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Alert

Bankruptcy Judge Requires Investment Funds to Disclose Major Investors

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The Federal Rules of Bankruptcy Procedure ("Bankruptcy Rules") require each corporate party in an adversary proceeding (i.e., a bankruptcy court suit) to file a statement identifying the holders of "10% or more" of the party's equity interests. Fed. R. Bankr. P. 7007.1(a). Bankruptcy Judge Martin Glenn, relying on another local Bankruptcy Rule (Bankr. S.D.N.Y. R. 7007.1-1), recently held that investment funds that are partnerships or joint ventures must also file their statements "in the public record without redactions." *In re Motors Liquidation Co.*, 2016 WL 7187298, at *1 (Bankr. S.D.N.Y. Dec. 9, 2016). In so holding, Judge Glenn denied the motion of a group of hedge fund lenders to seal their corporate ownership statements. According to the court, its ruling follows the "strong presumption and public policy favoring open access" to court records in the Second Circuit. *Id.* at *4.

Relevance

Parties in bankruptcy adversary proceedings regularly have relied on sealing motions to seek to protect confidential information. Investment funds ordinarily treat as confidential information the identities of their underlying investors. The *Motors Liquidation* decision, however, creates uncertainty regarding the ability of investment funds to protect the identities of their investors in the future. Indeed, as the court recognized, "[i]t is far from clear that the identities of the owners of 10% or more of the equity interests of a party in an adversary proceeding can ever be confidential commercial information" requiring protection from public disclosure. *Id.* at *6.

Motors Liquidation did not create a hard and fast rule. Rather, it merely applied the rules and existing case law to the particular facts before it. Significantly, the moving lenders submitted "[n]o evidence" to support their "arguments." *Id.* at *3. As the court stressed, "[e]vidence — not just argument — is required to support the extraordinary remedy of sealing." *Id.* at *5.

Facts

Bankruptcy Rule 7007.1 requires a corporate party in an adversary proceeding (other than the debtor or a governmental unit) to file a corporate ownership statement identifying any corporation that directly or indirectly owns 10 percent or more of the corporation's equity interests. "Corporation" includes "limited liability companies and similar entities that fall under the definition of a corporation in Bankruptcy Code § 101." Fed. R. Bankr. P. 7007.1 & Comm. Notes (2003); *In re McGraw*, 2007 WL 1076690, at *6 (Bankr. N.D. Ala. Apr. 5, 2007). The Southern District of New York Local Bankruptcy Rules expand the federal

rule even further by including any "general or limited partnership or joint venture." Bankr. S.D.N.Y. R. 7007.1-1. An investment fund partnership thus falls within the purview of the local rule.[1]

These disclosure requirements led a group of investment funds as defendants in a suit in *Motors Liquidation* to move to redact from their corporate ownership statements the names of the holders of 10 percent or more of their equity interests. They also sought to "file unredacted statements under seal, and provide the Court with unredacted statements for *in camera* review." *Motors Liquidation*, 2016 WL 7187298, at *2. No objection to the sealing motion was filed, but the court denied the motion, then reconsidered, and asked the U.S. Trustee to brief the issue.

On reconsideration, the court denied the investment funds' motion to redact. The court stressed that "[n]o evidence was submitted in support of the Movants' arguments," and that "[m]ovants have failed to file a declaration supporting their confidentiality arguments." *Id.* at *3.

The court also distinguished between "confidential information" and "commercial information." "[J]ust because information may be 'confidential' does not mean it is 'commercial information' entitled to the extraordinary procedure of sealing." *Id.* at *7. The movants, according to the court, failed to meet their evidentiary burden of proving that the investors' identities were "commercial information," for they provided only "conclusory statements regarding the information's commercial importance." *Id.* Rather, to prove that information is commercial, it must be "so critical to the operations of the entity seeking the protective order that its disclosure will unfairly benefit the entity's competitors." *Id.* at *5. Moreover, Section 107(b) of the Bankruptcy Code (which protects a party's commercial information) requires "an extraordinary circumstance or compelling need," which the movants failed to show. *Id.* at *4 (citations omitted).

Finally, the court relied on a "strong [federal] policy" of "transparent proceedings" as a primary consideration for the denial of the requested relief. *Id.* at *6. "While enabling the judge to determine whether he or she has a disqualifying conflict of interest is most certainly *one* of the goals of Rule 7007.1, it is not the only goal." *Id.* (emphasis in original). Indeed, "transparent proceedings" and "public confidence in the integrity of the federal courts," reasoned the court, are additional goals of Rule 7007.1 and the Bankruptcy Code generally.

Comments

Counsel to plaintiffs or defendants in an adversary proceeding should present evidence (e.g., tangible proof of benefit to the party's competitors) if their clients seek to redact or seal the identities of their investors. Conclusory arguments by counsel regarding confidentiality may not be sufficient. Even with this evidence, however, it is unclear whether, and to what extent, a court will permit redaction or sealing. As the court noted in *Motors Liquidation*, it is accountable to the public and must "advance the goal of transparent proceedings." *Id.* at *6.

There are subtle differences between Bankruptcy Rule 7007.1, applicable in adversary proceedings, and the similarly worded Fed. R. Civ. P. 7.1, applicable in other federal courts and on appeals from

[1] The disclosure requirement in Bankruptcy Rule 7007.1 does not apply to contested matters (i.e., most garden-variety bankruptcy disputes, such as objections to debtor-in-possession financing or plan confirmation), although bankruptcy judges can make the rule applicable under Bankruptcy Rule 9014(c). Groups or committees that consist of or represent multiple creditors or equity security holders do have to disclose certain facts under Bankruptcy Rule 2019, but unlike Bankruptcy Rule 7007.1, it does not require the disclosure of direct or indirect ownership of 10 percent or more of a corporate party's equity interests.

bankruptcy courts. The former requires disclosure of "any corporation … that directly or indirectly owns 10% or more" of a party's equity interests. Outside the bankruptcy court, a party need only disclose "any parent corporation and any publicly held corporation owning 10% or more of its stock." The disclosure requirement under the Bankruptcy Rules is broader, for it encompasses any corporation (not just a parent or a publicly held corporation) that owns, directly or indirectly, 10 percent or more of the party's equity interests. Thus, parties to bankruptcy adversary proceedings are subject to greater disclosure requirements than parties to non-bankruptcy federal court actions.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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