Del. Bankruptcy Struggles With Lingering Transparency Rep

Share us on: By **Matt Chiappardi**

Law360, Wilmington (October 30, 2017, 3:39 PM EDT) -- A recent rash of unusually broad motions to seal corporate information in the Delaware bankruptcy court has raised old criticisms about the venue being too quick to acquiesce to business pressure, despite the bids having been rejected, and stoked lingering and hard-to-shake perceptions among some about the propriety of corporate bankruptcy.

Over the past few months, the Delaware bankruptcy court has seen what critics say were overly broad bids to seal information — typically either salaries for executives or information about employees — in several cases, including Maxus Energy Corp., Rupari Food Services Inc. and Sports Authority Holdings Inc.

When the U.S. Trustee's Office objected to the sealing motions, it made forceful arguments that they ran directly counter to both the Bankruptcy Code and the U.S. Congress' intent regarding what's permissible to be withheld from the public record. Several attorneys, some of whom do not regularly practice in Delaware, privately decried the sealing bids as evidence that judges in the First State at the very least hold a reputation for being too deferential to requests from business interests, even if they stretch law.

But with the exception of the Sports Authority case — in which U.S. Bankruptcy Judge Mary F. Walrath approved an executive bonus plan in August 2016 over objections that too much information was sealed — each of the other seal requests were either roundly rejected by Delaware bankruptcy judges or withdrawn by the debtor when they faced opposition.

"Naysayers might say that the court is being too deferential and information is being filed under seal that shouldn't be," said Ted Gavin of corporate restructuring firm Gavin Solmonese LLC. "If they're right, then the problem isn't with the court, but with debtors who falsely represent that it's necessary to seal. Every time I've had a client in Delaware, I've seen no evidence the courts are more deferential to the debtor."

But the reputation persists — and is shared to a degree with the Southern District of New York — and experts have tied it to several factors that include the state's decadeslong effort to portray

Delaware as an advantageous place to incorporate, based in part on the strength of its judiciary, Third Circuit law and its deference to business judgment, and what some see as unsavory aspects of the history of corporate bankruptcy itself and how The First State's identity is tied to it.

"To a large extent, judges in Delaware look at themselves as in the service industry," said University of Chicago Law School professor Douglas G. Baird. "Their job as judges is to help [corporate players] sort out their problems. They're not there to transform the world and make it a better place."

Both Baird and Gavin noted that the law does well establish that there is corporate information that can be filed under seal, such as customer contracts or trade secrets, exposure of which is deemed to cause irreparable harm to a business.

Baird said there have been confidential meetings where the price of a bond is moving in real time because someone is communicating with a cellphone, and that from an academic perspective he is curious about information such as which vendors are being paid, "but that's not the relevant criteria."

Several attorneys cast the issue as a regional one, contrasting Delaware and New York's perceived quickness to allow information to be sealed to other venues.

Aram Ordubegian, Arent Fox LLP's West Coast team leader and a partner in its bankruptcy and financial restructuring group, noted that in California, the sealing procedures are only invoked "once or twice per year," and courts are hesitant to allow it.

"Courts are careful not to allow the seal process to be used as an advantage," Ordubegian said. "We grow up being told more disclosure is better than less."

Veteran attorney Hugh M. Ray, who heads McKool Smith PC's national bankruptcy practice, said that requests to seal often come from a company wanting as little publicity as possible about financial plight, and success in that endeavor can vary from venue to venue.

"Generally, requests to seal are from big guys looking to keep little guys in the dark," Ray said. "It happens more in Delaware than say in Texas or elsewhere and can be a red state/blue state thing, big guy versus little guy thing, but in a different sense of being conservative versus being liberal. If you think the sole purpose of the law is to make the system stable, then you can seal anything."

But local rules surrounding the issue tend to be similar, and experts have said that both Delaware and New York tend to get more complex business cases and thus generate an outsized result regarding sealing requests.

Ray says success or failure on a sealing bid can sometimes comes down to a judge-by-judge basis, based on how particular judges view their roles.

Several attorneys said that in Delaware, U.S. Bankruptcy Judge Brendan L. Shannon and U.S.

Bankruptcy Judge Christopher S. Sontchi are seen as the judges who are most unlikely to allow information to be sealed, with others viewed as being more permissive in contrast.

Moreover, U.S. Bankruptcy Judge Kevin J. Carey late last year rejected a bid to seal information about employee bonuses in the case for e-cigarette maker NJOY Inc.

Several requests, such as in the Maxus and Rupari cases, have centered on the addresses of employees, which are already in the public record, and both were also rejected.

Experts say history plays a role in how the Delaware bankruptcy is viewed, going back to both the 1980s when corporate judicial venue choice was solidifying and to practices that we perceived as unsavory in the days before bankruptcy reform in the late 1970s gave us the modern Bankruptcy Code.

Before the U.S. Bankruptcy Reform Act of 1978, what are thought of today as bankruptcy judges were mostly called bankruptcy referees and operated under a looser set of rules and standards.

"It wasn't even a court of record," Ray said. "Bankruptcy sort of took place in the back of building. There was so much fraud in those days that it was kind of dirty area."

Ray added that strict standards for proving certain situations were virtually nonexistent, often with whatever said by the party with the most leverage taken as fact and the case sometimes run by banking lawyers instead of bankruptcy specialists.

Baird said that the "old-fashioned bankruptcy referee was unattractive," and noted the system responded to a need for reform in the 1970s.

Some of that reputation extended into the 1980s, with several attorneys saying that celebrated judges at the time such as the late U.S. Bankruptcy Judge Burton R. Lifland in the Southern District of New York looked at corporate issues too uncritically.

Judge Lifland was widely viewed as an innovator when it came to business bankruptcies, almost single-handedly creating the paradigm by which modern corporate Chapter 11s are run, but his critics described him as too eager to please the lawyers before him, and by extension their clients, to ensure New York City would remain a top insolvency destination.

The same sort of split can be found around retired U.S. Bankruptcy Judge Helen S. Balick, who is credited with putting Delaware on the map as a bankruptcy law destination for out-of-state entities in the 1990s when she accepted the petition for Continental Airlines. While also revered in bankruptcy circles for injecting a smart and efficient ethic into proceedings, at least one attorney who was practicing during her tenure, which ended in 1999, expressed "shock" at how deferential to companies she could seem to be.

How deserved such an unfavorable reputation is remains up for debate, with Ray saying there is "a lot of lore, but not a lot of law"" that addresses the issue.

And things are different now, many experts say, even if consensus may not have caught up.

“Courts do give wide deference to debtors, but you really do need a good reason if you’re going to file something under seal,” Gavin said. “If you’re going to get up there and say your client is a special snowflake, you’d better be ready to back that up with a lot of photographic and microscopic evidence.”

--Editing by Rebecca Flanagan and Kelly Duncan.