The Company's Perspective on Selected Issues in the Handling of Nonpublic Information

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Introduction

In the "good old days" prior to the credit freeze, conversations regarding existing credit facilities among bankers, lawyers, and the financial officers of companies often focused on upsizing credit facilities for expansion or acquisitions. Banking institutions even competed in the market to provide companies with the best pricing and most flexibility in connection with credit facilities. This competition included negotiating company-favorable devices such as an accordion, which allows the facility to be upsized on the same terms and conditions. To the contrary, today's world is characterized not by discussions regarding expanded financing, but the negotiation of waivers, amendments, and the terms of forbearance agreements.

As part of any process that involves the modification of credit facilities, the lenders become privy to company confidential information. Furthermore, large companies with complex capital structures may have several layers of debt in the capital stack, including publicly traded notes that subject the company to the requirements of federal securities laws. In many situations, the same entity that is a lender under a traditional facility is also the holder of the high-yield publicly traded notes. Therefore, the passing of confidential information during the modification process can have securities law implications.

In this context, managing the disclosure of confidential information has become an uncertain task. Although a number of articles have been written that address the guidelines for trading in distressed debt from the perspective of the creditors, less guidance has been provided to the issuer. In addition to the business issues to be addressed by the distressed borrower, the issuer should understand the consequences of sharing its confidential information as part of the process of modifying its loan documents and otherwise commencing a restructuring. Just as the tenor of the relationship between the parties changes in this context, so do the implications to the company of certain provisions of confidentiality agreements and the management of its proprietary information when there is public trading in its debt instruments.

This article focuses on selected issues confronting a company that has syndicated and publicly traded debt outstanding during negotiations with its creditors prior to the commencement of a proceeding under the federal bankruptcy laws. Specifically, this article discusses the potential liability for the issuing company under the federal securities laws if its debt is traded based on nonpublic material information. Perhaps of greatest significance is understanding certain consequences of the disclosure of confidential information, including the empowerment of a potentially hostile bidder and the need to restrict the actions that the holder of such information can take through a standstill provision.

Background

Traditional Syndicated Bank Facilities

A syndicated bank facility is a loan given by a coalition of lenders, or a syndicate, to a single borrower. The main advantage to the syndicate is the spread of risk. For this type of transaction, a typical loan or credit agreement includes a confidentiality provision that requires the administrative agent[1] (if applicable) and other lending parties to the agreement to maintain the confidentiality of issuer "confidential information." The term "confidential information" and the requirements of the parties who have obtained it will be defined in the loan or credit agreement. For example, confidential information may be shared pursuant to the agreement in certain circumstances, including (i) with the lender's and its affiliate's officers, directors, employees, and other advisors, (ii) with any actual or prospective assignee of or participant in any of such lender's rights under the loan agreement, and (iii) in connection with the exercise of rights and remedies under the loan agreement.

A borrower is confronted with issues relating to the protection of its confidential information when it discloses such information to the syndicate. Typically, the senior lender and its advisors are reluctant to enter into a more extensive stand-alone confidentiality agreement with the borrower during the negotiations of modifications to the credit agreement; these parties prefer to rely on the existing provisions of the credit agreement. Generally, the protections contained within the credit agreement are more limited in scope than those contained in a stand-alone confidentiality agreement.[2] Notably, credit agreements generally do not contain a provision for injunctive relief in the context of a breach of the terms and conditions of the confidentiality agreement in the credit agreement. Finally, if the lender syndicate is sizeable in number, it is particularly difficult to maintain the confidentiality of issuer nonpublic information, including the terms and conditions of a proposed modification to the credit agreement and the conclusions that can be drawn from such modifications as to the anticipated financial condition of the company in the future.

The body of insider trading law in the United States is extensive and complicated; however, one core element is the prohibition on purchasing or selling a security *on the basis of* material nonpublic information.

Publicly Traded Debt

Many companies have publicly traded debt; often, that debt was initially issued in a private placement allowing resale under Rule 144A[3] of the Securities Act of 1933 (the "Securities Act").[4] Following the private placement, it has been fairly common practice to exchange the privately placed notes for registered notes pursuant to a registered exchange offer under the Securities Act and, thereby, the issuer becomes subject to the reporting requirements of the Securities Exchange Act of 1934[5] (the "Exchange Act"). In this situation, a significant amount of financial information is available regarding the issuer through its filings with the Securities and Exchange Commission ("SEC"). A subset of privately placed notes falls into the "144A for life" category, whereby the issuer does not engage in a registered exchange offer and is not subject to the periodic reporting requirements of the Exchange Act. However, the issuer is still often contractually required under the indenture that governs the notes[6] to otherwise make available relatively comparable information on a similar periodic basis to its noteholders through an internet-based data sharing site[7] or a comparable form of dissemination. This information is available to noteholders and purchasers of the notes but is not as accessible to the general public. In both cases, however, the financial statements and related narrative discussion of financial results (the management's discussion and analysis) is principally historical in nature with limited insight into trends and uncertainties facing the issuer and its liquidity.

Securities laws implications beyond registration requirements may also arise when dealing with public debt. Whereas assignments of or participations in traditional bank debt are generally not subject to security laws remedies, trading in bonds is generally recognized as a securities transaction and subject to the requirements of federal and state securities laws.[8] These securities laws are stringent and complicated, but they generally prohibit trading in securities with scienter in breach of a duty while in possession of material nonpublic information.[9]

Material Nonpublic Information

The body of insider trading law in the United States is extensive and complicated; however, one core element is the prohibition on purchasing or selling a security *on the basis of* [10] material nonpublic information. Prior to the SEC's adoption of Rule 10b5-1, much ambiguity existed as to whether a trader had to actually use, or merely possess, material nonpublic information. However, by defining "on the basis of" as trading while the person "was aware of" the material nonpublic information, the SEC adopted a cognizant possession standard.[11] Various elements of insider trading are described later in this article; two pre-conditions to any liability, however, are that the information in question be, in fact, both "material" and "nonpublic."

The answer to whether specific information is "material" involves an analysis of (i) whether there is a "substantial likelihood that a reasonable shareholder would consider [the information] important" in making an investment decision; and (ii) whether the disclosure of the information would be "viewed by the reasonable investor as having significantly altered the total mix of information made available."[12] Although the inquiry is fact specific, it is typically the case that projections that are made available in connection with negotiating amendments, waivers, and forbearances, or the potential for a restructuring transaction, are material. Other information that may be considered

material includes the tenor of amendments to or restructuring of debt, plans to engage in an exchange or tender offer (or potentially a bond repurchase program, depending on the significance of such purchases to the liquidity and financial condition of the company), proprietary advisor analyses, information regarding the restructuring or sale process, and insight into any liquidity problems.

Information is generally considered "nonpublic" unless and until it has been disseminated in a manner reasonably designed to make it generally available to investors. The SEC has stated that information is public if it has been disseminated in a manner making it available to investors generally, that insiders must wait a reasonable time after disclosure before trading, and that what constitutes a reasonable time depends on the circumstances of the dissemination.[13] As a rule of thumb, information is presumed to be "nonpublic" until one (1) business day following the earliest of the following events to occur: (i) the issuance by the company of a press release containing the information; or (ii) the filing by the company of a Periodic or Current Report (Form 10-K, Form 10-Q, or Form 8-K) containing the information. The analysis discussed in this article assumes that the information has not and will not be disseminated in a manner making it generally available to investors and will thus be considered nonpublic.

Analysis of Certain Concerns of the Issuer

Today's Scenario

Many loan agreements, especially those where the company is highly leveraged, contain financial covenants that require the borrowing company to attain a minimum EBITDA measured at specific points in time.[14] These agreements may also contain a covenant known as the "leverage ratio" that prohibits the relative level of debt (often measured separately as total debt and senior debt) to EBITDA from exceeding certain established numbers. In economic circumstances in which revenues are declining at a rate faster than costs, many companies are unable to comply with the minimum EBITDA or leverage ratios they had originally agreed to in vastly different economic times. A violation of one of these covenants generally constitutes an event of default under the credit agreement. Since the covenant breach cannot be remedied with time because it is based on a historical financial result, there is usually no grace period associated with the default. It is for this reason that a waiver of the covenant or the default (as well as an amendment to future covenants) is often required. Given the lack of visibility on the future of today's economy, the chief financial officers of these companies may desire a hiatus on the covenant measurement for some period of time. The banks, however, usually require the setting of new covenants, which requires the credit agreement to be renegotiated and modified, taking into account the future financial performance of the borrower.

As part of the process of negotiating a waiver, amendment, or forbearance agreement, the administrative agent and the lenders will become privy to confidential information regarding the company. To re-set the covenants, the company must provide the lenders with projections of its future revenues and anticipated expenses together with underlying supporting information. Not only will this disclosure often include competitive information, it will usually constitute material nonpublic information within the meaning of the federal and state securities laws.

In addition, a company may desire, or may be required, to bring in additional equity in order to de-lever the company concurrent with the waiver negotiation. This equity investment may come from an existing shareholder, or the company may simultaneously pursue a sale of equity to new investors, including noteholders (which may ultimately occur through a reorganization pursuant to a bankruptcy proceeding). Confidential information will likely pass to these potential investors during the negotiation process. Whereas the syndicated lenders and their advisors may object to additional restrictions beyond those contained in the credit agreement, the indentures that govern the notes generally do not contain covenants to maintain the confidentiality of certain information. Further, if the situation continues to deteriorate and there is a default under the indenture, advisors for a group of noteholders as well as individual noteholders who are willing to be restricted from trading[15] may seek access to information. A confidentiality agreement should be executed when financial or legal advisors are engaged to negotiate the terms of a transaction or restructuring, the noteholders seek additional information, or a seat at the table or a third party is approached

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for an equity investment. For a company that is required to file reports under Section 15(d) of the Exchange Act,[16] the confidentiality agreement also allows the issuer to rely upon the exclusion in Regulation FD to allow the selective disclosure to existing holders of its publicly traded debt securities.[17]

The remainder of this article will discuss specific concerns the issuer may face in the process of negotiating a waiver or forbearance with its lenders and noteholders, a sale of additional equity securities, or the terms and conditions of an out of court restructuring, with respect to managing the disclosure of its confidential information.

The common denominator among the multiple theories of Rule 10b-5 liability discussed above is the breach of a duty.

Thou Shalt Not Trade: The Use of Material Nonpublic Information

Courts have developed various theories for holding different persons liable for insider trading, an analysis of which merits its own article.[18] At the risk of oversimplifying, an insider has a duty to either abstain from trading on, or to disclose, material nonpublic information about the company. If an insider trades on material nonpublic information without properly disclosing the information first, then the insider breaches this duty and violates Rule 10b-5. A tipper or tippee generally can be liable for violating Rule 10b-5 if (1) an insider (or even a tippee) receiving some personal benefit discloses material nonpublic information to others in breach of a duty, or (2) a tippee executes trades based on material nonpublic information that the person knows, or should have known, was acquired by a breach of a company insider's duty to the company. Also, 10b-5 liability has been extended to the act of "misappropriation" that generally occurs when a non-insider trades on the basis of material nonpublic information in breach of a duty owed to any source to keep that information confidential.

With these theories in mind, one can easily see how the recipient (and the provider, if trading is reasonably foreseeable) of material nonpublic information would find it necessary to be extremely cautious when trading.[19] Arguably, the issuer company has significantly less clarity, in part, because the focus of most literary discussion is on the potential liability of the trader. Companies with publicly traded debt (or equity) when disclosing information to lenders and investors often attempt to include the following language in their form of a non-disclosure agreement:

> Recipient acknowledges and agrees that it is aware (and that its Representatives are aware or, on receipt of any Evaluation Information, will be advised by it) that (i) the Evaluation Material being furnished to Recipient or its Representatives may contain material, nonpublic information regarding the Company and (ii) the United States securities laws prohibit any person who has material, nonpublic information from purchasing or selling securities of a company that may be a party to a transaction of the type contemplated by this agreement or from communicating such information to any person under circumstances in which it is reasonably foreseeable that such person is likely to purchase or sell such securities in reliance on such information.

The recipient of the information often objects to the inclusion of this language and seeks to have it stricken. The relevant question then becomes whether the issuer company may have liability under the federal and state securities laws based on the recipient's trading on material nonpublic information that has been provided by the issuer. Put simply, should the company care if the language is ultimately deleted as the liability rests with the recipient in any event? Or is there any benefit (seen through the eyes of the law) from reminding the recipient of its obligations under the federal and state securities laws?

As could be predicted, the answers to these questions are complicated and unclear. The common denominator among the multiple theories of Rule 10b-5 liability discussed above is the breach of a duty. Under these theories, the issuer company would have to breach a duty to find itself liable for a Rule 10b-5 violation. Undoubtedly, an issuer company owes a duty to its holders of publicly traded equity. To avoid a breach of this duty, the issuer with publicly traded equity would selectively disclose confidential information for a legitimate business purpose to someone who is bound to keep it confidential. The central focus of this article, however, is the company with a capital structure comprised of publicly traded debt and privately held equity.

The more conservative approach is that an issuer owes a fiduciary duty to holders of its securities, even if the issuer's public capital

structure is comprised only of debt. An issuer looking to take a more aggressive position, however, would argue that it owes no fiduciary duty to debt holders. In *Salovaara v Jackson*, the United States District Court sitting in New Jersey differentiated the relationships between a company and its shareholders and a company and its debt security holders.[20] In that case, sellers of the company's debt securities sued the purchaser of the debt securities (an insider of the company) alleging that the purchaser/defendant failed to disclose material information to the sellers regarding the value of the securities and was under a duty to so disclose. The court noted that the debt security holder relationship is merely contractual, and not fiduciary, in nature as it is with its shareholders.[21] The court ultimately held that the defendant issuer company "did not violate § 10(b) and Rule 10b-5 because the Sale involved debt securities, and a corporation does not owe a duty with respect to debt securities. Alternatively, [the issuer company] did not owe a duty to Plaintiffs under the misappropriation theory because Plaintiffs were not the source of the information…and there was no fiduciary relationship."[22]

In 2007, a United States District Court sitting in New York expanded on *Salovaara* in *Alexandra Global v IKON*.[23] The *IKON* court suggested that "[i]t is well established that corporations do not have a fiduciary relationship with their unsecured creditors, including debt security holders.…The majority of courts have found that this rule applies even to convertible noteholders, who retain the contractual power to convert their notes into shares of the issuer's stock."[24] The court ultimately dismissed the Rule 10b-5 complaint because the plaintiffs could not bring forth any facts showing the existence of a duty, beyond a contractual duty, owed to it by the defendant issuer company.[25]

Although the analysis is different, Regulation FD also leads to the result that the company need not obtain from others an acknowledgment of their duties under the securities laws. In the publicly available telephone interpretations from the SEC in the context of Regulation FD, the SEC confirmed that if an issuer gets an agreement to maintain material nonpublic information in confidence, it need not also obtain a statement that the recipient agrees not to trade on the information in order to rely on the exclusion in Rule 100(b)(2)(ii). The SEC noted therein that the recipient who trades, or advises others to trade, could face insider trading liability because the recipient is a temporary insider with fiduciary duties.[26]

Although one would likely conclude from the preceding discussion that the issuer of public debt (whose equity is privately held) may rest easy and that the reminder not to trade need not, in fact, be retained in the confidentiality agreements, a word of caution is warranted. Other circuits do not have to follow the same reasoning as the cases described above, which could lead to different conclusions in different circuits. In addition, state courts adjudicating state securities laws have the potential to find a duty beyond a contractual one owed by issuers to their debt security holders. Furthermore, debt security holders could bring common law fraud claims against the issuer company in an attempt to get around the seeming lack of fiduciary duty issue.

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Complicity: Cutting a Deal in Advance

The discussions above conclude that the issuer with a capital structure comprised only of public debt and private equity may have a defense to an allegation of insider trading in the debt based on the absence of the prerequisite of a "duty," even if there are no stated prohibitions in its confidentiality agreement yet the recipient of confidential information chooses to trade on such information. The next question becomes whether the issuer company is exposed to liability if it acts in concert with potential security purchasers.

This difficult situation arises when the issuer company cuts a deal with a particular noteholder or new potential equity partner, which then proceeds to acquire a position in the debt. The potential investor may not itself hold confidential information although limited information might have been provided to the investor's advisors; alternatively, the investor may possess such information and be willing to trade under a "Big Boy" letter (as discussed briefly later in this article). More commonly, the process would involve the sharing of more extensive financial information, including projections and perhaps a "handshake" understanding with the new investor on the transaction that could be consummated once the new investor holds a significant position. The key strategic aspect, however, is that the new investor thereafter acquires at a minimum a blocking position (usually 25 percent) in a tranche[27] of notes and, ideally, a controlling position (at least

50.1 percent and more favorably 66 2/3 percent), which will enable the new investor to potentially control the terms of the restructured entity.

The existing equity owner(s)[28] and the new investor are unlikely to actually execute an understanding or agreement before the new investor acquires the notes at a low price. Although this is a risky maneuver for the existing equity owner because it will have empowered a partner that may or may not adhere to any "understanding" reached between the parties as to the ultimate allocation of both beneficial ownership and control of the company, the issue for this article is whether the company can have liability as a "tipper" since the investor is trading on nonpublic material information received from the company. The distinction between this situation and the scenario described above regarding deleting the acknowledgement in the confidentiality agreement about the Exchange Act restrictions is the actual or perceived complicity of the company with the party in the market.

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As an example under the classic tipper/tippee theory, complicity may exist between the tipper and tippee where the tipping party is an insider of the issuer. If the tipper has possession of material nonpublic information and passes it along for personal gain in breach of a duty, and the tippee knew, or should have known, that the insider was breaching a duty, then the pair is exposed to Rule 10b-5 liability.[29] As explained by the *Dirks* court, "a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."[30]

Surprisingly, this explanation results in the same conclusion as before. Assuming the corporation is considered an "insider," there also must be a breach of a fiduciary duty to the shareholders of the issuer company. Therefore, if the company is comprised only of the private shareholders attempting to consummate the transaction and debt security holders, there is arguably no fiduciary duty on the part of the company to be breached. This conclusion does not, however, seem appropriate. And, of course, the failure to establish all the elements of a claim under Rule 10b-5 does not preclude a common law fraud claim, particularly where, as in this instance, one could argue that the parties did not have "clean hands." Further, as a practical matter, any such scheme may be difficult to implement as the SEC has taken action that should increase the discomfort on the part of the recipient of the information if that person trades on the nonpublic information.[31]

There had been a practice involving institutions whereby a person in possession of material nonpublic information would trade on that information under a contractual disclaimer of reliance (so-called, "Big Boy" letters). To illustrate, the holder of the nonpublic information would enter into a letter agreement with the other party in which the other party (1) acknowledges that it is sophisticated and recognizes that the holder may have material nonpublic information, (2) specifically disclaims any reliance on the holder's disclosures or omissions, and (3) agrees not to sue the holder in connection with the transaction. The theory is that the playing field is somewhat leveled by putting the other party on notice that one of the participants in the transaction, the holder, has in its possession material nonpublic information and that the other party is, in effect, a "Big Boy" who can look after himself.[32] The concept that the risk associated with insider trading could be ameliorated through the use of a "Big Boy" letter is increasingly in question. In fact, the SEC has taken the position that it may be insufficient for the letter to merely recite possession of nonpublic information and that the holder might actually have an obligation to disclose the nature of the information. Based on recent SEC actions, it is relatively clear that these letters will not provide protection (at least *vis a vis* the SEC) if one party owes a duty of trust or confidence with the issuer or in defending against SEC actions.[33]

Friend or Foe: Standstill Provisions

Perhaps the most significant risk to be addressed in this article in selectively disclosing confidential information is the potential for a company to lose control of its restructuring process. As discussed, as a first step in this process, a company with outstanding notes may share confidential information with noteholders, advisors to the noteholders, and potential investors. These recipients may be empowered by the knowledge that this information provides. At an auction of a company that has publicly traded equity, the concern about a third party undertak-

ing a hostile transaction and accumulating a significant equity stake through purchases in the marketplace is obvious. As described by the Delaware Court of Chancery in *In re The Topps Company Shareholders Litigation*,[34] "[w]hen a corporation is running a sale process, it is responsible, if not mandated, for the board to ensure that confidential information is not misused by bidders and advisors whose interests are not aligned with the corporation…." The same loss of control of the process can, however, occur in the situation where the company has publicly traded debt. If the recipient is not subject to a prohibition, in terms of a "standstill provision," on making an uninvited run at the company or accumulating the debt (in each case either alone or with others), then the company has empowered what may become a hostile party by virtue of access to the confidential information.

A "standstill" provision typically prohibits the interested party from acquiring assets, equity, or debt of the company for some specified period of time except with the consent of the company. In addition, the party is precluded from acting jointly or in concert with any other party in undertaking such actions during a restricted period. Sample language in the context of an entity that does not have outstanding equity may read as follows:

> For a period of [three (3) years] from the date hereof, Recipient and its "affiliates" and "associates" (as such terms are defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended (the "*Exchange Act*")) and other Representatives will not (and Recipient and they will not instigate, advise, assist or encourage others), directly or indirectly, unless specifically requested or permitted in writing in advance by the Company: (a) make any public announcement with respect to, or submit any proposal for, a Transaction between the Company, its subsidiaries, divisions or affiliates or any of its security holders, secured creditors and Recipient (or any of Recipient's affiliates, associates, or Representatives) or any form of restructuring, recapitalization, or similar transaction with respect to the Company or any of its subsidiaries, divisions, or affiliates, whether or not any other parties are also involved, directly or indirectly, in such proposal or transaction, unless such proposal is directed and disclosed solely to the Board of Directors of the Company or its designated representatives, and the Company shall have requested in writing in advance the submission of such proposal (and shall have consented in writing in the case of any such proposal from or involving parties in addition to or other than Recipient, to the involvement of such additional or other parties); (b) by purchase or otherwise, through Recipient's affiliates, associates, Representatives, or otherwise, alone or with others, acquire, offer to acquire, or agree to acquire, ownership (including, but not limited to, beneficial ownership as defined in Rule 13d-3 under the Exchange Act) of any assets or business of the Company or any of its subsidiaries, divisions or affiliates or any of its equity securities, debt securities, or direct or indirect warrants, rights (including convertible or exchangeable securities), or options to acquire such ownership (or otherwise act in concert with any person which so acquires, offers to acquire, or agrees to acquire); or (c) enter into any discussions, negotiations, arrangements, or understandings with any third party with respect to any of the foregoing.

This provision is consistently objected to by the recipient of the confidential information because it precludes a party (whether or not that party holds outstanding debt of the issuer) from potentially acquiring a blocking position. As an alternative to requesting that the provision be stricken, the recipient may suggest that the provision terminate on the filing of a bankruptcy petition or the commencement of another hostile offer.

From the company's perspective, a party that holds in excess of 51 percent of a tranche of debt can effectively influence the restructuring process significantly,[35] and, with respect to certain consents or amendments to an indenture, control the process. If the standstill provisions cease on the filing of a bankruptcy petition, the party that performed due diligence could accumulate a position in the bonds with the goal of blocking or disrupting the company's efforts to con-

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firm its restructuring plan. Even where the company had successfully obtained lock-up agreements with creditors who represented a significant percentage of a tranche of debt (but less than the 66 2/3 percent of the requisite creditors) on the theory that some holdout creditors would join in the plan because of the momentum and significant support by those creditors who had executed lock-up agreements, another investor could buy bonds from parties who had not executed lock-up agreements and attempt to "block" the pre-negotiated plan contemplated by the lock-up agreement. Under such a scenario, the new investor could accumulate enough bonds (i.e. 33 1/3 percent) that are not subject to the lock-up such that it could block confirmation of any plan of reorganization that is not to its liking.

Thus, if the company wishes to remain in control of the process, the standstill provisions should be retained even if the applicable time-frame for the restriction is shortened. Further, the provision should not cease on the filing of a bankruptcy petition.

Conclusion

The old adage is, "it's an ill wind that blows nobody any good."[36] Apparently conceived in the days of sailing ships, this truism simply means that one person's misfortune is another person's opportunity. The economic crisis provides such an opportunity for those who wish to purchase distressed debt for enhanced returns as well as those who wish to buy on a "loan to own" basis with a view to eventually becoming an equity holder. While there are significant writings aimed at providing direction to the traders, there is less guidance available to the troubled issuer. In these times, the issuer should not view the confidentiality agreement as mere boilerplate. The recommended approach is for the issuer with publicly traded debt to only disclose confidential information for a valid business purpose, where it is not reasonably foreseeable that the recipient would trade on such information, and that disclosures be made pursuant to a confidentiality agreement. However, the limited caselaw in this area thus far goes even further and suggests, albeit cautiously, that because of the absence of a duty, the issuer with no publicly traded equity has at least an argument that it has no liability under the federal securities laws if a recipient of its confidential information trades on such information, thereby putting in perspective the prohibitions in the confidentiality agreement addressing such matters. On the other hand, as described in this article, information can be empowering and certain protections afforded by a confidentiality provision are designed to maximize, to the extent possible given the situation, the company's control over the process of negotiating modifications, amendments, and the initial stages of the restructuring process.

NOTES

1. The bank that handles all interest and principal payments and monitors the loan on behalf of the participants, has the direct contact with the borrower, and facilitates communication with the members of the syndicate.

2. Sometimes the company will seek language in the loan agreement that limits the ability of the lender to assign the debt or sell participations to an entity that is a competitor of the borrower; this prohibition also serves to restrain the sharing of such information with competitors.

3. 17 CFR 230.144A.

4. 15 USC 77a et seq. Rule 144A allows the privately placed securities to be resold to specified types of investors, primarily "Qualified Institutional Buyers" (as defined therein). Rule 144A offerings have historically been attractive because of their relative speed to market.

5. 15 USC 78a et seq.

6. The indenture is a written agreement which sets forth the terms and conditions of the notes and the covenants to which the issuer is subject.

7. For example, see the Intralinks website at http://www.intralinks.com/.

8. Securities Act of 1933, Section 2(a)(1), 15 USC 77b(a)(1); *see Reeves v Ernst & Young, 494 US 56 (1990).*

9. Rule 10b-5, 17 CFR 240.10b-5: "Employment of Manipulative and Deceptive Practices":

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person
>
> in connection with the purchase or sale of any security.

Rule 10b5-1 promulgated under Section 10 of the Exchange Act states that

> [t]he "manipulative and deceptive devices" prohibited by Section 10(b) of the Act and Rule 10b-5 thereunder include, among other things, the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.
>
> General Rules and Regulations Promulgated Under the Securities and Exchange Act, Rule 10b5-1(a).

10. "A purchase or sale of a security of an issuer is 'on the basis of' material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale." Exchange Act, Rule 10b5-1(b).

11. The SEC explained that the "goals of insider trading prohibitions—protecting investors and the integrity of securities markets—are best accomplished by a standard closer to the 'knowing possession' standard than to the 'use' standard", citing the Proposing Release for Rule 10b5-1. Final Rule: Selective Disclosure and Insider Trading, Release Nos. 33-7881, 34-43154 (August 24, 2000). Subsection (c) of the Rule establishes certain affirmative defenses whereby an entity can demonstrate that the purchase or sale was not "on the basis of" material nonpublic information, including through policies and procedures that, in effect, establish a Chinese wall. Rule 10b5-1(c).

12. *Basic Inc v Levinson*, 485 U.S. 224, 231-32 (1998), quoting *TSC Industries, Inc v Northway, Inc*, 426 US 438, 448-49 (1976).

13. Final Rule: Selective Disclosure and Insider Trading, Section III.A.1 of SEC Release Nos. 33-788, 34-43154 , 65 Fed Reg 51716 (August 24, 2000) (adopting release for Regulation FD and Rules 10b5-1 and 10b5-2). [(http://www.sec.gov/rules/final/33-7881.htm) Regulation FD defines public disclosure as "broad, non-exclusionary distribution of the information to the public." Regulation FD 101(e).

14. EBITDA, stands for "earnings before interest, taxes, depreciation and amortization." This calculated number is used as a proxy for measuring cash flow over a defined period of time.

15. As discussed with respect to the members of the loan syndicate, and also described later in this article, individual noteholders may opt not to receive confidential information so as to avoid becoming restricted in their ability to trade in the notes based on their possession of nonpublic information and will limit the information flow to their advisors. Alternatively, the noteholders may seek access to confidential information for a limited period of time after which any material nonpublic information would no longer be subject to a confidentiality obligation. The theory is that much of information would either become stale over time or would be reflected in the Exchange Act periodic reports. However, that approach does not address other "proprietary" information of the issuer that would, under no circumstances, become publicly available, including competitive information.

16. 15 USC 78o(d).

17. Regulation FD, Rule 100(b)(2)(ii).

18. This article does not purport to discuss all of the aspects of insider trading liability but rather is intended to provide certain guidelines to the issuer regarding the questions at issue.

19. Although bank debt is generally not considered a "security", lenders can have liability if in their capacity as a lender they receive nonpublic information and then trade in the publicly traded bonds. Lenders typically manage this risk either through the establishment of a "chinese wall" which provides a combination of physical and procedural barriers to ensure that confidential information is not shared with persons who could unfairly benefit from such information. In fact, certain credit agreements will include language acknowledging the receipt of confidential information and confirming that the lender has developed compliance procedures regarding the use of such material nonpublic information along the lines of a "chinese wall." This is also important in connection with one of the affirmative defenses to insider trading liability provided by Rule 10b5-1 under which an entity can establish that the individual making the investment decision on behalf of the entity was not aware of the nonpublic information and that the entity had implemented reasonable policies and procedures to prevent insider trading. Rule 10b5-1(c)(2). An alternative approach is for a member of the syndicate to opt to receive only "public side" and not "private side" information; the "private side" information typically contains the material nonpublic information and a recipient should be prepared to be subject to restrictions on trading while in possession of such information. *See* The Joint Market Practices Forum (the "Forum"). "Statement of Principles and Recommendations Regarding the Handling of Material Nonpublic Information by Credit Market Participants," October 2003. The Forum is a collaborative effort of the Bond Market Association, the International Association of Credit Portfolio Managers, the International Swaps and Derivative Association and the Loan Syndicates and Trading Association.

20. 66 F Supp2d 593 (D NJ 1999).

21. *Id.* at 599.

22. *Id.* at 601-02.

23. 2007 WL 2077153 (SD NY July 20, 2007).

24. *Id.* at *5.

25. *Id.* at *9.

26. The situation for the individual (although not necessarily the company) changes if the person has a fiduciary duty such as may arise from membership in a creditors' committee once the issuer is in bankruptcy. *See SEC v Barclays*, 07-CV-04427 (SD NY).

27. The tranche refers to the different layers of debt in the capital structure – this may include senior secured notes, senior subordinated notes, and senior unsecured notes.

28. The "existing equity holders" are private owners; the condition may change if equity is publicly traded.

29. *See Dirks v SEC*, 463 US 646 (1983).

30. 463 US at 660.

31. This may also be relevant to how strenuously the issuer needs to defend the non-trading language in the confidentiality agreement; the risk may be even greater on the recipient of the information.

32. One can analogize to other provisions of the federal securities laws in which certain types of investors are afforded lesser protection in terms of the disclosure of information; see, e.g. the limited information requirements under Regulation D of the Securities Act (17 CFR 230.501 et seq) if securities are sold only to accredited investors. However, Section 29(a) of the Exchange Act, 15 USC 78cc(a), forbids waivers of compliance with obligations under the federal securities laws. Courts may also refuse to enforce disclaimers based on public policy grounds.

33. Securities and Exchange Commission, Litigation Release No. 20132 (May 30, 2007), *SEC v Barclays Bank PLC and Steve J Landzberg*, 07-CV-04427 (SD NY) (involving the representation on a creditor's committee; the SEC pursued a misappropriation theory but did not express any opinion on Big Boy letters. The total settle-

ment was in excess of $22 million). In *R2 Investments v Salomon Smith Barney*, the allegation again related to the trading on material nonpublic information that had been obtained while serving on a creditors' committee and a transaction involving a Big Boy letter.

34. 926 A2d 58, 91 (2007). In *Topps*, the Chancery Court determined that under the particular facts at issue, the board's refusal to waive the standstill to allow a potential bidder to make a tender offer directly to Topp's stockholders after negotiations with the particular bidder failed was likely to be found to be a breach of fiduciary duty at trial.

35. Even though 66 2/3 percent in amount and more than 50 percent in number are required by class to approve a plan of reorganization, an ad hoc committee comprised of a group of close to a majority of creditors of a class will hold a recognized negotiating position with the company (which may also be obligated to pay the fees and expenses of such committee's legal and financial advisors).

36. John Heywood, "A dialogue conteinying the nomber in effect of all the prouerbes in the English tongue," 1546 .

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