

RECENT DEVELOPMENTS CONCERNING THE USE OF “BLOCKING PROCEDURES” IN CHAPTER 11 PROCEEDINGS

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I. INTRODUCTION

Creditors in chapter 11 proceedings who volunteer to serve as members of an official committee of unsecured creditors are frequently privy to confidential information about the chapter 11 debtor. That exposure to confidential information can present a dilemma for certain creditors whose fiduciary duty to the constituency of unsecured creditors represented by the committee may impact the creditor’s ability to undertake otherwise legitimate business activities that it would otherwise pursue. The classic example of this dilemma involves the ability of institutional financial investment firms who regularly trade securities to serve on creditors committees. Such firms owe fiduciary duties to their clients that, in order to enable those firms to serve as a member of a creditors committee, must be reconciled with the fiduciary duty owed by committee members to unsecured creditors.

Since the early 1990’s, this dilemma has been resolved by numerous courts through the approval and implementation of so-called “blocking procedures.” The seminal decision in this area was *In the Matter of Federated Department Stores, Inc.*, 1991 WL 79143 (Bankr. S.D. Ohio 1991). In *Federated Department Stores*, the bankruptcy court ordered that members of the committee who engaged in the trading of securities as a regular part of their business would not violate their fiduciary duties as a member of the committee by trading in securities of the debtor and its affiliates, provided that such members employed appropriate information blocking devices – what are now

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also described as “ethical walls” – reasonably designed to prevent the exchange of information between committee personnel and trading personnel. Significantly, in *Federal Department Stores*, the United States Securities and Exchange Commission (the “SEC”) filed a brief in support of the relief requested by Fidelity, finding that the use of ethical walls and blocking procedures was consistent with federal securities laws and would encourage multi-service financial institutions, and other entities that trade securities as a regular part of their business, to serve on committees in bankruptcy cases.²

Numerous court have following the lead of Judge Aug in *Federal Department Stores*, and held that institutional investment firms who regularly engage in trading activities and establish “ethical walls” can serve on creditors committees and engage in trading activities without violating their fiduciary duties to unsecured creditors.³

Notwithstanding the fact that orders approving the use of ethical walls and other blocking procedures have become prevalent, they are not universally accepted. For example, the

² A copy of the memorandum filed by the Securities and Exchange Commission is appended hereto as Attachment A.

³ A non-exhaustive list of orders approving such blocking procedures includes the following: *In re Ace-Texas, Inc.*, No. 96-166 (Bankr. D. Del. July 17, 1996); *In re Mid Am. Waste Sys., Inc.*, No. 97-0104 (Bankr. D. Del. Feb. 26, 1997); *In re Acme Metals, Inc.*, No. 98-2179 (Bankr. D. Del. Dec. 21, 1998); *In re ICO Global Communications Servs. Inc.*, No. 99-2933 (MFW)(Bankr. D. Del. Sept. 21, 1999); *In re Integrated Health Services, Inc.*, No. 00-0389 (Bankr. D. Del. May 4, 2000); *In re Sun Healthcare Group, Inc.*, No. 99-3657 (MFW)(Bankr. D. Del. Jan. 11, 2000); *In re Vista Eyecare, Inc.*, No. A00-65214 (Bankr. N.D. Ga. June 1, 2000); *In re GST Telecom, Inc.*, No. 00-1982 (GMS)(Bankr. D. Del. Oct. 19, 2000); *In re the Finova Group, Inc.*, No. 01-0697 (Bankr. D. Del. Apr. 12, 2001); *In re Iridium Operating LLC*, No. 99-45005 (Bankr. S.D.N.Y. Nov. 3, 1999); *In re Pac Gas & Elec. Co.*, No. 01-30923 (Bankr. N.D. Cal. July 26, 2001); *In re USG Corp.*, No. 01-2094 (Bankr. D. Del. Oct. 22, 2001); *In re Dairy Mart Convenience Stores, Inc.*, No. 01-42400 (Bankr. S.D.N.Y. Dec. 20, 2001); *In re Enron Corp.*, No. 01-16034 9 (Bankr. S.D.N.Y. Feb. 27, 2002); *In re Global Crossing, Ltd.*, Nos. 02-40187 through 02-40241 (Bankr. S.D.N.Y. Mar. 25, 2002); *In re Flag Telecom Holdings Ltd.*, Nos. 02-11732 through 02-11736 and 02-11975 through 02-11979 (Bankr. S.D.N.Y. Jul. 22, 2002); *In re World Com, Inc.*, 02-13533 (Bankr. S.D.N.Y. Aug. 6, 2002); *In re Magellan Health Servs. Inc.*, No. 03-40515 (Bankr. S.D.N.Y. May 6, 2003); *In re Mirant Corp.*, NO. 03-46590 (Bankr. N.D. Tex. Aug. 18, 2003); *In re Loral Space & Communications Ltd.*, No. 03-41710 (Bankr. S.D.N.Y. Sep. 4, 2003); *In re Solutia Inc.*, No. 03-17949 (Bankr. S.D.N.Y. Jan. 22, 2004); *In re Pegasus Satellite Television, Inc.*, No. 04-20878 (Bankr. D. Me. Jun. 24, 2004); *In re FiberMark, Inc.*, No. 04-10463 (Bankr. D. Vt. Oct. 19, 2004).

Office of the United States Trustee has taken the position that such orders constitute “advisory opinions” that bankruptcy courts lack the constitutional authority to issue. Although a majority of courts have either explicitly or implicitly concluded that they have the necessary authority to grant such relief, as discussed below, at least one bankruptcy court has held to the contrary.

In recent years, there have been efforts by committees to expand the utilization of “blocking procedures” to protect activities of committee members beyond the trading of securities issued by the debtor. For example, in the bankruptcy case of Pacific Gas & Electric Company, the committee sought approval of blocking procedures that would apply to the trading of commodities. Likewise, in a bankruptcy case now pending in Hawaii, *In re Azabu Buildings Company, Ltd.*, the committee sought approval of blocking procedures that would apply not only to the trading of claims but also to the acquisition of assets owned by the debtors. The rationale offered by the committees in support of those requests resembled the one offered in support of more traditional blocking procedures: namely, to encourage participation of creditors on committees and not to discourage those creditors by preventing them from engaging in activities that they might otherwise undertake.

Notably, the Office of the United States Trustee has fiercely resisted such efforts, and has even taken the position that fees incurred by committee professionals to obtain such relief are for the exclusive benefit of members and thus may not be subject to reimbursement under section 330 of the Bankruptcy Code. As for the courts, they appear to have adopted the view that the dilemma faced by institutional investment firms who regularly engage in the business of buying and selling securities, which has traditionally justified the approval of blocking procedures, does not necessarily apply to or warrant protection of other kinds of activities.

II. THE GENESIS OF THE USE OF “BLOCKING PROCEDURES” TO PROTECT COMMITTEE MEMBERS – *FEDERATED DEPARTMENT STORES*

In order to evaluate the arguments in favor of and against expansion of the use of “blocking procedures,” it is instructive to reexamine *Federated Department Stores*, along with the memorandum filed by the United States Securities and Exchange Committee in support of the relief granted in that case.

As discussed above, the order entered in *Federated Department Stores* was the first to authorize members of a creditors committee to trade in the debtor’s securities subject to the implementation of appropriate blocking procedures. In *Federated Department Stores*, the issue arose after the Office of the United States Trustee sent a letter to the official Federated bondholders committee, stating that members of the committee would be precluded from trading in the securities of Federated or its affiliates.⁴ That led one of the members of that committee, Fidelity Management & Research Company (“Fidelity”), to file a motion requesting the bankruptcy court to enter an order determining that Fidelity would not be violating its duties as a committee member by trading in the securities of Federated or its affiliates.

In response to that motion, the SEC filed a memorandum supporting the relief requested by Fidelity. In that memorandum, the SEC provided a detailed overview of its perspective on the intersection of federal securities law and bankruptcy law. The SEC labeled the members of an official committee of creditors as “temporary insiders” who are subject to the same insider trading restrictions as “true insiders” such as corporate directors.⁵ The SEC then proceeded to describe the manner in which blocking procedures have been used in the securities law context. The SEC explained the importance of

⁴ A statement of the case was provided in the memorandum filed by the United States Securities and Exchange Commission, which is appended as Attachment A, at pages 4-5.

⁵ *Id.*, at 5.

blocking procedures in what it called the “classic case” where a firm’s investment banking department obtains material nonpublic information about a company at the same time that the broker-dealer department of a firm is recommending or executing customer transactions in the securities of that company based on public information that is not consistent with the confidential information held by the investment banking department.⁶ In its memorandum, the SEC identified several provisions under securities laws where the use of blocking procedures had been formalized.⁷

The SEC then proceeded to review bankruptcy law. In particular, the SEC focused on the repeal of section 249 of the former Bankruptcy Act, which had provided that fiduciaries would be denied compensations for services rendered in bankruptcy proceedings if they engaged in any trading of the debtor’s securities. After reviewing the legislative history to the Bankruptcy Code, which originally proposed to include section 249 but then omitted the provision from the final bill as enacted, the SEC offered, as the “most likely” explanation for that omission, its view that “Congress intended to give more flexibility for interpretation of the fiduciary duty that is owed by members of official committees,” and that such determinations should be left to the bankruptcy court’s “general equitable powers.”⁸

⁶ *Id.* at 8.

⁷ These examples included the following: 1) the adoption of Rule 14e-3, 17 C.F.R. 240.14e-3, which provides an exception from an entity’s duty to disclose inside information or abstain from trading where a tender offer is pending, if the entity can “show that the individuals making the investment decision are not privy to the inside information and that the entity has implemented policies and procedures, reasonable under the circumstances, to ensure that the securities laws would not be violated”; 2) the application of principles under Rule 14e-3 to actions under section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder; and 3) the enactment of the Insider Trading Securities Fraud Enforcement Act of 1988 (“ITSFEA”), which mandates such devices for broker-dealers and investment advisors. *Id.* at 6-13.

⁸ *Id.* at 13-21.

Significantly, the SEC urged the bankruptcy court to permit trading only by committee members that “are engaged in the trading of securities as a regular part of their business.” As stated by the SEC:

The Commission does not urge that the Court hold that all entities be permitted to trade in the securities of the debtor while serving on an official committee. Information blocking devices are not fool-proof, and therefore an absolute bar to trading would be a more effective means of preventing the misuse of material, nonpublic information. Also, there are arguments rooted in bankruptcy law that no trading should be allowed by committee members. The Commission therefore believes that trading by committee members should only be permitted if there exists a significant policy rationale in favor of allowing trading.⁹

From the SEC’s perspective, the “significant policy rationale” applied only to firms “that engage in the trading of securities in the regular course of business”:

Such entities – such as investment advisors, banks, broker-dealers, pension funds, and insurance companies – have the type of expertise which is valuable to official committees. In addition, such entities traditionally have considerable experience with the implementation of blocking devices. Moreover, it is unfair to force such an entity to make a choice between serving on a committee and continuing to engage in its regular business; such a dilemma is not faced by entities that do not regularly engage in securities trading.¹⁰

In short, the SEC offered three reasons why it believed investment firms should be entitled to serve on committees and continue to trade in securities issued by the debtor:

1) they offer unique expertise that is valuable to committees; 2) they are well versed in the proper use of blocking procedures; and 3) without the blocking procedures in place,

⁹ *Id.* at 21-22.

¹⁰ *Id.* at 22.

they truly would be unable to serve on a committee, given their competing obligation to engage in their regular business of trading for their customers.

Notwithstanding the above, the SEC urged the bankruptcy court to require each committee member to file a copy of its blocking device procedure with the bankruptcy court prior to trading, offering the rationale that “[s]uch written notice would likely serve as a deterrent to illegal insider trading and would require that the entity take its obligations in this area seriously.”¹¹

In *Federated Department Stores*, the bankruptcy court appears to have adopted, nearly wholesale, the recommendations of the SEC. Judge Aug held that Fidelity would not be violating its fiduciary duties as a committee member nor subjecting its claims to possible disallowance, subordination or other adverse treatment, provided that Fidelity employed an “appropriate information blocking device” to prevent the flow of information between committee personnel and trading personnel. In particular, the bankruptcy court identified five features necessary for the blocking procedures to be “appropriate”:

- All committee personnel with access to nonpublic information were required to execute a letter acknowledging that they may receive nonpublic information and were aware of the ethical wall in effect with respect to the debtors and affiliates.
- Committee personnel would not share nonpublic information with other employees of that member (except the general counsel for the purpose of rendering advice and subject to the general counsel’s agreement not to share such information with other employees).

¹¹ *Id.*

- Committee personnel would maintain all files containing non-public information generated from committee activities in cabinets inaccessible to other employees.
- Committee personnel would not be permitted to receive any information regarding current securities trades in advance of such trades, except that they could receive ownership reports no more frequently than monthly.
- The committee member's compliance department personnel would review the trades of the member's trading personnel to confirm compliance with the procedures, and maintain records of that review.¹²

Significantly, the bankruptcy court in *Federated Department Stores* retained some flexibility in the event the approved blocking procedures proved to be inadequate, by including language in the order that said it was “not intended to preclude the Court from taking any action it may deem appropriate in the event that it is determined that an actual breach of fiduciary duty has occurred because the procedures employed are not so effective”¹³

III. EFFORTS TO CURTAIL AND EXPAND THE SCOPE OF *FEDERATED DEPARTMENT STORES*

Since *Federated Department Stores*, other courts have been asked to enter orders similar to the one entered in that case. As reflected in footnote 3, *supra*, numerous courts have entered such orders, albeit subject to similar limitations and conditions as were imposed in *Federated Department Stores*.

This is not to say that all bankruptcy courts have enthusiastically endorsed approval of blocking procedures for committee members. For example, in *In re*

¹² *Federated Department Stores*, 1991 WL 79143, at 1.

¹³ *Id.*

Spiegel,¹⁴ Judge Blackshear declined to approve proposed information blocking procedures. In that decision, the bankruptcy court acknowledged that it had previously approved such procedures in *In re Iridium Operating LLC*,¹⁵ but went on to say that “[h]indsight is always 20/20, and this Court [ruled] the day it opened the Pandora’s Box in Iridium.”¹⁶ The court made clear that it would “hold the Committee to full and strict compliance with its fiduciary obligations,” expressing concern that “if members of the Committee are allowed to trade in the securities of the Debtor, regardless of how the creditor internally divides its office, there is an appearance of impropriety,” and that such trading information, if made public, “could influence non-members in the marketplace who might not be aware of the screening mechanisms in place.”¹⁷

In certain cases, the courts and/or parties in interest have sought to limit or expand, or otherwise consider the implications of, the scope of the protection granted in *Federated Department Stores*. Among the issues addressed by courts or by parties in interest such as the Office of the United States Trustee have been the following: 1) the “justiciability” of an order approving blocking procedures; 2) the expansion of the protection to activities other than the trading of securities; 3) whether the committee itself (and perhaps more importantly, the committee’s professionals who are paid by the estate) can or should seek approval of blocking procedures that apply to its members; and 4) the implications of section 1102(b)(3) of the Bankruptcy Code, which provides for a committee to share information with its constituents. These issues are addressed in turn.

¹⁴ 292 B.R. 748 (Bankr. S.D.N.Y. 2003).

¹⁵ Case No. 99 B 45005 (CB) (Bankr. S.D.N.Y. Nov. 3, 1999).

¹⁶ *Id.* at 751.

¹⁷ *Id.*

A. The “Justiciability” of Blocking Procedures Orders

While it appears that the majority of courts presented with a request to approve blocking procedures have explicitly or implicitly found that they have the authority to do so, not every court has come to that conclusion. At least one court has expressly held that such relief constitutes nothing more than an advisory opinion. In *In re Amresco, Inc.*,¹⁸ the bankruptcy court declined to enter an order along the lines approved by other courts, even though neither the debtor nor any other party in interest opposed the motion. In response to the request for what it termed a “comfort order,” the court characterized the request as seeking an “abstract opinion on a matter not ripe for decision, one in which there is no present conflict between parties in interest, either under a contested matter established under the Bankruptcy Code or in an adversary proceeding.”¹⁹ Accordingly, the court found there to be an absence of any “live case or controversy.” The court was unwilling to rely upon section 105 of the Bankruptcy Code to confer the authority necessary to enter the order. Instead, the court made clear that each committee member would have to decide for itself how to discharge its affairs, and/or whether to resign from their positions on the committee.²⁰

Other courts have more readily concluded that a request for an order approving blocking procedures is justiciable. The most notable of those decisions was issued by Judge Montali in the Pacific Gas & Electric (“PG&E”) bankruptcy case.²¹ In *PG&E*, the court reviewed the Supreme Court precedent regarding “justiciability” to determine whether the question before him arose in an “adversary context” or instead merely

¹⁸ Case No. 01-35327-SAF-11 (Bankr. N.D. Tex. 2001). A copy of the Amresco decision is appended as Attachment B.

¹⁹ *Id.* at 2.

²⁰ *Id.* at 5-6.

²¹ *In re Pacific Gas & Electric Company*, Case No. 01-30923-DM (Bankr. N.D. Cal. Jul 26, 2001). A copy of the decision is appended as Attachment C.

reflected “the rarified atmosphere of a debating society.”²² Noting that bankruptcy “inherently brings immediacy and an ‘adversary context’ to issues that otherwise would not be ripe or adversarial,” the bankruptcy court cited to numerous examples under bankruptcy law where bankruptcy courts must, “on a daily basis . . . grant relief against all creditors after notice and, if no party in interest comes forth, often without a hearing.”²³ Judge Montali further observed that (a) bankruptcy courts must adjudicate issues, such as whether plans of reorganization and fee applications comply with the Bankruptcy Code, even in the absence of any objection, and (b) bankruptcy courts have the power to estimate contingent liabilities notwithstanding the “ripeness” issues that might otherwise preclude such relief outside of bankruptcy.²⁴ The bankruptcy court also pointed to the fact that requests for instructions regarding the proper role and composition of a fiduciary (such as a committee member) was “historically common in bankruptcies and receiverships.” Ultimately, the bankruptcy court in *PG&E* concluded that making a decision on the motion was entirely consistent with the above principles.²⁵

At least one other court has adopted the reasoning of Judge Montali in expressly concluding that the question of whether to approve blocking procedures is a justiciable controversy. In *In re Azabu Buildings Co., Ltd.*,²⁶ the United States Bankruptcy Court for the District of Hawaii rejected the argument of the Office of the United States Trustee and the debtor that the request sought an advisory opinion, instead finding the request to

²² *Id.* at 7-8.

²³ *Id.* at 8.

²⁴ *Id.* at 8-9.

²⁵ *Id.* at 10.

²⁶ Case No. 05-50011 (Bankr. D. Haw. Sept. 29, 2006).

be “analogous to a request for instructions by a traditional equity receiver or bankruptcy trustee or some other fiduciary functioning under a court’s control.”²⁷

Given the number of courts that have been willing to grant motions for approval of blocking procedures, as well as the reasoning of the court in *PG&E*, it appears unlikely that arguments about lack of justiciability are likely to present any serious obstacle to bankruptcy courts that are otherwise prepared to grant such relief where requested.

B. Efforts to Expand the Scope of Activities Protected by Blocking Procedures Orders.

As discussed above, orders to approve blocking procedures have typically been granted for the limited purpose of protecting financial investment firms whose regular business involves the trading of securities. In recent years, motions have been brought seeking to expand the protection of blocking procedures to cover the following activities by committee members: 1) preparing and publishing research with respect to the debtor; 2) trading in commodities; and 3) purchasing assets from the debtor.

Of the above activities, the only one that has received court approval involved the preparation and publication of research regarding the securities issued by a debtor. In *In re PG&E*,²⁸ the blocking procedures were tailored to permit committee members such as Bank of America, Merrill Lynch, Enron Corp., and Morgan Guaranty Trust Company of New York not only to trade securities, but also to publish their research. For example, the blocking procedures prevented committee members from obtaining access to such research until after the reports were released to the public. The order also contained a provision to address the possibility that a committee member might inadvertently receive

²⁷ See *In re Azabu Buildings Co., Ltd.*, Case No. 05-50011, Transcript of Hearing Held Sept. 18, 2006 (“Azabu Hearing Transcript”), at 6:12-18.

²⁸ Case No. 01-30923-DM (Bankr. N.D. Cal. Jun. 26, 2001). Notably, this order is separate from the one referenced above which addressed the justiciability of a request for approval of blocking procedures. That decision, which sought approval for the trading of commodities, is addressed below.

such information before its release to the public: in the event that occurred, the committee member was obligated to disclose that fact in writing to the committee's legal counsel and to abstain from voting on any matter that might be affected by such non-public information.²⁹

In contrast, the bankruptcy court in *PG&E* was unwilling to approve, over the objection of the Office of the United States Trustee and the City of San Francisco, blocking procedures for the trading of commodities (and/or publishing of such information). In reaching that decision, the court first focused on what it perceived to be “fundamental differences” between trading in securities issued by PG&E or its affiliates, versus “engaging in commodities trading at the same time PG&E does so as part of its fundamental business.”³⁰ The bankruptcy court viewed securities abuse as primarily tending to harm the parties who trade in the securities, and only secondarily to issuers such as PG&E. In contrast, Judge Montali held that trading in commodities such as electricity or gas, or their financial derivatives, “could directly affect the price at which PG&E purchases those commodities or could enhance the trader's competitive position over PG&E,” with the potentially adverse impact on PG&E likely to be “direct and immediate.”³¹

The bankruptcy court also pointed to differences between the markets for securities and commodities, noting that the wholesale market for electricity had been called “dysfunctional” and that prices had been “very volatile.” Judge Montali observed that the nature of the commodities market could “create enormous incentives to misuse confidential information” and that “ethical walls can crumble under such pressure.”³²

²⁹ *Id.* at 4.

³⁰ *See* Attachment C, at 11.

³¹ *Id.* at 12.

³² *Id.*

The court in *PG&E* was also reluctant to grant approval of the blocking procedures given the committee's inability to cite any authorities supporting the motion in the commodities context – unlike in the securities context where the committee not only was able to provide copies of similar orders but also the supporting memorandum filed by the SEC in the *Federated Department Stores* case. The bankruptcy court called attention to the fact that, in stark contrast to the SEC's support of blocking procedures, neither the Commodities Futures Trading Commission nor the Federal Energy Regulatory Commission had submitted a brief in support of blocking procedures for commodities trading, and there was thus no evidence to support the efficacy of ethical walls in the commodities industry.³³

Finally, the court in *PG&E* was unable to conclude that the members of the committee in that case would, if deprived of the protection of the blocking procedures, either resign or cause any significant harm to the estate if they did resign. Five of the eleven members had stated that they would “consider” resigning, but the Office of the United States Trustee had stated that she had seventy five prospective creditors ready to replace any members who resigned. Given the bankruptcy court's conclusion that the benefit to PG&E and its estate was “speculative and vague and best,” any potential benefit was outweighed by the risk of permitting committee members to “compete in the same business arena as PG&E while they obtain sensitive and confidential information as fiduciaries to the estate.”³⁴

³³ *Id.* at 13 n.10.

³⁴ *Id.* at 14-15. Interestingly, the United States Trustee Manual does not *per se* preclude competitors of a debtor from serving on the committee, although it does highlight the potential issues regarding a competitor's receipt and potential misuse of confidential information. See www.usdoj.com/UST, United States Trustee Manual, at § 3-4.4.1.4. The Office of the United States Trustee has been proactive in seeking to implement blocking procedures under such circumstances, albeit without affording the kind of protections granted by other courts. In the Delta bankruptcy case, the Office of the United States Trustee filed a motion requesting that the bankruptcy court enter an order establishing blocking procedures for creditors of airlines that serve on committees in multiple bankruptcy cases. Over the objection of one of the committee

In *Azabu Buildings*, the committee sought approval of blocking procedures that would not only permit members of the committee to purchase and sell claims against the debtor, but also grant protection if a committee member decided to make a bid to purchase the assets of the estate. Both the Office of the United States Trustee and the debtor, along with other parties in interest, objected to the motion. In addition to arguing that the motion sought an advisory opinion (which, as discussed above, was rejected by the bankruptcy court), the Office of the United States Trustee complained that the proposed guidelines were vague and overbroad, and that granting protection could shield committee members from liability for breaches of fiduciary duty.

In denying the motion, Judge Faris observed that requests for approval of blocking procedures must be reviewed on a case by case basis, and concluded that no significant benefit would result from approval of the blocking procedures.³⁵ In part, this conclusion was based on the court's conclusion that there was no indication any member would resign or could not be replaced by another creditor who was equally competent and equally motivated.³⁶ The court also expressed concern about potential detriment to the estate if the blocking procedures were not followed.³⁷

Ultimately, after hearing oral argument, the bankruptcy court in *Azabu Buildings* concluded that committee members are always in a difficult position, but that as fiduciaries, "they had to make a choice."³⁸ The court did observe that there may be cases

members, that motion was ultimately granted. *In re Delta Airlines, Inc.*, Case No. 05-17923 (PCB) (Bankr. S.D.N.Y. Dec. 23, 2005). See Jane Lee Vris, Current Developments: Official Committees Review of Recent Cases, 888 PLI/Comm 391, 403 & Appx. A (2006) (attaching protocol adopted in *Delta* for segregating information when a committee member serves on the committee of a competitor-debtor).

³⁵ Azabu Hearing Transcript, at 7:10-13.

³⁶ *Id.* at 7:17-22.

³⁷ *Id.* at 7:23-25.

³⁸ *Id.* at 19:7-16.

involving “the really big public company cases” where it would be necessary and beneficial to the estate to establish blocking procedures and run the risk of leaked confidential information simply to have a functioning qualified committee, but the court simply was not persuaded that *Azabu Buildings* was that case.³⁹

In evaluating the above cases, it appears that courts may be somewhat hesitant to expand the scope of the activities protected under *Federated Department Stores*. Moreover, courts also appear hesitant to grant such protection to creditors who do not regularly engage in such trading activity. This may be a result of two factors distinguishing institutional financial investment firms from other creditors: first, general creditors are not necessarily perceived to require such dispensation to serve on creditors committees since they do not engage in trading as a regular part of their business; and second, general creditors are not perceived to be as well versed in the implementation of blocking procedures as those firms that, in the regular course of their business, implement and review such procedures on a daily basis.

C. Is It Appropriate for the Committee and Its Professionals (As Opposed to Individual Members) to Seek Approval of Blocking Procedures?

In *Federated Department Stores*, the motion seeking approval of the blocking procedures was filed by one of its members, Fidelity. Since then, the general practice has been for committees and their professionals (whose fees and expenses are paid by the estate) to prepare and file motions for approval of blocking procedures.

In *Spiegel*, the bankruptcy court expressed concern about the fact that the motion was brought by the committee and its counsel rather than the individual members of the committee:

This Court is further concerned that the Application was made by proposed counsel for the Committee, on behalf of

³⁹ *Id.* at 19:17-25.

the committee, where the relief requested benefits a limited number of committee members to the potential detriment of the unsecured creditor body as a whole. This Court will address counsel's behavior at a later date.⁴⁰

The concern raised by the bankruptcy court in *Spiegel* was echoed by the Office of the United States Trustee in pleadings filed in opposition to motions seeking approval of blocking procedures. For example, in *Azabu Buildings*, the Office of the United States Trustee argued that “the relief requested by the UCC benefits the committee members, not the committee or the estate.”⁴¹ Based on that rationale, the Office of the United States Trustee, citing *Spiegel*, asserted that “[i]t is therefore doubtful whether the estate should bear the legal expense of this matter.”⁴²

Of course, the fact that a majority of courts have approved blocking procedures on the basis that they provide benefit to the estate suggests that, in such cases, the committee's professionals are likely to (and should) be reimbursed for their efforts in seeking approval of such procedures. But in light of the fact that at least one court and the Office of the United States Trustee have expressed the view that such services might not be reimbursable, one can expect that committees and their professionals are likely to be more cautious in filing such motions, and may be inclined to consider more carefully whether the estate as a whole will benefit from the implementation of blocking procedures. That caution may serve as a further constraint to any further expansion of the use of blocking procedures in bankruptcy cases.

⁴⁰ *Spiegel*, 292 B.R. at 751.

⁴¹ See Case No. 05-50011 (Bankr. D. Haw), Memorandum in Opposition to Committee's Motion for Entry of an Order Approving Specified Information Blocking Procedures and Permitting Trading of the Claims Against, or Purchase of Assets of, the Debtor Upon the Establishment of Blocking Procedures, dated Aug. 31, 2006, at 8 n.3.

⁴² *Id.*

D. The Potential Impact of Section 1102(b)(3) on the Use of Blocking Procedures.

Under the recently enacted Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), Congress included a new provision, section 1102(b)(3) of the Bankruptcy Code. The language of that provision appears to require a committee to provide creditors who are not members of the committee with access to information. 11 U.S.C. § 1102(b)(3). In *In re Refco, Inc.*,⁴³ the bankruptcy court commented on “the mischief that might arise by construing section 1102(b)(3) to require the unfettered release of such information to other, perhaps friendly, parties who are engaged in such trading [in the debtor’s securities], particularly given today’s enormous market in distressed debt securities and claims.”⁴⁴ As stated by Judge Drain, “[t]he selective possession of material information can equate to very large swings in value and, therefore, creditors may seek such information not for legitimate purposes related to their position in the case but, rather, to obtain an unfair trading edge.”⁴⁵

For certain creditors who seek access to information yet wish to preserve the ability to buy and sell claims, the use of blocking procedures may offer a potential solution to enable them to protect their position in the case while not precluding the ability to trade claims. However, bankruptcy courts may be reluctant to approve such blocking procedures for individual creditors. Such reluctance would be expected not only because such creditors are not bound by any fiduciary duty to other creditors, but also because it is not clear that the estate would benefit to the same extent, from sharing confidential information with individual creditors, that an estate arguably benefits from encouraging participation of sophisticated creditors on the committee.

⁴³ 336 B.R. 187 (Bankr. S.D.N.Y. 2006).

⁴⁴ *Id.* at 196.

⁴⁵ *Id.* at 196-97.

IV. CONCLUSION

The use of blocking procedures to protect the activities of institutional financial investment firms appears to be relatively entrenched in chapter 11 proceedings. It remains unclear, however, whether such court approval of blocking procedures can, should or will be expanded to include activities and creditors beyond those specifically protected in *Federated Department Stores* and its progeny.