably should not apply to bankruptcy claims."); Fortgang & Mayer, *supra* note 15, at 52 (concluding under existing case law, bankruptcy trade claims are not within definition of "security"); Daniel Sullivan, Comment, *Big Boys and Chinese Walls*, 75 U. CHI. L. REV. 533, 542 (2008) (acknowledging many commentators agree securities laws do not apply to trade claims in bankruptcy and noting Supreme Court *Reves* test for withholding application of securities laws).

[170] *See* Drain & Schwartz, *supra* note 15, at 572 ("[P]erhaps the most salient point about the securities laws and bankruptcy claim trading, which often is stated with some pride, is that there is an active, functioning, and enormous (in terms of dollar amount) market in distressed claims that is *not actively regulated*."); *see also In re* Revere Copper & Brass, Inc., 58 B.R. 1, 2–3 (Bankr. S.D.N.Y. 1985) (discussing "evils" of assigning bankruptcy claims for cash and noting remedy of disclosure by section 1125); Fortgang & Mayer, *supra* note 15, at 8–9 (discussing how regulation of bankruptcy trade claims has not kept pace with market activity and has now gone "underground"); Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1645–46 (describing market for claims trading, its transparency, and securities laws' lack of disclosure requirements for such claims).

[171] *See* Seligman, *Two Masters*, *supra* note 144, at 450 (discussing primary policy of federal securities laws to be correction of information asymmetries between outside and inside investors through mandatory disclosure system); *see also* Glassman v. Computervision Corp., 90 F.3d 617, 623 (1st Cir. 1996) (noting "strong affirmative duty of disclosure" in offering of public securities); *In re* Evergreen Ultra Short Opp. Fund Sec. Litig., 705 F. Supp. 2d 86, 91 (D. Mass. 2010) (describing enforcement mechanisms of securities laws' mandatory disclosure requirements).

[172] *See* Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1038–39 (1999) (discussing effects of SEC's rules on lowering regulatory barriers and costs of collective shareholder action); *see also* Richard E. Mendales, *Intensive Care For the Public Corporation: Securities Law, Corporate Governance, and the Reorganization Process*, 91 MARQ. L. REV. 979, 1003 (2008) (noting 1934 Act governs corporate control with rules for voting rather than for selling of assets); David G. Yosifon, *The Consumer Interest in Corporate Law*, 43 U.C. DAVIS L. REV. 253, 311 (2009) (arguing for increased use of federal securities laws as mechanisms for influencing corporate governance). The rules on proxy contests, for example, can be seen as affecting governance, and thus collective action by shareholders seeking to influence corporate policy. *See* Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1264 (2009) (discussing effect of SEC Rule 14a-8 on proxy solicitation and shareholder voting rights); Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late*, 43 AM. U. L. REV. 379, 382 (1994) (arguing SEC proxy rules do affect shareholder participation in corporate governance but only produce marginal benefits). *But see* Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L.

contract and property rights that often fluctuates rapidly and unpredictably.[173] It is run largely by administrators in the executive branch (*i.e.*, the SEC) and self-regulatory bodies, such as the NASDAQ.[174]

As discussed further below, the reorganization system, by contrast, exists to rehabilitate firms that can be salvaged and to create a comparatively fair and efficient means for liquidating assets and paying claims when firms are beyond hope. It is essentially a remedial structure, not an administrative one, and is organized and operated largely by lawyers in courts, not bureaucrats in the executive branch.

Perhaps the most important difference between the securities and reorganization regimes are their respective stakeholders. Douglas designed the disclosure models for both in the 1930s with the expectation that they would protect average investors.[175] While investors remain the principal focus of SEC concern, they are but one of many possible constituencies affected by a large reorganization. A large firm's failure (potentially) hurts not only investors, but non-investor (trade) creditors, employees, taxing authorities, tort claimants, other regulators, and so on. Does the disclosure model (putatively) designed to protect investors simultaneously protect these others? Does one disclosure model fit all?

B. Bankruptcy Policy

To ask the question implies that the answer is "no." While the securities law model may have been appropriate for reorganization at one time—and while the SEC and the securities regulation system have much to teach us—reorganization requires its own information policy, designed to serve its larger, unique policy goals. Thus, in order to develop a meaningful theory of information control in reorganization, we should draw information policy from bankruptcy policy.

REV. 605, 614–16 (2007) (concluding SEC proxy regulations are more detrimental than beneficial to shareholder voting rights).

[173] *See* Bevill, Bresler & Schulman Asset Mgmt. Corp. v. Spencer Sav. & Loan Ass'n, 878 F.2d 742, 747 (3d Cir. 1989) (discussing Congress's concern with volatility of securities markets and possible collapse of one securities firm threatening entire market); *In re* Stewart Fin. Co., 367 B.R. 909, 919 (Bankr. M.D. Ga. 2007) (noting concern within legislative history of volatile nature of securities markets and potential for insolvency of one firm to affect entire market); Robert B. Ahdieh, *Making Markets: Network Effects and the Role of Law in the Creation of Strong Securities Markets*, 76 S. CAL. L. REV. 277, 322 (2003) (footnotes omitted) (highlighting two functions of securities laws as providing "clear property entitlements" and "reliable contract enforcement mechanisms").

[174] *See* Standard Inv. Chartered, Inc. v. NASD, Inc., 560 F.3d 118, 119 (2d Cir. 2009) (noting importance of self-regulatory organizations in assisting SEC's enforcement of securities laws); DL Capital Group, LLC v. Nasdaq Stock Mkt, Inc. 409 F.3d 93, 95 (2d Cir. 2005) (describing NASD's delegation of authority to Nasdaq to perform regulatory functions of SEC); Lippitt v. Raymond James Fin. Serv., Inc., 340 F.3d 1033, 1038 (9th Cir. 2003) (highlighting market oversight by both SEC and self-regulatory organizations).

[175] *See* Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1636–37 (highlighting Douglas's conclusion that "the interests of investors – not reorganizers – had to be paramount in reorganization, [because] '[i]t is . . . their investment which is at stake'" (quoting DOUGLAS REPORT, *supra* note 56, at 897)).

While we may have spent little time thinking about what information policy in bankruptcy should be, we have devoted countless pages to debates about the proper policy goals of bankruptcy in general, and reorganization in particular. At the risk of simplification, on one side are those who tend to view bankruptcy as a set of federal procedures wrapped around—and limited by—a state private law (contract) core. The "distinctive characteristic" of this position is "its focus on procedure and its belief that a coherent bankruptcy law must recognize how it fits into both the rest of the legal system and a vibrant market economy."[176] This position is associated chiefly with Thomas Jackson's 1982 article on the so-called "creditor's bargain," in which he argued that the appropriate way to view the bankruptcy system was from the perspective of the deal that creditors would have chosen for themselves had they been in a position to do so before the debtor's bankruptcy.[177] Thus, "bankruptcy law should make a fundamental decision to honor negotiated non-bankruptcy entitlements."[178]

In reorganization, the strongest arguments here are that it should be a largely private or contractual affair. Thus, Robert Rasmussen, Barry Adler, and Alan Schwartz, among others, have argued in various ways that contract could, in effect, overcome the collective action problem of general default if we permitted debtors and select creditors to choose the proper contracting mechanisms.[179] Those choices may be reflected in the securities a firm issues, in the charter it adopts, or in certain of the bargains it strikes. At the core, it advanced the (then) "trendy slogan: Privatize bankruptcy,"[180] a prospect that could have been realized if we had taken seriously the argument of Bradley & Rosenzweig to repeal chapter 11.[181]

The vision here was utilitarian welfare economics applied to the reorganization process. Reorganization should not be the product of mandatory rules because

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[176] Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 576–77 (1998) (footnotes omitted).

[177] Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 860 (1982) (describing application of bankruptcy law to non-bankruptcy entitlements).

[178] *Id.* at 871. An "enhanced" version of the creditors' bargain model, which attempted to respond to some of its critics, appears in Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155 (1989).

[179] *See* Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy,* 45 STAN. L. REV. 311, 311 (1993) ("In a legal environment hospitable to all forms of contract, investors could agree efficiently to preserve a firm's value without the aid of the costly, rule-based bankruptcy process."); Robert K. Rasmussen, *Debtors Choice: A Menu Approach to Corporate Bankruptcy,* 71 TEX. L. REV. 51, 53 (1992) (arguing "a firm's ability to file for bankruptcy reorganization should be determined by the firm's investors rather than by the government" and "a creditor's treatment in bankruptcy is nothing more than a term of the contract that a firm makes with that creditor"); Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy,* 107 YALE L.J. 1807, 1850 (1998) (implying "the state should permit parties to contract for the bankruptcy system that they prefer" and that "a bankruptcy system should not contain mandatory rules that seek only to augment the value of bankruptcy estates").

[180] Schwartz, *supra* note 179, at 1851.

[181] Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1050 (1992) (discussing "market-based" approach to corporate bankruptcy and proposing to abolish court-supervised reorganizations).

those rules will reduce overall social welfare. If we permit contract bankruptcy, we would enable firms to "make a better contribution to the maximization of social wealth" than is possible under the current system.[182] Firms would be able to finance projects that they currently cannot, because a more fully contractual loss allocation mechanism would permit and encourage (more) optimal capital investing.[183]

This proceduralist/contractualist vision has been hotly contested, from its assumptions[184] to its method and logic.[185] Yet no elegant theory has been proposed to supplant it. Rather, on the other side of the debate, we find a loose collection of academics and practitioners who argue that bankruptcy embraces complex, "competing—and sometimes conflicting—values" and aspirations on which Congress should have the power to legislate.[186] This is, in many respects, a realist approach to bankruptcy: bankruptcy law is a product of political compromises over largely indeterminate values.

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[182] Schwartz, *supra* note 179, at 1838; *see* Christopher W. Frost, *Bankruptcy Redistributive Policies and the Limits of the Judicial Process*, 74 N.C. L. REV. 75, 85 (1995) (footnote omitted) ("[R]eform proposals . . . share creditor wealth maximization as a common criterion for a well-functioning bankruptcy regime."); Robert K. Rasmussen, *An Essay on Optimal Bankruptcy Rules and Social Justice*, 1994 U. ILL. L. REV. 1, 18–19 (1994) (stating modern economic approach to bankruptcy, which views bankruptcy law as contract term between debtor and creditor, "comports with the goal of maximizing societal wealth").

[183] *See, e.g.*, Rasmussen, *supra* note 182, at 19 ("Letting debtors decide whether the benefits of a certain regime exceed its costs increases societal wealth because no debtor is forced to adopt a bankruptcy term which it views as decreasing its own wealth."); Schwartz, *supra* note 179, at 1832 ("Firms today cannot finance projects that they would be able to finance if the ban [on free contracting] were repealed."); Alan Schwartz, *A Normative Theory of Business Bankruptcy*, 91 VA. L. REV. 1199, 1206–07 (2005) (stating increasing contractual freedom in bankruptcy would reduce interest rates and uncertainty, which would accelerate search for good projects).

[184] *See* Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 827 (1985) ("[Jackson and other proponents of the creditors' bargain model] assnme [sic] that every creditor—apparently including asbestos victims and other tort claimants . . .—will have full information and competent legal advice in dealing with the debtor. They assume further that every creditor will make the same assumptions they do and bring to bear their same highly skilled free market economic analysis . . . . I do not find their approach helpful . . . ."); *see also* Donald R. Korobkin, *Contractarianism and the Normative Foundations of Bankruptcy Law*, 71 TEX. L. REV. 541, 555–56 (1993) (criticizing view of bankruptcy as response to problem of debt collection and asserting bankruptcy is response to financial distress); Mark J. Roe, *Commentary on "On the Nature of Bankruptcy": Bankruptcy, Priority, and Economics*, 75 VA. L. REV. 219, 219–20 (1989) (criticizing assertions of Jackson and Scott regarding creditors' bargain model).

[185] *See, e.g.*, Lynn M. LoPucki, *Contract Bankruptcy: A Reply to Alan Schwartz*, 109 YALE L.J. 317, 319 (1999) ("Schwartz's proof [of the welfare-enhancing power of contract bankruptcy] is defective. The model employs materially inconsistent assumptions and the proof reaches its goal only through miscalculations from those assumptions."); *see* Korobkin, *supra* note 184, at 554–55 (arguing outcomes of creditors' bargain model reflect only interests of contractual relationships, disregarding interests of parties without contractually-acquired legal rights). *See generally* David Gray Carlson, *Philosophy in Bankruptcy*, 85 MICH. L. REV. 1341, 1342 (1987) (reviewing THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986)) (criticizing creditors' bargain model upon which Jackson's work heavily relies, asserting, "at his best, Jackson rises to mere tautology").

[186] Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 777 (1987); *see* J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 217 (1991) (arguing bankruptcy and nonbankruptcy law create each party's "bargaining identities," which encompass rights and interests, and shape negotiating process).

The important question is: What do these debates teach us about what information policy in bankruptcy ought to be? One might expect that contractualists would tend towards a contractual view of information policy. State private law generally creates no affirmative disclosure obligations in the absence of contract, and bankruptcy should deviate from this policy only for very good reason. Perhaps we should forbid fraud, and so require debtors to file schedules of assets, liabilities, recent transfers and so on, as we currently do.[187] But absent true fraud, contractualists might teach us that mandatory disclosure of anything—voting coalitions, executive compensation, short positions—is simply a drag on the market forces we believe likely to produce greater wealth in the long run.

Realists might respond that it is precisely because bankruptcy has become a market that we must seriously consider imposing mandatory disclosure obligations in a variety of contexts. They might, for example, argue that the power to control an outcome—such as by delaying or destabilizing restructuring negotiations—should bring with it a corresponding obligation to make one's identity and intentions known. They might further argue that those who benefit from the reorganization process—debtors as well as creditors—are engaged in a larger social bargain, which requires different social norms than might otherwise apply. Those social norms might include norms about disclosure.

While these approaches may offer support for greater or lesser degrees of mandatory disclosure, they fail to tell us what appropriate information policy in bankruptcy should be in a world with rapidly changing market practices and information technologies. Our view is that, until repeal, chapter 11 reflects a deliberate decision by Congress to promote the negotiated reorganization of distressed going concerns where possible,[188] subject to check by various mechanisms of creditor governance, including the power to remove management, convert the case, and so on. The important question, then, is what should information policy consider in the light of this goal?

C. Connecting Information Policy and Bankruptcy Policy

If we accept that the goal of reorganization under chapter 11 is the preservation of going concerns and jobs where possible, then the question is simple: Does any

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[187] *See* 11 U.S.C. § 521 (2006) (enumerating debtors' duties).

[188] *See* H.R. REP. NO. 95-595, at 220 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179 ("The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap."); 123 CONG. REC. 35,444 (1977) (statement of Rep. Rodino) ("For businesses, the bill facilitates reorganizations, protecting investments and jobs."); s*ee also In re* Winshall Settlor's Trust, 758 F.2d 1136, 1137 (6th Cir. 1985) ("The purpose of Chapter 11 reorganization is to assist financially distressed business enterprises by providing them with breathing space in which to return to a viable state."); MARTIN J. BIENENSTOCK, BANKRUPTCY REORGANIZATION 6–10 (1987) (discussing automatic stay, cramdown, and other options enabling chapter 11 debtor to successfully reorganize).

particular information policy advance that goal? It would seem that having no policy—or one that is purely contractual—is unlikely to do so. As explained above, poorly calibrated information policy has added a layer of transaction and agency costs to a system already burdened by expensive professionals. It creates confusion and undermines the mechanism Congress probably thought most likely to result in successful reorganization: negotiated loss reallocations among stakeholders.[189] As for contract, there is no particular reason to expect that sophisticated parties have any reason—or the desire—to disclose to the "world" anything more than they have to. They may swim in the "fishbowl" of chapter 11, but they would almost certainly prefer to be camouflaged, as strategy dictates.

Yet, a mandatory regime that is inattentive to the behavior of real participants in the system seems equally unsustainable. Rule 2019 is an attractive locus for litigation precisely because it is ostensibly mandatory and yet fails to connect existing bankruptcy policy to current market practices and problems. Bankruptcy examiners are controversial in part because a fair reading of the Bankruptcy Code suggests that they, too, should be mandatory under certain circumstances, although they hardly are treated that way.

Information policy in reorganization—during the gap period and in a formal chapter 11 case—should reflect chapter 11's other policy goals bearing in mind that mandatory disclosure for its own sake is a costly proposition with often elusive benefits. Thus, consider what information policy might look like from the perspective of the following types of stakeholders:

> *Private investors.* Private investors make money on information arbitrage. They make more money than you and I because, in part, they know more than you and I about certain (likely) market events. There is nothing wrong with information arbitrage if it is not opportunistic. Thus, forcing private investors to disclose their trading strategies, the prices they paid for their securities (in many cases), and the formulas they use to divine future market movements seems both inappropriate and counterproductive. Yet, knowing whether these investors hold short positions—positions that might lead the investor to promote a firm's demise—is obviously important, as it bespeaks their true incentives. So, too, with creeping control. As one of us has argued extensively elsewhere, it is very difficult to explain why

[189] *See, e.g.*, Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 458 n.28 (1999) ("[T]he Chapter 11 process relies on creditors and equity holders to engage in negotiations toward resolution of their interests." (quoting Brunstad, Sigal & Schorling, *supra* note 163, at 1405–06 n.136 (1998))); *see also* Broude, *supra* note 163, at 443 (highlighting drafters of chapter 11 of Bankruptcy Code recognized importance of deal-making among creditors in reorganization); Klee, *supra* note 163, at 229 (noting codification of "fair and equitable" rule in section 1129(b)); *see also* LoPucki & Whitford, *supra* note 163, at 126 ("Current law provides a complex legal environment in which representatives of thousands of creditors and shareholders bargain over the disposition of billions of dollars in assets. Adjudication of cases within that environment is thought to be virtually impossible.").

Rule 13d-1 does not apply to traded debt once a firm is in distress.[190] Acquiring debt after a covenant default will be the way a private investor obtains control. If disclosing control is what really matters—and that is the logic of Rule 13d-1—it is hard to see why debt should be exempt. Information policy in reorganization should address opportunities for market control and manipulation through the purchase of debt and other instruments, just as it does when the purchase of shares produces similar problems.

Non-investor creditors. Many creditors are not investors in any conventional sense. They are creditors because they have not been paid for goods or services supplied to the debtor. They may be able to trade their claims, but they may not. They may not like the price the secondary market offers, a price which is now available (if at all) through informal and unregulated avenues. Similarly, these creditors may have little appetite for detailed discussions about the debtor and its prospects. They are unlikely to read or directly benefit from a voluminous disclosure statement or examiner's report. One hopes they will be adequately represented by a creditors' committee, whose members and counsel will read these documents. But in the first instance, the massive amount of information the system does force out likely is of little use to many trade creditors. Information policy in reorganization should recognize that these end users of information will have informational needs and interests vastly different from those of private investors, or those the securities law system has traditionally had in mind.

Involuntary creditors. Large debtors often have involuntary creditors (tort claimants, employees, taxing authorities). In some cases (future tort claimants, potentially terminated employees), these creditors may not even know their status yet. Yet, decisions made in reorganization surely will affect them. If private investors obtain control of the debtor and outsource its operations, some may lose their jobs. If investors and professionals extract large fees from a reorganizing (or reorganized) firm, that may imperil its long-term viability, affecting tax bases, and so on. Information policy in reorganization should recognize that the actions of those in control should be communicated to those who may be affected directly and indirectly by that control. Here, too, we should expect variation in informational needs. Involuntary creditors certainly need to know important information about a debtor, so that they can act to minimize their losses, but it may be unrealistic to expect them to have the sophistication and resources to absorb information in the same ways as private, professional distress investors.

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[190] *See* Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1630 (footnotes omitted) ("The problem is that this rule does not apply to 'straight' debt securities. Its application to derivative and short positions is uncertain.").

Information policy in reorganization should, in short, reflect the need to tailor disclosure to the needs and circumstances of a debtor's various constituencies. There are doubtless other constituencies and concerns that information policy should take into consideration. The important point is simple: one size—the supply-side, kitchen-sink model—almost certainly does not fit all.

Details about how to implement such policies will be contentious. One of us has argued elsewhere that many problems of reorganizational information asymmetry can be solved by mimicking the best of what the SEC has taught us, while leaving behind its excesses. Thus, we might require mandatory disclosure of "material" information in this context, but do so via online platforms that can capture and present far greater data in real time than could filings in bankruptcy court dockets. "Materiality" in this context might mean, among other things, the ability to significantly alter the outcome of a case.[191] Refining and adapting such a standard to the world of reorganization could easily occupy several more articles. At this point, it is enough to observe that there are ways to make disclosure more effective and less costly without reassessing the entire field of information economics.

D. The Enforcement Question

But this leaves an important question: Enforcement. There is little doubt that the SEC got out of the business of bankruptcy for good reason. Imposing the SEC on chapter 11 cases is like trying to teach a pig to fly: it wastes your time and makes the pig angry. Except for outlier cases—*WorldCom*,[192] for instance, where there was egregious fraud—there should be little active, day-to-day work for the SEC in reorganization. Bankruptcy has been designed to be a process negotiated by and among the parties. With the United States Trustee ostensibly policing the front lines, it is difficult to justify a greater role for the SEC than it currently has.

Yet, this does not mean the reorganization system cannot learn from the SEC's experience. Perhaps the most powerful tool in the enforcement of federal securities laws has not been the SEC itself, but instead private litigations. Although private litigations are the subject of abuse and concern—some of which were addressed in the PSLRA[193] and SLUSA[194]—the simple reality was that officers and directors were much more likely to be concerned about suit by "private attorneys general" under 10b-5 than the Enforcement Division.

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[191] Having the power to control a class of votes on a plan, for example, would probably be material. *See id.* at 1669–70 (analyzing "materiality" of investment).

[192] *See id.* at 1650 (discussing egregious behavior of private investor in *WorldCom* bankruptcy).

[193] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 and 18 U.S.C.).

[194] Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified as amended in scattered sections of 15 U.S.C.).

What can we learn from this? If we want to implement a different disclosure policy, one mechanism might be private enforcement. In chapter 11, this could take one of several routes. First, as argued elsewhere, material disclosure failures could be the basis for the subordination or disallowance of a claim.[195] Second, positive incentives may also be appropriate. Permitting private causes of action may induce better disclosure where appropriate. Private attorneys who identify material misstatements or omissions may be compensated from the estate on a substantial contribution theory under 503(b)(3)(D).[196] Perhaps those found to have violated the disclosure rules should pick up the tab, as has been the case in private securities litigation.

It is not difficult to imagine howls of outrage in response to the suggestion that private attorneys be given the authority to police the system, with a fee-shifting incentive to motivate them. Yet, the reality is that there appear to have been fewer serious securities scandals prior to the PSLRA and SLUSA, laws which were designed to deter securities fraud lawsuits.[197] While those amendments may have been appropriate corrections to a plaintiffs' bar that had become too zealous, that is not the same as saying there should be no system for private enforcement at all. The important question—for another paper—is how to design that private enforcement mechanism.

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[195] *See* Lipson, *Shadow Bankruptcy*, *supra* note 6, at 1674 ("Negative enforcement would render unenforceable material positions that should have been disclosed, but were not.").

[196] *See In re* Bayou Group, LLC, 431 B.R. 549, 561 (Bankr. S.D.N.Y. 2010) (citations omitted) ("[S]ection 503(b)(3)(D) . . . may not be used to buy off a pest, who did little if anything to advance, and in fact may have impeded, the proper administration of the case."); *In re* Pow Wow River Campground, Inc., 296 B.R. 81, 89 (Bankr. D.N.H. 2003) ("[T]he determination of what constitutes a substantial contribution must of necessity be left to a case-by-case determination. A court must weigh the cost of the claimed fees and expenses against the benefits to the estate which flow directly from those actions."); *see also In re* Hall, 373 B.R. 788, 800 (Bankr. S.D. Ga. 2006) (granting compensation under section 503(b)(3)(D) for recovery of real property for benefit of debtor's estate, but denying it for general casework completed prior to conversion from chapter 11 to chapter 7). Section 503 provides, in relevant part:

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502 (f) of this title, including—
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> . . .
>
> (3) the actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by—
>
> . . .
>
> (D) a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title, in making a substantial contribution in a case under chapter 9 or 11 of this title;

11 U.S.C. § 503 (2006).

[197] *See* Newby v. Enron Corp. (*In re* Enron Corp. Sec.), 535 F.3d 325, 337 (5th Cir. 2008) (describing abuses that led to Congress's enactments of the PSLRA and SLUSA); LaSala v. TSB Bank, PLC, 514 F. Supp. 2d 447, 467–68 (S.D.N.Y. 2007) (highlighting abuses Congress sought to prevent through the PSLRA and SLUSA); *In re* WorldCom, Inc. Sec. Litig., 293 B.R. 308, 326, (S.D.N.Y. 2003) (discussing procedural reforms promulgated in connection with PSLRA).

CONCLUSION

We used to fight about more substantive matters in reorganization: cash collateral, adequate protection, exclusivity, and plan confirmation, to name a few. Today, we increasingly fight about information, or the rules that exist to control its flow. This is not surprising. The marketization of reorganization has placed a greater premium on information—especially about the company and its stakeholders. Information is the oxygen of markets. Without it, they cannot clear.

We have thus added a layer of fights about information on top of other substantive fights. This paper has described some of those fights, and argued that they arise both because of the growing value of information and an underlying failure to develop a cogent policy about information in reorganization that responds both to current market forces and deeper bankruptcy policies. This paper is hardly the last word on the subject. While the reorganization and securities law systems may share common roots, and overlap in important ways, they serve different purposes and constituencies, and should thus have different information rules, reflecting different information policies.