New York Law Journal
Corporate Restructuring and Bankruptcy
WWW.NYLJ.COM
An ALM Publication
VOLUME 256—NO. 107
MONDAY, DECEMBER 5, 2016

NDAs With Compelled Disclosure Are Critical to Reaching a Deal

SHUTTERSTOCK

BY STEPHEN D. ZIDE AND JOSEPH A. SHIFER

Many practitioners and in-house counsel are familiar with the use of non-disclosure agreements (NDAs) in a variety of contexts, including litigation discovery and corporate due diligence. For the most part, NDAs provide that information shared among the parties will remain confidential either indefinitely or until an agreed point in time when it is contemplated that the information shared will no longer be sensitive.

In the restructuring context, however, negotiations are frequently conducted among the distressed company (i.e., the debtor) and parties holding debt and/or equity securities of the debtor. This often leads to a complicated dynamic whereby the security holders do not want to receive confidential information about the debtor because trading in the securities of a debtor while in possession of material non-public information (MNPI) about the debtor may trigger insider trading liability under §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.[1] Trading while in the possession of MNPI could subject a securities holder to private civil suit, regulatory enforcement action by the U.S. Securities and Exchange Commission (SEC), or criminal prosecution by the U.S. Department of Justice. In addition, a party trading while in possession of MNPI may be subject to claims to subordinate recoveries on their securities to other parties for inequitable conduct under §510(c) of the Bankruptcy Code.[2]

For example, in the bankruptcy case of *Washington Mutual* (WaMu), an official committee of equity holders sought standing to seek to subordinate the claims of certain debt holders under the theory that the debt holders engaged in trading the debt of WaMu while in possession of MNPI.[3] In *WaMu*, the debtor sought to negotiate the terms of a Chapter 11 plan and entered into NDAs with certain large creditors to share confidential information pertinent to the negotiations. While the NDAs provided that the debtor would publicly disclose all MNPI it shared with its creditors following the negotiations, the debtors did not make public the terms of the negotiations because the negotiations did not result in an agreement. The equity committee argued, among other things, that knowledge of the negotiation terms constituted MNPI, and, therefore, the negotiating creditors improperly traded in WaMu securities following the negotiations. In a decision granting the equity committee standing to pursue its claims, the Bankruptcy Court

STEPHEN D. ZIDE *is a partner and* JOSEPH A. SHIFER *is an associate in the corporate restructuring and bankruptcy department of Kramer Levin Naftalis & Frankel.* ABBE L. DIENSTAG, *a partner of the firm, assisted in the preparation of this article.*

found that the terms of the negotiations may constitute MNPI such that securities laws may have restricted the negotiating creditors from trading securities.[4] Ultimately, as part of confirmation of WaMu's Chapter 11 plan, the Bankruptcy Court vacated its decision granting the equity committee standing.[5]

More recently, in the *Aéropostale* bankruptcy, the debtors alleged that their secured lenders, affiliates of the debtor's equity holder, should be denied the right to credit bid their secured debt in connection with a sale of the debtors' assets (which was collateral for the secured debt) on the theory, among others, that the equity holder traded in securities of the debtor while in the possession of MNPI of the debtor. The MNPI in question was financial data that was supplied to the secured lenders under the terms of their credit agreement with the debtors.[6] There, the Bankruptcy Court rejected the debtors' arguments because there was insufficient evidence supporting the debtors' allegation of insider trading.[7]

Holders of a debtor's securities will therefore often be wary of receiving information from the debtor as part of restructuring negotiations because, in the event such information constitutes MNPI, they may be unable to trade the debtor's securities without exposure to private or governmental litigation risk.[8] Indeed, as noted above, the terms of the restructuring being negotiated may constitute MNPI, and the holder may become restricted from trading the debtor's securities simply by participating in restructuring negotiations.

The hesitancy of a debt or equity holder to receive MNPI about a debtor often creates a significant roadblock to meaningful restructuring negotiations. Having informed participants with adequate business and financial data about the debtor is critical to the negotiation process, particularly among constituents in a restructuring of a debtor's debt obligations. The situation is particularly acute when the financial circumstances of the debtor are deteriorating, as parties will want to maintain maximum flexibility to quickly sell their securities before the debtor's business declines further.

The risks associated with buying and selling securities of a debtor while in possession of MNPI have given rise to so-called "disclosure," or "blowout" provisions in NDAs. These disclosure provisions provide that the debtor will make public the MNPI shared pursuant to the NDA by an agreed-upon date. By agreeing in advance to a disclosure provision, the debtor can facilitate meaningful participation in restructuring negotiations by removing the possibility that its security holders will become indefinitely restricted.

A key component of a disclosure provision is agreement on the information that will be made public on the disclosure date. The language of the NDA in this regard can range from a broad catch all, which provides that any MNPI shared will be disclosed, to more specific language, which explicitly identifies the information to be disclosed. Ideally from the debtor's perspective, information that the parties intend to make public, such as a term sheet or presentation containing the terms of a restructuring proposal or a specific set of financial or business data, can be specifically identified as disclosure material in the NDA. Alternatively, the parties can agree to mark the information to be disclosed as "disclosure material," and professionals for the security holder will transmit to their clients only information that is subject to disclosure. By clearly marking the information in advance, the parties should eliminate any dispute as to the information to be disclosed. A well-drafted cleansing NDA will also include procedures that will allow the parties to quickly resolve disputes over whether certain information must be disclosed.

The NDA should specify the discrete dates or events that would trigger disclosure of the cleansing material. The parties must agree on the point in time when certain MNPI is no longer worth keeping confidential. Where the material to be disclosed consists of the terms of a restructuring being negotiated, upon the completion of a defined period of negotiation, such as the conclusion of a mediation session or the filing of a bankruptcy petition, there may no longer be any purpose to keeping the information confidential. Alternatively, a cleansing trigger can be a fixed calendar date that will serve to focus the parties' negotiations. Of course, if circumstances warrant, the parties can mutually agree to extend the date, which often happens.

Typically if a debtor is a public company that is required to file reports with the SEC, a cleansing NDA will require the debtor to publish the disclosure information with the SEC, such as part of a Form 8-K, any periodic report permitted to be filed under the Exchange Act, or in such other manner that the parties determine will result in public dissemination of the information. If the debtor is not a public company and cannot file reports with the SEC, the alternative may be to publish the cleansing information with a newswire service, or, if the debtor has initiated bankruptcy proceedings, with the Bankruptcy Court. Because the party to the NDA with the debtor does not have control over whether the debtor will be in a position to fulfill its disclosure obligations, a well-drafted cleansing NDA will provide the recipient with the option of publishing the cleansing information if the debtor does not do so in a timely manner.

In sum, the cleansing NDA has become an indispensable tool in the context of restructuring negotiations. It bridges the competing interests of the parties by providing the debtor with protection for its confidential information and security holders with the assurance that they will not be restricted from trading indefinitely. The debtor and its creditors will then be best situated to negotiate a consensual restructuring.

1. See 17 C.F.R. 240.10b-5.
2. Section 510(c) of the Bankruptcy Code permits a bankruptcy court to subordinate a creditor's claim "under principles of equitable subordination."
3. *In re Washington Mutual*, 461 B.R. 200 (Bankr. D. Del. 2011), vacated in part *In re Washington Mutual*, Case No. 08-12229 (MFW), 2012 WL 1563880 (Bankr. D. Del. Feb. 24, 2012).
4. Id. at 263 ("Based on the evidence presented thus far, however, it appears that the negotiations may have shifted towards the material end of the spectrum and that the Settlement Noteholders traded on that information which was not known to the public.").
5. See *In re Washington Mutual*, Case No. 08-12229 (MFW), 2012 WL 1563880 (Bankr. D. Del. Feb. 24, 2012)
6. *In re Aéropostale*, 555 B.R. 369, 410 (Bankr. S.D.N.Y. 2016).
7. Id. at 413-14.
8. Depending on the circumstances, counterparties may still be willing to trade pursuant to so-called "big boy" letters, which is an agreement where both parties to a transaction acknowledge that one of the parties may be in possession of MNPI.