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Column
Last in Line

*28 YOUR SECRET MIGHT BE SAFE WITH ME
Protection of Proprietary Information in Bankruptcy

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Most of us believe that unsecured creditors occupy the worst position in any bankruptcy case because they are "last in line" on the payment priority ladder. However, there is an *even worse* position in bankruptcy—*i.e., when the debtor possesses your client's trade secrets or confidential information.* In this scenario, the debtor—indeed the bankruptcy system itself—threatens to devastate your client by the disclosure of your client's precious confidential information. Imagine the following scenario, which I'll call the "new product scenario." Your client plans to market a new product. Your client and the debtor, a business enterprise, entered into a pre-petition contract under which the debtor was to manufacture the new product according to your client's specifications, which were licensed to the debtor solely for the manufacture of the new product. The contract provides that the specifications and all information furnished remain the property of your client, and there are strong prohibitions against their disclosure.

However, the debtor's bankruptcy filing ushers in a new universe of people and interests, all of whom seek disclosure of your client's confidential information. A chapter 7 trustee or chapter 11 creditors' committee wants a complete review of the situation to determine, *inter alia*, whether the contract should be assumed or rejected. Secured creditors want to repossess their collateral, which may include machinery that contains the tooling necessary to make your client's new product. Worse yet, the secured creditor may want to conduct a public auction sale of its repossessed collateral, which means that your client's competitors could actually seize the opportunity to purchase the machinery and use the tooling to make *your* client's new product! The U.S. Trustee or the chapter 7 trustee, whichever the case may be, wants to investigate the debtor's affairs and ask probing, in-depth questions about the contract. While the contract itself may not contain your client's specifications, it likely identifies your client's new product. Thus, the contract itself must be protected from disclosure, along with your client's specifications, and any tooling, work in process and other embodiments of the new product.

Your client's needs are obviously at odds with the public nature and full disclosure of the bankruptcy process, as is the general rule that public access to court records ought to be ensured in order to preserve the public confidence in the integrity of the judicial process. *See In re 50-Off Stores Inc.*, 213 B.R. 646, 650 (Bankr. W.D. Tex. 1997). 11 U.S.C. § 107(a) codifies these concepts as follows:
§107. Public access to papers.

(a) Except as provided in subsection (b) of this section, a paper filed in a case under this title and the dockets of a bankruptcy court are public records and open to examination by an entity at reasonable times without charge.
However, it is also well-established that the public's right to access is not absolute. 11 U.S.C. §107(b) of the Bankruptcy Code is a statutory exception to 11 U.S.C. §107(a), and reads as follows:

(b) On request of a party in interest, the bankruptcy court shall, and on the bankruptcy court's own motion, the bankruptcy court may—
(1) protect an entity with respect to a trade secret or confidential research, development, or commercial information; or

(2) protect a person with respect to scandalous or defamatory matter contained in a paper filed in a case under this title.

On its face, 11 U.S.C. §107(b) *requires* the court to protect trade secrets, confidential research, development or commercial information if a party requests protection. The court may also grant protection on its own motion. S. Rep. No. 989, 95th Cong., 2d. Sess. 30, reprinted in 1978 U.S.C.C.A.N. 5787, 5816. Section 107(b) is carefully drafted in the disjunctive to protect "trade secrets" *or* "confidential research, development, *or* commercial information." Thus, the confidential research, development or commercial information need not rise to the level of a trade secret in order to be entitled to protection under §107(b). *See In re Orion Pictures Corp.*, 21 F.3d 24, 28 (2d Cir. 1994). Indeed, case law has generally defined commercial information as information that would give a competitor an unfair advantage. *See In re Handy Andy Home Improvement Centers Inc.*, 199 B.R. 376, 782 (Bankr. N.D. Ill. 1996).[2] Once information is found to be commercial information, it is entitled to protection under 11 U.S.C. §107(b) whether it belongs to the debtor or to third parties.

Section 107(b) evidences congressional intent to effectively address those instances requiring some level of secrecy in bankruptcy—perhaps due to the particularly intrusive scrutiny imposed by the bankruptcy process itself—wherein the debtor's inner workings are laid out for all to see. *See, e.g., In re 50-Off Stores Inc.*, 213 B.R. 646, 654 (Bankr. W.D. Tex. 1997). Thus, although the language in 11 U.S.C. §107(b) *appears to* have been drawn from Federal Rule of Civil Procedure 26(c)(7), the differences between §107(b) and F.R.Civ.P. 26(c)(7) demonstrate congressional intent to protect confidential materials in bankruptcy courts, because in a non-bankruptcy context, those confidential materials would "enjoy a certain expectation of privacy." *See In re 50-Off Stores, Id.* For example, F.R.Civ.P. 26(c)(7) states that a court *may* enter a protective order to protect trade secrets or other confidential research, development or commercial information upon a showing of "good cause."[3] However, §107(b) conspicuously *omits any* requirement that "good cause" be shown, and *requires* the court to protect trade secrets, or confidential research, development or commercial information, upon a party's request. As the Second Circuit Court of Appeals has noted: "Thus, if the information fits any of the specified categories, the court is *required* to protect a requesting party and has no discretion to deny the application. *In re Orion Pictures Corp.*, 21 F.3d 24, 27 (2d Cir. 1994), citing 2, *Collier on Bankruptcy*, ¶107.01, at 107-2 (15th ed. 1993).

***29** Although 11 U.S.C. §107(b) is drafted to effectively protect confidential information in bankruptcy court, at least one court has held that §107(b) only applies to *filed* documents. *See In re Handy Andy Home Improvement Centers Inc.*, 199 B.R. 376, 381 (Bankr. N.D. Ill. 1996). In *Handy Andy*, the parties sought entry of a stipulated protective order that governed the discovery, production and protection of certain confidential information in connection with a request by the bank committee to review the debtor's affairs. There was no contested matter or adversary proceeding pending. Because local bankruptcy rules prohibited the filing of discovery materials, the bankruptcy court declined to enter the stipulated protective order under 11 U.S.C. §107(b). However, the court proceeded to enter the protective order, drawing its authority from a different source, namely Bankruptcy Rule 9018, which applies to "secret, confidential, scandalous or defamatory matter."

Bankruptcy Rule 9018 states:
Secret, Confidential, Scandalous, or Defamatory Matter.

On motion or on its own initiative, with or without notice, the court may make any order which justice requires (1) to protect the estate or any entity in respect of a trade secret or other confidential research, development, or commercial information, (2) to protect any entity against scandalous or defamatory matter contained in any paper filed in a case under the Code, or (3) to protect governmental matters that are made confidential by statute or regulation. If an order is entered under this rule without

notice, any entity affected thereby may move to vacate or modify the order, and after a hearing on notice of the court shall determine the motion.

Unlike 11 U.S.C. §107(b), Rule 9018(1) protects *all* types and forms of confidential matter, whether filed with the court or not. Rule 9018 also differs from 11 U.S.C. §107(b) because the Rule uses the word "may" rather than "shall," and therefore *empowers*, rather than *requires*, a bankruptcy court to protect confidential information. Like 11 U.S.C. §107(b), Rule 9018 enables the bankruptcy court to protect the debtor or any entity, and to act either on its own initiative or on the request of a party; there is no "good cause" prerequisite to relief under Rule 9018.

On its face, Rule 9018 confirms that protection of confidential information should be sought by filing a motion. However, if the motion seeking the protective order is going to be filed with the court, then, pursuant to 11 U.S.C. §107(a), the motion itself becomes a public document. Thus, the motion should be carefully drafted, and all attachments to the motion should be carefully scrutinized, to ensure that the motion seeking the protective order does not inadvertently disclose the information for which protection is being sought. Alternatively, perhaps the motion for a protective order could be filed under seal if the court permits that, although sealing of pleadings is the exception rather than the rule. *In re Nunn*, 49 B.R. 963 (Bankr. E.D. Va. 1985). Similarly, if the court determines that it needs additional information in order to decide a motion for protective order, the attorney seeking protection under 11 U.S.C. §107(b) should to seek to submit the additional information to the court *in camera* or under seal. *See, e.g., In re Moses*, 171 B.R. 789, 797 (Bankr. E.D. Mich. 1994); *In re 50-Off Stores Inc.*, 213 B.R. 646 (Bankr. W.D. Tex. 1997).

The timing of a motion for protective order is also important. *See, e.g., In re Nunn*, 49 B.R. 963 (Bankr. E.D. Va. 1985). In a chapter 11 case, try to file the motion so that ***35** the protective order can be entered *and* served upon the appropriate parties *before* the meeting of creditors held pursuant to 11 U.S.C. §341(a); otherwise, the U.S. Trustee or other creditors present may try to have the debtor disclose your client's confidential information at the §341 meeting. If you represent a client whose confidential information is in the debtor's hands, you should attend the §341 meeting to make sure that the parties bound by the protective order abide by its terms, and promptly take court action if the protective order is violated. In a chapter 7 or chapter 13 bankruptcy, try to file the motion as soon as possible to prevent the trustee from disclosing any confidential information. If a protective order is entered in a chapter 11 case that later converts to a chapter 7 or chapter 13, a motion should be made to bind the chapter 7 or chapter 13 trustee to the protective order (if he or she will not so stipulate).

While entry of the protective order is certainly a watershed event in protecting your client's confidential information, your work may not yet be done—especially in the new product scenario. Indeed, interesting issues can arise when dealing with secured creditors, landlords and asset sales while trying to protect your client's confidential information. As counsel, you need to analyze *each* event or request in the debtor's bankruptcy case to determine whether there is a chance that your client's confidential information might be disclosed, and then take action to prevent that disclosure. For example, in the new product scenario you will likely need to object to any cash collateral order that enables a secured creditor to view, gather, repossess or resell collateral before you and your client inspect and retrieve all of your client's confidential information. Similarly, if a trustee seeks to sell any assets of the debtor, you will likely have to object to the sale unless your client is given the right *and the time* to thoroughly inspect any assets before sale, and to make sure that the trustee does not sell your client's confidential information.

In the new product scenario, your client will likely want to retrieve confidential information as the debtor's bankruptcy case progresses. Once a protective order is in place, it will become easier for your client to prepare a list of the "confidential items" in the hope that appropriate parties (who, hopefully, are bound by a protective order) can agree upon which items constitute your client's confidential information, and can further agree upon your client's retrieval thereof. In the absence of such an agreement, your client should seek appropriate relief from the bankruptcy court, seeking a determination that the confidential information belongs to your client, is not subject to the automatic stay and may be retrieved by your client. Consider asking the court to hold these proceedings under seal in the bankruptcy court. *See, e.g., In re 50-Off Stores Inc.*, 213 B.R. 646 (Bankr. W.D. Tex. 1997).

The debtor's landlord can also pose a problem. You may want to consider seeking an order that prevents the landlord from evicting the debtor or from showing the leased premises until after your client has retrieved the confidential information.

In addition to formal events and requests for relief in the bankruptcy court, you need to ask a lot of questions about the day-to-day activities of the debtor in order to be alert to potential opportunities for accidental disclosure of the confidential information. For example, in the new product scenario, you want to be present when the real estate agent tours the leased premises in case your client's confidential information—such as a prototype of the product—is out in out in plain view. You should also be present when any appraisal is performed to prevent the appraiser from viewing the confidential information, and to ask the appraiser about any tooling or work in process that may constitute embodiments of your client's confidential information. Indeed, the appraiser may help you locate your client's confidential information in those obscure places on the debtor's premises.

In conclusion, §107(b) and federal Bankruptcy Rule 9018 are uniquely designed to protect confidential information from disclosure in bankruptcy. When your knowledge of this statute and rule is coupled with general opportunities to object to other events in bankruptcy (such as cash collateral orders, assumption of leases, sale of assets, etc.) and your knowledge of the debtor's day-to-day activities and operations, your client's secret *should* be safe in bankruptcy.

Footnotes

1 The author wishes to acknowledge the assistance of Patrick Casey Coston in editing this article.

2 However, *In re Lomas*, 1991 WL 21231 (Bankr. S.D.N.Y. 1991) held that this interpretation of "commercial information" is too narrow, and that "commercial information" also includes information related to the buying and selling of securities on the open market.

3 Although "good cause" is not specifically defined in F.R.Civ.P. 26(c)(7), several factors are generally considered, such as "whether disclosure will violate any privacy interest, whether the information is being sought for a legitimate purpose, whether disclosure will embarrass a party, whether the information being sought is important to public health and safety, whether the sharing of information will promote fairness and efficiency, whether a party benefiting from the order of confidentiality is a public entity or official, and whether the case involves issues important to the public...and a balancing of private versus public interests." *In re Handy Andy, supra*, at 380.

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