SOLICITATION UNDER SECTION 1125 OF THE BANKRUPTCY CODE: *CENTURY GLOVE* AND THE FIRST AMENDMENT

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I. INTRODUCTION

The chapter 11 reorganization solicitation process is both commercial in its purpose and political in its outcome because it results in the casting of ballots, which affect compromise on social as well as economic issues. Such social issue compromises include treatment of retirees and employees, the role of management vis-a-vis ownership, the primacy of creditor repayment over corporate rehabilitation and the role of the reorganization process in resolving mass tort problems. As such, the concept of "free speech" has relevance to the chapter 11 reorganization and disclosure process. This confluence of social and economic issues makes it difficult to reconcile the latitude allowed under the First Amendment for political free speech and the constraints imposed on so-called commercial speech. The authors believe that neither the limitations of commercial speech nor the overwhelming lack of prohibitions associated with political speech doctrines should be deemed fully applicable to a chapter 11 reorganization case.

This Article is a comment on the role of the First Amendment in protecting speech in connection with the commercial and social debates and negotiations which are part of the chapter 11 disclosure and solicitation process. The Article first contrasts solicitation under the Bankruptcy Act[1] with solicitation under the

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[1] Bankruptcy Act of 1898, as amended (repealed 1978) ("Bankruptcy Act").

Bankruptcy Code,[2] and then examines what is commonly perceived as commercial speech and issues that arise in applying the prevailing law on commercial speech in the context of solicitations and disclosure under the Bankruptcy Code.

II. SOLICITATION AND DISCLOSURE UNDER THE BANKRUPTCY ACT AND THE ROLE OF THE SECURITIES AND EXCHANGE COMMISSION

In order to understand the modern solicitation process under the Bankruptcy Code, one must look at the provisions of prior law and the role of the Securities and Exchange Commission ("SEC"). Under the Bankruptcy Act, there were two principal reorganization chapters.[3] Chapter X was for large, publicly-held corporations through the use of a form of equity receivership. Chapter XI was designed for non-public companies. It was a faster procedure and less rigid than Chapter X, more commonly used, and prescribed the ground rules for restructuring creditors' rights similar to a composition under state law. Accordingly, under the old Bankruptcy Act, whether disclosure and solicitation in reorganization cases were strictly or loosely regulated depended on the Chapter filed.[4]

A. The SEC and the Unsophisticated Investor

In most Chapter X cases,[5] a trustee was appointed who took control of the debtor, investigated the debtor, apprised the court of the results of the investigation, reported such results to interested parties, and finally, formulated a plan of reorganization. Solicitation of creditor and shareholder votes came only after the court had approved the plan and solicitation materials.

The SEC played a major role in this scenario. Basing its involvement on the image of the "unsophisticated creditor" who

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[2] 11 U.S.C. §§ 1 *et seq.*, as amended; known as the Bankruptcy Reform Act of 1978 ("Bankruptcy Code").

[3] Bankruptcy Act of 1898, Chapters X and XI, §§ 101-276, 301-399, 11 U.S.C. §§ 501-676, 701-799, (1976) (repealed 1978). The Chandler Act of 1938, §§ 101-276, 11 U.S.C. §§ 501-676, made further modifications of prior reorganization law under the Bankruptcy Act. A Chapter X case resulted in a plan of "reorganization," while a Chapter XI case resulted in a plan of "arrangement."

[4] *See* Thomas W. Kahle, Comment, *The Issuance of Securities in Reorganizations and Arrangements Under the Bankruptcy Act and The Proposed Bankruptcy Act*, 36 OHIO ST. L.J. 380, 407-08 (1975).

[5] Appointment of a trustee was mandatory when the debtor's liabilities were $250,000 or more. *See* Bankruptcy Act §§ 156, 167, 169, 11 U.S.C. §§ 556, 557, 589 (1976).

needed its protection, the SEC policed the Chapter X process in order to protect creditors', shareholders', and potential investors' interests.[6] Before approval of the plan, the SEC typically initiated its own investigation of the debtor and advised the court on significant matters during the Chapter X proceeding.[7] Additionally, before approving the plan, the court usually sent it to the SEC for an advisory report.[8] Once the plan was approved, creditors and shareholders were sent the SEC's advisory report on the plan,[9] along with the other disclosure materials: the plan of reorganization, the court-approved summary of the plan and opinion on same, and the notice of the confirmation hearing. The SEC's involvement was premised on protecting what the court and the SEC perceived as the unsophisticated creditor and shareholder by policing all information and providing enough information to allow an unsophisticated person to vote.[10]

By contrast, the SEC did not play a major role in Chapter XI proceedings aside from its rights as a party-in-interest (which rights continue today under § 1109 of the Bankruptcy Code). If, however, securities were involved in a Chapter XI plan of arrangement, the debtor was not exempt from the proxy requirements of the securities laws.[11] Any solicitation materials first had to be submitted to the SEC for approval.[12] If, pursuant to the SEC's recommendation or challenge, the court found that the solicitation materials contained false or misleading information or material omissions, the court could order a re-solicitation, or additional disclosure, or void the consents received.[13] Additionally,

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[6] *See* Levy, *The Role of the Securities and Exchange Commission and the Judicial Functions Under the Bankruptcy Reform Act of 1978*, 54 AM. BANKR. L.J. 29, 41 (1980); *see generally* Allen F. Corotto & Irving H. Picard, *Business Reorganizations Under The Bankruptcy Reform Act of 1978 - A New Approach to Investor Protections And The Role Of The SEC*, 28 DEPAUL L. REV. 961, 994-95 (1979).

[7] *See* Paul J. Thimmig, Note, *Adequate Disclosure Under Chapter 11 Of The Bankruptcy Code*, S. CAL. L. REV. 1527, 1530 (1980). *See generally* Paul R. Glassman, *Solicitations Of Plan Rejections Under The Bankruptcy Code*, 62 AM. BANKR. L.J. 261 (1988).

[8] The court was required to submit the plan to the SEC for approval only if the debtor's total schedule of liabilities exceeded $3 million. Bankruptcy Act § 172, 11 U.S.C. § 575 (1976) (repealed 1978).

[9] *See* 11 U.S.C. §§ 572, 575(3) (1976) (repealed 1978).

[10] *See* 11 U.S.C. § 575 (1976) (repealed 1978) (submission of information to creditors and stockholders after court approval).

[11] *See* Glassman, *supra* note 7, at 264; *see also* Corotto & Picard, *supra* note 6, at 961-63.

[12] *See* Rule 14a-6, 17 C.F.R. § 240.14g-6, cited in Allen F. Corotto, *SEC Reporting, Proxy and Antifraud Compliance — An Additional Perspective on Bankruptcy Reorganization Proceedings*, 63 CAL. L. REV. 1563, 1581 n.70 (1975).

[13] SEC v. Crumpton Builders, Inc., 337 F.2d 907, 912 (5th Cir. 1964) ("the man-

the SEC also retained the right, at any time, to move to transfer the Chapter XI case to one under Chapter X, in which instance any pre-petition consents would be voided, the case would proceed under the supervision of the SEC and the Bankruptcy Court, and the process would be a much longer and more rigid one than under Chapter XI.

Under the Bankruptcy Act, the SEC, acting in accordance with its own rules and regulations and objective of investor protection, exercised its authority in reorganization proceedings to enjoin the distribution of disclosure and solicitation materials because of misleading or inadequate information.[14] Because the information in or about a Chapter X reorganization disclosure statement and plan was primarily economic, and viewed explicitly or implicitly by the courts as commercial speech, the dissemination of such information was viewed as outside the purview and protection of the First Amendment.[15] Consequently, there was no apparent First Amendment conflict created when the SEC sought, and the Bankruptcy Court ordered, a restraint on the dissemination of such information.

Similarly, under Chapter XI cases, where the SEC had a lesser role, the bankruptcy court possessed the injunctive power to restrain communications among creditors notwithstanding the First Amendment.

In re W.T. Grant Co.[16] illustrates this point. In *Grant*, the Chapter XI trustee for the debtor's estate sought to enjoin holders of a debtor's convertible subordinated debentures from solic-

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ner in which affirmations for the arrangement were solicited caused the court to void the responses"); *In re* American Trailer Rentals Co., 325 F.2d 47, 53 (10th Cir. 1963), *rev'd on other grounds sub nom*, SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965) ("If it appears that, for the protection of those being solicited to accept the plan, additional information is necessary, the Court should so order.").

[14] *In re* First Home Inv. Corp. of America, Inc., 368 F. Supp. 5907 (D. Kan. 1973) (respondents in Chapter X case upon application of SEC enjoined under § 2(a)(15) of the Bankruptcy Act from soliciting funds and authorizations from investors in violation of § 14 of the Securities Exchange Act of 1934); *see also* Halsted v. SEC, 182 F.2d 660 (D.C. Cir. 1950) (upholding authority of the SEC to prohibit a stockholders' committee from soliciting financial contributions from shareholders it represented in reorganization proceeding under Public Utility Holding Company Act of 1935 to be used for bearing expenses of the committee).

[15] This was especially true before the Court in Virginia State Board of Pharmacy v. Virginia Citizen's Consumer Council, 425 U.S. 748 (1976) recognized a limited First Amendment protection for commercial speech as long as the speech was neither false nor misleading. See discussion, Section III, *infra* notes 41-102 and accompanying text.

[16] 6 B.R. 762 (Bankr. S.D.N.Y. 1980), *rendered moot on other grounds*, 13 B.R. 1001 (S.D.N.Y. 1981).

iting written support for their dissenting position on a settlement agreement. In support of the injunction, the trustee argued that the debentureholders' information in their solicitation letter was biased and misleading and would interfere with the administration of the debtor's estate. More importantly, the trustee claimed that the proposed communication violated: (1) Bankruptcy Rule 208 which prohibited proxy solicitations; (2) the Securities and Exchange Act of 1934's (the "1934 Act") prohibition on misleading or incomplete communications; and (3) the Trust Indenture Act of 1939's requirement of the Indenture Trustee's prior approval of communications.

In order to justify the restraint ultimately imposed, the bankruptcy court noted that the objecting debentureholders' proposed communication requesting support of their position on the offer was a proxy solicitation and as such had to conform to both bankruptcy law and securities law. The court also pointed out that while bankruptcy law defined a proxy,[17] the 1934 Act prohibited inadequate disclosure, and injunctive relief was readily available to "guard against a defect in a proxy solicitation because the 'use of a solicitation that is materially misleading is itself a violation of the law.' "[18]

The court relied further on the concept of the unsophisticated investor, and opined on the trustee's duties to "provide creditors with sufficient information regarding the possibility of recovery on their claims. . . . He must protect them from any information which would unduly bias their understanding, and thus he owes an administrative duty to creditors as well as to the estate."[19] Accordingly, because the solicitation did not point out that debentureholders ran the risk of recovering less than the settlement amount if they participated in the solicitation, and the information in the solicitation was a "one-sided" version of the

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[17] Then existing Bankruptcy Rule 208(a) provided in pertinent part:

> (1) Proxy. A proxy includes a power of attorney, proof of claim, or other writing authorizing any person who does not then own a claim to vote the claim or otherwise act as the owner's attorney in fact in connection with the administration of an estate of Bankruptcy.
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> (2) Solicitation of a proxy. The Solicitation of a proxy is any communication, other than one from an attorney to a regular client, who owns a claim or from the attorney to the owner of a claim who has requested the attorney to represent him, by which a creditor is asked, directly or indirectly, to give a proxy after or in contemplation of the filing of a petition by or against the bankrupt.

[18] *In re* W.T. Grant Co., 6 B.R. at 766 (citing Mills v. Electric Auto-Lite Co., 396 U.S. 375, 383 (1970)).

[19] *Id.* at 767.

facts, the court issued the injunction on the belief that even if additional antidotal, factual information were then sent to the debentureholders at that time, it would have been too late if the debentureholders had already been poisoned by the biased information in the solicitation letter.[20]

More importantly, the bankruptcy court dismissed the First Amendment challenge by relying on the Supreme Court's definition of commercial speech as an "expression related solely to the economic interests of the speaker and its audience" and unprotected by the First Amendment.[21] The bankruptcy court noted that the solicitation letter fell squarely within the two categories of commercial communications regularly regulated by means of prior restraint without offending the First Amendment: corporate proxy statements,[22] and exchange of information about securities.[23] Further, the court adjudged this solicitation to be misleading such that it did not merit protection.[24] In the court's view, cases holding that solicitations were entitled to First Amendment protection involved solicitations exclusively for political or associational concerns that were easily distinguishable from unprotected forms of communication to solicit clients for commercial purposes which undermine the intent of the securities laws.[25]

B. Solicitation and Control by the Court

In *In re Portland Electric Power Co.*,[26] the debtor's Chapter X trustee and Guaranty Trust Company, as Indenture Trustee, had each submitted plans of reorganization to the SEC. After consideration, the SEC approved the Chapter X trustee's plan. The bankruptcy court then ordered that the Chapter X trustee's plan be sent to the creditors for a vote. Without notifying the court,

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20 *Id.* at 767-70. *See also* Victor Brudney, *Insiders, Outsiders And Informational Advantages Under The Federal Securities Laws*, 93 HARV. L. REV. 322,344 (1979) (grant of an injunction warranted where rules against deceptive proxy solicitations are violated).

21 *Id.* (quoting Central Hudson Gas & Elec. Corp. v. Public Service Comm'n of N.Y., 447 U.S. 557 (1978)).

22 *See* Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970).

23 *See* SEC v. Texas Gulf Sulfur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

24 This was an important conclusion in light of the *Virginia State Board of Pharmacy* requirement of truthfulness for commercial speech to remain free of restraint. *See* Virginia State Board of Pharmacy v. Virginia Consumer Council, 425 U.S. 748, 770 (1975).

25 *In re* W.T. Grant Co., 6 B.R. at 768-69.

26 97 F. Supp. 903 (D. Or. 1947).

the Indenture Trustee issued a statement to bondholders "for the purpose of influencing the votes of the bondholders."[27] After counting the votes, the court determined that "[u]nquestionably the statement did influence the vote."[28] The district court cited the Indenture Trustee for contempt.

Disclaiming contumacious conduct toward the court, the Indenture Trustee claimed the constitutional protection of the First Amendment. The court, however, proclaimed that:

> The invocation of the fetish of free speech is of no avail here. In judicial proceedings there is no uncontrolled right to speech. The litigant can neither whisper to the judge nor wear placards proclaiming his unfairness. Even a defendant on trial for his life is permitted to speak only at appropriate times and places, under control of the presiding judge. A New York institution has no higher privilege in a civil proceeding.[29]

The court's analysis relied in part on the Bankruptcy Act theme of the courts' and the SEC's protection of innocent and unsophisticated investors. The court continued:

> Congress specially provided for the transmission of all material to those who have the franchise upon a plan through the medium of the court. The reason is plain. *The fairness of the representations could be judicially checked. An effort was thus made to protect investors from circularization by predatory interests.* If such programs could be carried on, the standing of the securities of a company in reorganization could be seriously affected. *No one is more easily stampeded than the investors in securities which are the subject of court actions.*[30]

The court also expressed concern about the market effect of a public statement by a major institution, stating that market control could be the end result of a "well-timed statement."[31] Indeed, the court asserted that all communications related to a reorganization plan emanated from the court alone and found inconceivable the concept that a New York financial institution could dominate and manipulate a debtor and perhaps block a plan where the debtor had been in bankruptcy proceedings for eight years.[32] In dicta, the court suggested that it was prepared to enjoin all parties from action that might sabotage the plan, if that were the only means to carry out the

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27 *Id.* at 907.
28 *Id.*
29 *Id.* at 909.
30 *Id.* (emphasis added).
31 *Id.*
32 *Id.* at 910.

statutory purpose of the reorganization of this debtor.[33]

In *In re Realty Assoc. Sec. Corp.*,[34] the district court took a surprisingly laissez-faire approach to an application for an order enjoining and restraining the Chapter X debtor and its sole shareholder from circulating a proposed plan of reorganization and solicitation letter before the trustee had prepared and filed a plan. The district court noted that the Second Circuit had expressly stated that "the courts fully recognized the legislative objective of free communication among security holders for purposes of organization and an exchange of views,"[35] and then suggested: "[a]nd there, perhaps, could be added the free interchange of ideas among the debtor, the stockholders and creditors."[36] Although the court noted that, in its own discretion, it would have granted the motion, it found nothing in the law prohibiting such communication, and denied the motion for a restraining order. At least one court widened this same spirit of laissez-fair in a later decision.[37]

C. *Solicitation Under the Bankruptcy Code: Exit for the Securities and Exchange Commission*

Congress substantially revised prior reorganization law in enacting the Bankruptcy Reform Act of 1978.[38] In so doing, Congress sought to combine the best features of Chapters X and XI of the Bankruptcy Act and to build into the Bankruptcy Code certain investor protections. Congress also rejected, however, the thesis of the unsophisticated investor who needed governmental protection because he or she could not make an informed decision on a plan.[39] In the Bankruptcy Code, Congress attempted to encourage creditors to negotiate and reach agreements on a plan of reorganization without the strict supervision of the SEC and the bankruptcy court, under the Bankruptcy Act. Congress did not incorporate the requirements of the securities laws related to disclosure and effectively deleted from the Code the power of the SEC to police the debtor.

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33 *Id.*

34 59 F. Supp. 90 (E.D.N.Y. 1944).

35 *Id.* at 91.

36 *Id.*

37 *See In re Colonial Commercial Corp.*, *infra* note 128 and accompanying text.

38 *See* Pub. L. No. 95-598, 92 Stat. 2549 (1978) (enacting the provisions of the Bankruptcy Reform Act of 1978, codified at 11 U.S.C. §§ 101, *et seq.*

39 *See* 124 CONG. REC. H11, 101 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards); 124 CONG. REC. S17, 418 (daily ed. Oct. 1978) (statement of Sen. DeConcini); 5 *Collier on Bankruptcy* ¶ 1125.02 at 1125-12 (15th ed. 1991).

Congress recognized, however, that in order to make an informed decision creditors and shareholders needed sufficient information, and thus provided under § 1125 of the Code for adequate disclosure by a plan proponent.[40] Until the bankruptcy court approved the adequacy of the disclosure statement, votes could not be solicited.

III. COMMERCIAL SPEECH AND THE FIRST AMENDMENT

Freedom of speech, as embodied in the First Amendment to the Constitution, is one of the most venerable concepts of the American political landscape. It is the touchstone of a democratic process that permits people to choose what they believe and say what they think. Political theorists and jurists, such as Thomas Jefferson and Justice Oliver Wendell Holmes, have argued that such freedom and intellectual enlightenment are coincident, because the best test of truth is the power of the thought to get itself accepted in the competition of the marketplace of ideas.[41] The art of governance often, however, requires certain limitations to be placed upon the doctrine of freedom of speech, or rather, the possible extreme results of such freedom. Common law actions based on libel and slander, fighting words,[42] as well as legislation from the Alien and Sedition Acts of the early days of the Republic to modern regulations on bankruptcy disclosure[43] and SEC proxy statements,[44] are manifestations by the

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[40] *See* 11 U.S.C. § 1125 (1988). If adequate disclosure is provided to all creditors and stockholders whose rights are to be affected, then they should be able to make an informed judgment of their own, rather than having the court or the Securities and Exchange Commission inform them in advance of whether the proposed plan is a good plan. The overriding purpose of disclosure in reorganization context is to provide the investor with adequate information to make an informed decision about the reorganization plan. *See In re* Century Glove, 860 F.2d 94, 100 (3d Cir. 1988). Therefore, once the bankruptcy court has determined that this threshold has been met, the issues regarding what constitutes permissible solicitation arise.

[41] Abrams v. U.S., 250 U.S. 616, 630 (1919) (Holmes, J., dissenting). The theory reflects the view that the most effective way to combat false speech is by combating it in the marketplace of ideas. Where there is free trade in ideas, truth will be known and accepted through competition in the market by means of discussion and argument.

[42] Brandenburg v. Ohio, 395 U.S. 444 (1969) embodies the present status of the United States Supreme Court's view on political speech. In *Brandenburg*, the Supreme Court combined the standards of Justices Holmes's and Brandeis's "clear and present danger" test, first articulated in *Schenck v. U.S.*, 249 U.S. 47 (1919) with Judge Learned Hand's "advocacy/indictment" distinction first incorporated in Masses Publishing Co. v. Patten, 244 F. 535 (S.D.N.Y. 1917).

[43] *See* Bankruptcy Code, *supra* note 3, § 1125.

[44] *See, e.g.*, Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

judicial and legislative branches of government of their recognition that the First Amendment must have its limits. As one court cogently declared, "there is no right so absolute that it may be exercised under any circumstances and without any qualification."[45]

Political speech and commercial speech, however, have not been accorded the same degree of philosophical importance in our governance process. It was less than twenty years ago that the United States Supreme Court first granted explicit First Amendment protection to commercial speech in the seminal case, *Virginia State Board of Pharmacy v. Virginia Citizens' Consumer Council*.[46] In that decision,[47] the United States Supreme Court recognized the First Amendment differences between commercial speech and non-commercial speech, but held that commercial speech should not be entirely beyond the scope of First Amendment protection, provided it is truthful and concerns lawful activity.[48] Unlike prior First Amendment cases, which focused on the right of personal expression, the Supreme Court in *Virginia Pharmacy* for the first time recognized a First Amendment right to receive information.[49]

The contrary view had been expressed in *Valentine v. Chrestensen*,[50] where the Supreme Court held that handbill advertise-

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45 Read v. Schroeder Hotel Co. (*In re* Schroeder Hotel Co.), 86 F.2d 491, 494 (7th Cir. 1936) (citing Hutchman Coal & Coke Co. v. Mitchell, 245 U.S. 229 (1917)).

46 425 U.S. 748 (1976). The Court defined commercial speech as "speech which does no more than propose a commercial transaction." *Id.* at 752 (citing Pittsburgh Press Co. v. Pittsburgh Comm'n on Human Relations, 413 U.S. 376, 386 (1973)). Later, in *Central Hudson Gas v. Public Service Comm'n*, the Court described commercial speech as "expression related solely to the economic interests of the speaker and its audience." 447 U.S. 557, 561 (1980).

47 *Virginia State Board of Pharmacy* involved a dispute over the prohibition placed on advertising by the state board of pharmacy. *Virginia State Board*, 425 U.S. at 749-53.

48 *Id.* at 770-73.

49 For a controversial, cogent analysis of a proposed distinction between commercial speech as hearer-centered, as contrasted with political speech as speech-centered, see Burt Neuborne, *The First Amendment and Government Regulation of Capital Markets*, 55 BROOKLYN L. REV. 5 (1989) and for comments on and analysis of his thesis, see *Some Comments on Professor Neuborne's Paper*, 55 BROOKLYN L. REV. 65 (1989); R.K. Winter, *A First Amendment Overview*, 55 BROOKLYN L. REV. 71 (1989). *See also* Cramer v. Skinner, 931 F.2d 10102, 1026 (5th Cir. 1991) (quoting *Virginia Pharmacy*, plaintiff asserted that statute restricting advertising on air services for interstate travel violated his First Amendment right to hear information).

50 316 U.S. 52 (1942). *Virginia State Board of Pharmacy* restricted *Valentine* to its narrow holding that reasonable restrictions on time, place, and manner may be placed on commercial speech.

ments were commercial speech. As a result, the state government could restrain handbill distribution as it deemed appropriate. The *Valentine* court bluntly stated that "the Constitution imposes no restraint on government as respects purely commercial advertising."[51] This exception to First Amendment protection for commercial speech remained in force until 1976.[52]

A. Central Hudson Gas v. Public Service Commission

Four years after *Virginia State Board of Pharmacy*, the United States Supreme Court, in *Central Hudson Gas v. Public Service Commission*,[53] announced the prevailing test for determining the level of First Amendment protection for commercial speech. In *Central Hudson Gas*, the Public Service Commission of the State of New York, responding to fuel shortages, had ordered electric utilities to cease all advertising which promoted the use of electricity. After the shortage had eased, the Public Service Commission refused to change the rules and to allow advertising by the state's electric corporations. The New York Court of Appeals reviewed the ban on advertising, and concluded that the governmental interests involved outweighed whatever constitutional protection was to have been granted to commercial speech in this situation.

Relying on *Virginia State Board of Pharmacy*, the Court acknowledged that it had "rejected the 'highly paternalistic' view that government has a complete power to suppress or regulate commercial speech."[54] The Court recognized however, that a "common sense" distinction exists between commercial and other forms of speech, and held that commercial speech could be regulated under a four-part analysis despite the First Amendment protection. In order to be protected, the speech in question must concern a lawful activity, and must not be false or misleading. The second inquiry is whether the asserted governmental interest is substantial. Assuming that the first two inquiries yield positive answers, the final two tests are those commonly associated with constitutional balancing under the rational basis approach — namely, that the manner and term of regulation

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[51] *Id.* at 54.

[52] *See, e.g.*, Pittsburgh Press Co. v. Pittsburgh Comm'n on Human Rights, 413 U.S. 376, 384-85, 388-91 (1973) (commercial advertisement in question similar to that in *Valentine*, and thus beyond scope of First Amendment); Breard v. Alexandria, 341 U.S. 622, 641-45 (1951) (commercial peddling not protected by First Amendment).

[53] 447 U.S. 557 (1980).

[54] *Id.* at 562.

must directly advance the asserted governmental interest, and, finally, the regulation must be narrowly tailored to serve that governmental interest.

The lone dissent in *Central Hudson Gas* was then Justice Rehnquist, who stated the view "that the Court unlocked a Pandora's Box when it 'elevated' commercial speech to the level of traditional political speech by according it First Amendment protection in *Virginia State Board of Pharmacy v. Virginia Citizens' Consumer Council*,"[55] and that, while there are fraudulent ideas to be protected against in the commercial context, there are none in the political context. Further, commercial speech, unlike political speech, is not essential to our system of government. This "Pandora's Box" argument was insufficient to sway the other Justices, who, while generally agreeing that commercial speech was deserving of some First Amendment protection, felt obligated to write no less than four separate opinions.[56]

B. Weakened Protection for Commercial Speech

The *Central Hudson Gas* test remained essentially unchanged until 1986 when the Supreme Court decided *Posadas de Puerto Rico Associates v. Tourism Co. of Puerto Rico*.[57] In *Posadas*, the Court deferred to the state legislature and allowed the state to ban adver-

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55 *Id.* at 598 (Rehnquist, J., dissenting).

56 Perhaps the most interesting point raised in the concurring opinions is that raised by both Justice Brennan and Justice Blackmun, that "no differences between commercial speech and other protected speech justify suppression of commercial speech in order to influence public conduct through manipulation of the availability of information." *Id.* at 572 (Brennan, J., concurring); *id.* at 578 (Blackmun, J., concurring). *See also* Linmark Associates, Inc. v. Willingboro, 431 U.S. 85 (1977) (town ordinance prohibiting real estate signs struck down as unconstitutionally suppressing information because the message might cause harm). Thus, the flow of information may not be stopped in order to protect the public. *Willingboro* reiterated the rationale of the right to receive information.

57 478 U.S. 326 (1986). In *Posadas*, after the Puerto Rican government had legalized certain forms of gambling, it prohibited gambling casinos from advertising to the general public in Puerto Rico but allowed restricted advertising outside Puerto Rico. *Id.* at 330-32. The Supreme Court decided that the restrictive statute and regulations were constitutionally valid based on the state's determination that the information was not in the best interest of the public. The Court stated: "The [Puerto Rican] legislature could conclude, as they apparently did here, that residents of Puerto Rico are already aware of the risks of casino gambling, yet would nevertheless be induced by widespread advertising to engage in such potentially harmful conduct [gambling]." *Id.* at 344. For other Supreme Court cases applying the *Central Hudson Gas* four-pronged test, see, *e.g.*, Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 647-49 (1985) (applying *Central Hudson Gas* test to analyze regulation of commercial speech and holding that a state ban restricting lawyer advertising where there was no deception was unconstitutional); Bolger v. Youngs

tising where it had the power to ban the activity. In effect, and contrary to the basic constitutional underpinnings of *Virginia Pharmacy*,[58] the Court banned truthful, non-deceptive advertising of a lawful activity for the express purpose of preventing involvement in the activity. Additionally, in endorsing the ban on speech, the Court regressed to the "highly paternalistic" notion of government control of speech which the Court expressly rejected in *Virginia Pharmacy*.[59]

In its analysis, the *Posadas* Court quickly pointed out that the state had a substantial interest in protecting the welfare of its citizens by passing the regulations[60] and then deferentially conceded that the legislature's interest was advanced by the regulations. In so facilely substituting the state legislature's judgment for its own to satisfy both prongs of the *Central Hudson Gas* test, the Court effectively weakened these two tests. Finally, paving the way for its rejection of the least restrictive means test four years later, the Court noted that it was also the legislature's judgment as to whether the statute was narrowly drawn, and then buttressed its conclusions by reasoning that if the state could prohibit the underlying activity, it could regulate it by restricting advertising.[61]

In the next significant case, *Board of Trustees of the State of New York v. Fox*,[62] the Court considered whether regulations of the State University of New York prohibiting private commercial enterprises from operating on State University campuses could be applied to so-called "Tupperware" parties in dormitory rooms which consisted of demonstrating and offering products for sale to small groups of students were invalid. The Court revisited its previous interpretations of the fourth prong of the *Central Hudson*

Drug Prods. Corp., 463 U.S. 60, 68-80 (1983) (holding that a ban on unsolicited advertising of contraceptives was unconstitutional).

58 *See Virginia Pharmacy*, 425 U.S. at 773 ("[A] State may [not] completely suppress the dissemination of concededly truthful information about entirely lawful activity, fearful of that information's effect upon its disseminators and its recipients.").

59 *Id.* at 770, 784.

60 *Posadas*, 478 U.S. at 341-42 ("the Puerto Rico Legislature obviously believed, when it enacted [the statute and regulations] . . ., that advertising of casino gambling aimed at the residents . . . would serve to increase the demand for the product advertised).

61 *Id.* at 346.

62 492 U.S. 469 (1989). In *Fox*, students and a corporation brought an action against the university because of the university's refusal to allow product demonstrations in campus dormitory rooms. *Id.* at 472.

Gas test — the least restrictive means requirement.[63] Totally deferring to the state legislature's judgment, the Court asserted that its former references to the least restrictive means test were mere dicta,[64] and now held that the fit between the means and the speech to be regulated need only to be reasonable. The Court opined that

> [w]hat our decisions require is a " 'fit' between the legislature's ends and the means chosen to accomplish those ends," — a fit that is not necessarily perfect, but reasonable; that represents not necessarily the single best disposition but one whose scope is "in proportion to the interest served," that employs not necessarily the least restrictive means, but . . . a means narrowly tailored to achieve the desired objective. Within those bounds we leave it to governmental decision makers to judge what manner of regulation may best be employed.[65]

The *Fox* majority, in characterizing the fourth prong of the *Central Hudson Gas* decision, appeared to have sounded a death knell to the least restrictive means test.[66] However, while the Court's analysis and decisions in the *Fox* and *Posadas* cases substantially weaken both cases, the protection previously accorded to commercial speech has not been eliminated.[67] Appellate and lower court deciding First Amendment commercial speech issues after *Posadas* and *Fox*, however, have not been consistent in their application of the revised, weakened *Central Hudson Gas* four-pronged test.[68]

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[63] The *Central Hudson Gas* test contemplated that in order to regulate commercial speech, the burden was on the state to show that other, less restrictive means will not suffice to uphold its substantial interest. Thus, under *Central Hudson Gas*, any regulation advocated by the state had to be narrowly drawn, *i.e.*, there had to be a close fit. *See Central Hudson Gas*, 447 U.S. at 564.

[64] Referring to its decisions in Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 644 (1985). *See also Central Hudson Gas*, 447 U.S. at 564.

[65] *Fox*, 492 U.S. at 480 (quotation omitted).

[66] *Id.* at 476-81.

[67] *See generally* Albert P. Mauro, Jr., Comment, *Commercial Speech after* Posadas *and* Fox*: A Rational Basis Wolf in Intermediate Sheep's Clothing*, 66 TUL. L. REV. 1931 (1992). *See also* Comment, Board of Trustees of the State University of New York v. Fox: *Cutting Back on Commercial Speech Standards*, 75 IOWA L. REV. 1335 (1990). Project 80's, Inc. v. City of Pocatello, 942 F.2d 635 (9th Cir. 1991) (notwithstanding the Supreme Court's vacating the previous opinion and remanding the case to be decided in the light of *Fox*, the court of appeals opined on the newly articulated standards but analyzed the fourth prong under a least restrictive means test and found, for the second time, that the ordinances were not narrowly tailored).

[68] *See, e.g.*, National Advertising Co. v. Town of Babylon, 900 F.2d 551, 555 (3d Cir.), *cert. denied*, 111 S. Ct. 146 (1990) (rejecting the municipality's arguments that under *Fox* a complete ban on billboard advertising may be upheld without any least restrictive means inquiry; reiterating that the party seeking to uphold a restriction

Indeed, the Supreme Court's recent decisions illustrate this inconsistency. The Supreme Court in *City of Cincinnati v. Discovery Network, Inc.*,[69] recently ruled that the City of Cincinnati's refusal to allow distribution of commercial publication through freestanding newsracks situated on public property violated First Amendment rights. The majority opinion (which did not mention *Posadas*) found that the city's ban on commercial newsracks placed too much importance on the distinction between commercial and non-commercial speech which under the facts bore no relationship "whatsoever" to the interests (esthetics) the city had asserted.[70] The Court noted that while the city's desire to limit the total number of newsracks was justified, there was no justification for discriminating against newsracks distributing commercial publications.[71]

In *Edenfield v. Fane*,[72] in a decision by Justice Kennedy, the Court held unconstitutional a Florida (Board of Accountancy) ban on direct, in-person, uninvited solicitations by certified public accountants ("CPAs"). The Court held that the Board failed to demonstrate that solicitation of prospective business clients by CPAs created the danger of fraud and overreaching or compromised independence that the Board feared, and that the Board regulation failed to pass the penultimate prong of *Central Hudson*, in that it provided only ineffective or remote support for the government's purpose of preventing fraud and other forms of deception

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has the burden of justifying it, and holding that the ordinances were unconstitutional); Greater Baltimore Board of Realtors, Inc. v. Baltimore County, 752 F. Supp. 193, 197-99 (D. Md. 1990) (invalidating statute on analysis of third prong of *Central Hudson Gas*—to advance governmental interest—and although not necessary, analyzing the fourth prong, and notwithstanding defendant-county's assertions, relying on *Central Hudson*, finding that the statute was not narrowly tailored), *aff'd without opinion*, 956 F.2d 263 (4th Cir. 1992); Adams Outdoor Advertising of Atlanta, Inc. v. Fulton County, Ga., 738 F. Supp. 1431, 1433 (N.D. Ga. 1990) (invalidating county ordinance where government did not meet test of substantial government interest). Finally, some reported decisions adopt the guidelines of *Fox* and defer to the legislating body. *See, e.g.*, Cramer v. Skinner, 931 F.2d 10102, 1034 (5th Cir. 1991) (deferentially finding: (1) a substantial government interest; and, (2) the restriction advancing that interest under *Posadas*, then identifying the fourth prong as the critical component of the test and relying on the more lenient *Fox*, rejecting plaintiff's First Amendment challenge to statute finding a reasonable fit between the challenged advertising restrictions and the government's asserted interest); Central American Refugee Center-Carecen v. City of Glen Cove, 753 F. Supp. 437, 440 (E.D.N.Y. 1990) (upholding town's ordinance prohibiting solicitation of employment, quoting the *Fox* "not necessarily perfect, reasonable fit").

69 113 S. Ct. 1505 (1993).

70 *Id.* at 1524.

71 *Id.* at 1524-25.

72 113 S. Ct. 1772 (1993).

and protecting privacy.[73] By contrast, the court viewed the direct solicitation process as having "considerable value" where carried on in a "commercial context."[74]

Although the Supreme Court in *City of Cincinnati* and *Edenfield* appeared to have broadened the scope of commercial free speech[75] protection by ignoring the *Posadas* Court's deference to the legislature's determination as to the fit between the regulation and its purpose, the Court subsequently reaffirmed the four prong test of *Central Hudson* as the benchmark for examining commercial free speech, but found *Posadas*'s deference to be consistent with it.

In *United States v. Edge Broadcast Co.*,[76] the Court upheld a provision of the Federal Communications Act of 1934, as amended by the Charity Games Advertising Clarification Act of 1988,[77] which prohibits broadcasting of lottery communication by radio stations licensed to a state in which lotteries are prohibited under state law. In *Edge Broadcasting*, in an opinion by Justice White (in four parts to which different majorities joined) to which Justices Stevens and Blackmun dissented, and to which Justice Souter filed a separate opinion in which Justice Kennedy joined concurring in part, the Court found that 18 U.S.C. § 1307 met each of the four criteria of *Central Hudson*. Justice White attempted to harmonize *Posadas* with *Central Hudson* in applying the fourth criterion of *Central Hudson*, i.e., whether the government regulation that advances the governmental interest asserted is no more extensive that necessary to preserve that interest. Justice White wrote that the Court merely requires "a

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[73] *Id.* at 1799-800.

[74] *Id.* at 1797.

[75] It has been suggested that the Court in *City of Cincinnati* may have added a test in addition to that articulated by *Central Hudson Gas*, and that the distinction made by a regulation between commercial and non-commercial speech should bear a relationship to the asserted governmental interest. *See* Felix H. Kent, *Re-Affirmation of First Amendment in Commercial Speech*, N.Y.L.J., April 16, 1993.

[76] 113 S. Ct. 2696 (1993).

[77] *See* 18 U.S.C. § 1304, PUB. L. No. 100-625, § 3(a)(4), 102 Stat. 3206. Section 316 of the Communications Act of 1934 prohibited the broadcast of lottery commercials. An exception to this rule embodied in 18 U.S.C. § 1307 allows broadcasters to advertise state-run lotteries if the broadcast station is licensed to a state that conducts a state-run lottery. Section 1307 provides in relevant part:

> (a) the provisions of sections 1301, 1302, 1303, and 1304 shall not apply to
>
> (1) an advertisement, list of prizes, or the information concerning a lottery conducted by a state acting under the authority of state law which is —
>
> (B) broadcast by a radio or television station licensed to a location in that state or a state which conducts such a lottery.

18 U.S.C. § 1307.

fit between the restriction and the government interest that is not necessarily perfect, but reasonable,"[78] and that such a gloss on *Central Hudson* was also consistent with the approach taken by the Court in *Posadas*.[79] The choice among alternative reasonable approaches remains with the legislature.[80]

C. *Non-Personalized Investment Advice as Protected Speech* — Lowe v. Securities and Exchange Commission

The lid on "Pandora's Box" raised by Justice Rehnquist in his dissent in *Central Hudson* may have been opened a little wider in *Lowe v. Securities and Exchange Commission*.[81] Prior to that decision, "nobody would have believed that a First Amendment attack on a Securities and Exchange Commission regulation would stand a chance."[82] In *Lowe*, an "investment advisor," who had been barred from giving advice about securities because of convictions for various criminal acts,[83] was indicted for publishing newsletters giving securities advice to subscribers without registering under the Investment Advisors Act of 1940.[84] The SEC brought an action under the Investment Advisors Act to halt publication and to bar Lowe from involvement in the newsletters.[85]

In the district court, Judge Weinstein made a lengthy search into the First Amendment implications of the SEC's actions.[86] By reviewing the *Central Hudson* case to determine the level of protection afforded commercial speech, the court determined that the publication of the newsletters was lawful activity and not necessarily misleading. Although the government had a substantial

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78 1993 LEXIS 4402, 21 (citing Board of Trustees of State Univ. of New York v. Fox, 492 U.S. 469, 480 (1989); Posadas de Puerto Rico Assoc. v. Tourism Co. of Puerto Rico, 478 U.S. 328, 344 (1986)).

79 *Id.* at 21.

80 *Id.* at 29.

81 472 U.S. 181 (1985).

82 Nicholas Wolfson, *The First Amendment And The SEC*, 20 CONN. L. REV. 265, 265 (1988).

83 Lowe had been convicted in 1977 of appropriating funds of clients, and failing to file as an investment advisor under New York law. SEC v. Lowe, 556 F. Supp. 1359, 1361 (E.D.N.Y. 1983), *rev'd*, 725 F.2d 892 (2d Cir. 1984), *rev'd*, Lowe v. SEC, 472 U.S. 181 (1985). He was also convicted in 1978 of tampering with evidence to cover up fraud on a client and of stealing from a bank. *Id.* Finally, a New Jersey court sentenced him to three years imprisonment in 1982 on two counts of theft by deception through issuance of worthless checks. *Id.*

84 *Lowe*, 472 U.S. at 183. *See also* 15 U.S.C. § 80-52 (1940).

85 The publications in question were *The Lowe Stock Advisory* and the *Lowe Chart Service*. *Lowe*, 556 F. Supp. at 1361.

86 *See id.* at 1365.

interest in protecting investors from the abuses that were prevalent in the securities industry, according to the court, the restraint placed by the Investment Advisors' Act failed to meet the fourth criterion of the *Central Hudson* case; namely, that the remedy was not narrowly tailored to the government's interest. The district court believed that disclosure would be a less drastic means of protecting investors from securities fraud. the district court opined that "economic discussion [*i.e.*, commercial speech] addresses issues of public concern and qualifies as ideological debate," and that "the combination of fact, economic and political analyses, conjecture, and recommendation characteristic of investment newsletters places them outside the rubric of commercial speech and raises unanswered questions concerning the conditions, if any, under which an absolute restraint may constitutionally be imposed on them."[87] Thus, the district court[88] implied that the restrictions the SEC sought to place on Lowe and his publications were constitutionally invalid under the *Central Hudson* test.[89]

In reversing Judge Weinstein, the Second Circuit held that the Investment Advisors Act draws no distinction between personal and impersonal advice, and the only distinction made by the Act is between publications which give investment advice and legitimate magazines and newspapers.[90] Following its decision in *SEC v. Wall Street Transcript Corp.*,[91] the Second Circuit held that Lowe's newsletters were not in fact a bona fide newspaper under the Investment Advisors Act,[92] and that *Central Hudson Gas* and *Virginia State Board of Pharmacy* did not alter its conclusion regarding Lowe's publications because, in light of Lowe's checkered past, there could be a presumption that harmful, false material

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87 *Id.* at 1367.

88 The district court did, however, enjoin Lowe from giving securities information to subscribers or potential subscribers by letter, by telephone or in person, and thus limited Lowe's giving personal investment advice. *Id.* at 1371.

89 The district court's conclusion was that the Investment Advisers' Act of 1940 could not be read to authorize the denial of registration to a publisher of this type of impersonal newsletter simply on the basis of past acts and that because the defendants were denied registration as publishers, they would not be enjoined from "publishing their newsletter and [from] other impersonal services." *Id.*

90 SEC v. Lowe, 725 F.2d 892, 901-02 (2d Cir. 1984), *rev'd*, Lowe v. SEC, 472 U.S. 181 (1985).

91 422 F.2d 1371 (2d Cir.), *cert. denied*, 398 U.S. 958 (1970).

92 In *Wall Street Transcript*, the Second Circuit held that a newsletter which sold for five dollars an issue and which consisted primarily of reports on securities was not a bona fide newspaper, such that it would be excluded from the definition of an investment advisor under the Act. *Id.* at 1377.

would be published.[93]

The discussion proved to be mere academic interest, however, as the Supreme Court eventually interpreted the Investment Advisors Act in a way that would avoid the First Amendment issues.[94] The Supreme Court avoided a direct ruling on the constitutional issue by reversing the Second Circuit decision on non-constitutional grounds,[95] i.e., that consistent with the congressional deference to protecting the First Amendment rights of newspapers and periodicals evidenced in the legislative history of the Investment Advisors Act, the publications involved were determined to have been excluded from the scope of the Investment Advisors Act.[96] Furthermore, the majority opinion in *Lowe* did not characterize the investment letter in terms of "commercial speech," which the Court had defined in *Virginia State Board of Pharmacy* as speech which " 'propose[s] a commercial transaction.' "[97] To the contrary, the *Lowe* Court stated that, "[t]he mere fact that a publication contains advice and comment about specific securities does not give it the personalized character that identifies a professional investment adviser."[98]

The concurrence, written by Justice White and joined by the Chief Justice Burger and Justice Rehnquist, criticized the majority's decision as being disingenuous.[99] According to Justice White, Lowe was an investment advisor and thus was properly subject to the Investment Advisors Act, but the application of that Act to Lowe was clearly inconsistent with the First Amendment. The concurrence stated that the flat prohibition provided

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93 *Lowe*, 725 F.2d at 900-02. The Second Circuit justified the publication injunction by reasoning that Lowe's prior history of criminal misconduct in the securities area created a potential for deception. *Id.* at 901. Prevention of deception, it opined, constituted a sufficient government interest to justify the imposition of a prior restraint on commercial speech. *Id.* The Second Circuit stated that "[j]ust as the potential for deception may justify the regulation of a profession . . . the potential for deception permits government to ban potentially deceptive commercial speech." *Id.* (citations omitted).

94 *Lowe*, 472 U.S. at 204-05. The court held that the Investment Advisers' Act of 1940 could not be read to authorize the denial of registration to a publisher of this type of impersonal newsletter simply on the basis of past acts. *Id.* at 210-11.

95 *See id.* at 190 ("[A] careful study of the statute may either eliminate, or narrowly limit, the constitutional question that we must confront.").

96 *Id.* at 190-91, 211.

97 Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, 425 U.S. 748, 762 (1975) (citation omitted); *see also* Board of Trustees of the State University of New York v. Fox, 492 U.S. 469, 472 (1988).

98 *Lowe*, 472 U.S. at 208.

99 *Id.* at 226-27 (White, J., concurring).

by the Investment Advisors Act was an impermissible prior restraint on speech regardless of whether it was commercial. The concurrence, without deciding whether the newsletter was fully protected speech or commercial speech,[100] further opined that publication of non-personalized investment advice is protected speech.[101] Justice White stated that "the Act, as applied to prevent petitioner from publishing investment advice altogether, is too blunt an instrument to survive even the reduced level of scrutiny called for by restrictions on commercial speech."[102] The concurring Justices suggested alternative measures such as anti-fraud laws as more narrowly-tailored remedies to help prevent securities abuses.

Chapter 11 disclosure statements are both financial and political documents. They contain financial information and recommendations of a debtor and creditors committee and sometimes an equity committee. The goal of the document is to persuade creditors that a plan proponent's approach to debt repayment is in their best interests. It is in every sense non-personalized investment advice. Under the approach described by Justice White's concurrence, it is possible that the contents of a disclosure statement and its use by others constitutes protected speech.

IV. APPLICATION OF COMMERCIAL SPEECH DOCTRINE TO REORGANIZATIONS

The Bankruptcy Code is less intertwined with the SEC and less restrictive than the Bankruptcy Act, and as a result the possibility of First Amendment conflicts appear somewhat reduced. However, a basic question remains as to whether the prohibition under § 1125 of the Bankruptcy Code of vote solicitation without prior judicial approval of the disclosure statement presents an impermissible prior restraint on speech in general or as it may be

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100 *Id.* at 234 (White, J., concurring).

101 *Id.* at 236 (White, J., concurring).

102 *Id.* at 235 (White, J., concurring). The concurrence cited as applicable the court's observation in *Schneider v. State*, 308 U.S. 147, 164 (1939):

> Frauds may be denounced as offenses and punishable by law . . . If it is said that these means are less efficient and convenient than bestowal of power on police authorities to decide what information may be disseminated . . . and who may impart the information, the answer is that considerations of this sort do not empower [government] to abridge freedom of speech and press.

Id.

applied.[103]

Under *Central Hudson Gas*, one must first determine whether the regulated speech is commercial or non-commercial.[104] Commercial speech speaks *solely* to the economic interests of the receiving party. Like the advertisements in *Valentine v. Christensen*, solicitations and disclosures of "adequate information" designed to induce a "hypothetical reasonable investor" to vote on a plan for a business reorganization is clearly commercial speech.[105] This has been the traditional view of corporate reorganization materials. Thus, in *In re W.T. Grant Co.*,[106] the Bankruptcy Court stated that Chapter X vote solicitation material was a form of commercial communication, as it fell somewhere between "corporate proxy statements and exchange of information about securities."[107]

If commercial speech is false or misleading, it is within the court's power to restrain it.[108] As the Supreme court said in *Lowe*, however, one cannot presume in advance that a form of speech will be misleading.[109] Accepting the proposition that restrained speech in the reorganization context is not presumptively misleading, it must be determined whether the requirements placed on participants in chapter 11 cases by § 1125 of the Bankruptcy Code constitute impermissible prior restraints on speech.[110]

A. Application of Central Hudson Four Prong Test to Reorganization Cases

The four prong test of *Central Hudson*, discussed earlier, may be applied to disclosure and solicitations in a chapter 11 reorganization.

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103 There can be little doubt that the requirement of court approval of disclosure statements as well as the limitations on solicitation of votes during the debtor's exclusivity period are prior restraints on free speech.

104 Central Hudson Gas & Elec. Corp. v. Public Service Comm'n of New York, 447 U.S. 557, 561 (1979).

105 11 U.S.C. § 1125(a); *see* Valentine v. Christensen, 316 U.S. 52 (1941).

106 6 B.R. 762 (Bankr. S.D.N.Y. 1980), *rendered moot on other grounds*, 13 B.R. 1001 (S.D.N.Y. 1981).

107 *Id.* at 768.

108 *In re* Corey, 892 F.2d 829 (9th Cir. 1989), *cert. denied*, 111 S. Ct. 56 (1990).

109 *Lowe*, 472 U.S. at 208-09.

110 An interesting question exists as to whether *Central Hudson Gas* would apply to solicitations not based on "economic" considerations, such as political hostility to the debtor or its business, e.g., the manufacture of asbestos or other toxic or environmentally damaging products.

1. Lawful Activity and Not Misleading Statements.

To be deserving of protection under the First Amendment, commercial speech must have a lawful purpose and must not be misleading or false. Although it is always possible that a creditor or other party in a bankruptcy proceeding will be less than truthful in a disclosure statement or other solicitation, under *Lowe* it cannot be presumed that, generally, statements will be false and misleading.[111] Furthermore, protecting one's economic interests in a reorganization case is still a "lawful" activity.

2. Substantial Government Interests.

The federal government clearly has an interest in orderly reorganization proceedings. The economic situations which lead debtors to seek the protection of bankruptcy and the concomitant financial exposure of creditors, employees and shareholders which arises in situations of economic distress are strong reasons for government action to protect commerce. Indeed, the basic necessity for bankruptcy laws to protect debtors is recognized in the Constitution,[112] and there have been bankruptcy laws implementing such power in the United States since the Bankruptcy Act of 1800.[113] Protection of debtors and interstate commerce clearly are substantial government interests.

3. Advances Government Interest.

The prior court approval requirements for disclosure statements advance governmental interests. By requiring court approval of disclosure statements, the Code, in addition to assuring adequate information to third parties, provides a forum to guard against misleading or false statements that could otherwise be distributed to creditors and shareholders.[114] When combined with congressional limitations on the rights of creditors or shareholders to propose alternative plans during the exclusivity period, the court gives the debtor the first chance to save its own company, and advances the government's interest in speedy and efficient bankruptcy proceedings.[115] Even absent exclusivity, prior approval of at least one disclosure statement advances the government's interest in the accuracy of market place knowledge

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111 *Id.*
112 U.S. CONST. art. I, § 8, cl. 4.
113 *See generally*, 1 COLLIER ON BANKRUPTCY, ¶ 1.02 (15th ed. 1991).
114 11 U.S.C. § 1125(a) and (b).
115 *Id.* § 1121(b).

without the social cost of remedial litigation after the disclosure statement has been distributed. In limiting the rights of creditors and/or shareholders to circulate alternative plans without prior court approval of the disclosure statement at any time, the Bankruptcy Code protects the creditor or shareholders as the "hypothetical reasonable investor"[116] by assuring adequate information for the investor.

4. Narrowly Tailored.

The gravamen of the test as to whether § 1125 creates an impermissible prior restraint on the First Amendment rights of commercial speech is whether the rules are narrowly tailored in the least restrictive way to protect the interests involved, or at least constitute a fit between the restriction and the government interest that is not necessarily perfect, but reasonable. This determination mandates comparison with a less restrictive alternative.

One alternative to any prior restraints might be a laissez-faire approach. Under this approach, commercial speech would be treated similarly to other types of First Amendment protected speech. The assumption would be that the marketplace of ideas — which concept is held dear in the context of political speech — would also win in the efficient marketplace of debtors and creditors. In fact, particularly in large, complex chapter 11 cases, the checks and balances provided by the "marketplace of ideas" are quite strong. One could agree that the debtor might be required to transmit more information prior to vote solicitation in order to combat market impressions created by hostile communications by others. In such event, even unsophisticated individuals who became creditors or equity holders in a bankrupt corporation would have ample access to appropriate information. The process would enhance the role of the committee professional, who could be relied upon in most cases to adequately evaluate disclosure statements made by other parties and make a more neutral recommendation. The economic self-interest of all the parties in the bankruptcy proceeding would virtually ensure that adequate information is made available to the constituencies. To protect against fraud, this system could use civil or criminal fraud, RICO and other weapons that are frequently applied in the securities

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[116] *Id.* § 1125(a).

context.[117]

The laissez-faire system has limitations, however, which are met by the current system. First and foremost, the current system clearly leads to some form of judicial economy. By requiring that at least the first plan proponent, usually the debtor, submit its disclosure statement for court approval, the court sets a certain date whereby all parties can come and give their opinions as to the fairness and accuracy of the disclosure statement. "The Court [is] able to determine what is necessary in light of the facts and circumstances of each particular case."[118]

Although the grant to the debtor of an exclusive right to file and solicit a plan under § 1121 of the Bankruptcy Code compounds the restraint on speech, it advances strong governmental interests. The purpose of chapter 11 is to rehabilitate the debtor.[119] By granting the reorganizing debtor an exclusivity period, the debtor has the first chance to pull itself out of bankruptcy while all other parties are evaluating the debtor's proposal. In the absence of this exclusivity period, every party to the reorganization case would be free from the outset to present its alternative plan. This approach could lead to an administrative nightmare which also runs counter to the theme of rehabilitation.

Furthermore, the retroactive use of fraud actions and other litigation methods to police the accuracy of disclosure statements, the good or bad faith of plans, solicitations, etc., would be a cumbersome and costly process. To require the debtor to pay for its own participation plus the participation of official committees in such long-term litigation could be a heavy burden on an estate.

B. Century Glove and the First Amendment

Section 1125 of the Bankruptcy Code of 1978, as amended, provides that after the bankruptcy court has approved the disclosure statement, parties may solicit acceptances or rejections of the plan or reorganization.[120] Section 1125 left unanswered

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117 This approach was advocated by the concurring opinion in *Lowe*. *Lowe*, 472 U.S. at 225 (White, J., concurring).

118 H.R. REP. No. 95-595, 95th Cong., 1st Sess. at 408 (1977).

119 *In re* Bildisco & Bildisco, 465 U.S. 513, 527 (1984); *See also* Perez v. Campbell, 402 U.S. 637, 648 (1971) (" '[o]ne of the primary purposes of the bankruptcy act' is to give debtors 'a new opportunity in life' ") (citing Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934))).

120 11 U.S.C. § 1125.

questions regarding the full extent of permissible communications during reorganization cases, especially by a creditor committee with its constituency or those who might pose an alternative to a debtor's plan of reorganization.

The leading case in determining the permissible degrees of regulated speech under § 1125(b) is the Third Circuit's decision in *Century Glove v. First American Bank (In re Century Glove)*.[121]

Century Glove questioned the limits on regulating the permissible communication between creditors in the process of solicitation for a plan of reorganization in a chapter 11 case under the Bankruptcy Code. The conduct at issue in *Century Glove* — communication by a disaffected creditor — lies at the heart of the relationship between reorganization creditors and the First Amendment. In championing the rights of creditors to communicate on issues surrounding solicitation of the plan of reorganization, the Third Circuit expressly held that § 1125 does not limit communication between creditors with respect to a proposed plan or reorganization.

In *Century Glove*, after a disclosure statement by the debtor had been approved and distributed, a major creditor of the debtor sought to solicit rejections of the debtor's plan from other creditors. The creditor, First American Bank of New York ("FAB"), notified the bankruptcy court that it planned to submit its own proposed plan at the end of the exclusivity period of the debtor. However, prior to seeking court approval of its disclosure statement, FAB solicited individual rejections and forwarded a draft of its own plan to selected creditors. The bankruptcy judge stated that the requirements of § 1125(b) required court approval for all solicitation matters prior to their being sent to any creditors. Armed with that reasoning, the court invalidated one of the rejecting votes.[122]

The district court reversed the bankruptcy court's holding,[123] narrowly construing § 1125(b), and determining that there was no requirement that further approval be garnered for materials sent to creditors once any disclosure statement had been approved by the court and disseminated to the creditors.

On appeal, the Third Circuit affirmed the lower court's holding. The court rejected the bankruptcy court's interpretation of

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121 860 F.2d 94 (3d Cir. 1988).

122 The court also applied sanctions against FAB Century Glove. Century Glove, 74 B.R. 952 (Bankr. D. Del. 1987).

123 Century Glove, 81 B.R. 274 (D. Del. 1988).

§ 1125 as requiring prior approval of solicitation materials by creditors where an approved disclosure statement prepared by the debtor had already been distributed:

> Century Glove argues, and the Bankruptcy Court assumed, that only approved statements may be communicated to creditors. The statute, however, never limits the facts which a creditor may receive, but only the time when the creditor may be solicited. . . . The provision sets a floor, not a ceiling. Thus, we find that § 1125 does not on its face empower the Bankruptcy Court to require that all communications between creditors be approved by the court.[124]

The court rejected the argument that to be safe, "the creditor must seek prior court approval for every communication with another creditor." As to whether FAB violated § 1125 by soliciting acceptances of its own plan prior to approval, the court said that it found "no principled, predictable difference between negotiations and solicitations of future acceptances, and [we] therefore reject any definition of solicitation which might cause creditors to limit their negotiations."[125] Thus, the court decided that § 1125 must be read extremely narrowly to encourage the kind of good-faith negotiations that occur during a bankruptcy proceeding, that anything that could cast an impermissible chill on this practice should be avoided, and that the term "solicitation" in § 1125 means only vote solicitation.[126]

Had the Third Circuit in *Century Glove* interpreted § 1125 to require prior judicial approval of every creditor communication, it would have generated serious First Amendment problems. First, it would have been a more restrictive alternative requiring greater judicial interference in the communication process. Given Congress's rejection of the unsophisticated investor approach, the only legitimate purpose for interference would be in aid of the discredited presumption that the creditor intends to distribute misleading materials.[127] Second, it does not advance the government's interest, as required by *Central Hudson Gas, i.e.*, the rehabilitation of debtors or the protection of creditors from marketplace abuse, if creditors are not allowed to communicate the desirability of negative votes

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124 Century Glove, Inc. v. First American Bank of New York, 860 F.2d 94, 100 (3d Cir. 1988).

125 *Id.* at 101, 102.

126 *See also In re* Snyder, 51 B.R. 432, 437 (Bankr. D. Utah 1985) ("solicit" and "solicitation" must be interpreted narrowly to include only a specific request for a vote).

127 *See* Lowe v. SEC, 472 U.S. 181, 208-09 (1985).

after one disclosure statement has been mailed. Third, were the court to read § 1125 in a manner to impede discussions that enhanced inter-creditor negotiation, it would constitute unnecessary additional leverage in favor of the debtors by giving it a means to control the context and form of any debate regarding its repayment obligations.

An analogous laissez-faire approach was advocated by Bankruptcy Judge Roy Babbitt in *In re Colonial Commercial Corp.*[128] In that case, the creditors' committee asked the court to approve its recommendation to the creditors, to which the court replied:

> There is no authority for me to approve what [counsel for the committee] tells his creditors . . . how dare you — let the record show — you have no right to come to this court for me to put a seal of benediction on something for which you know there is no authority in law . . . I don't want to hear from you.[129]

There are certain formalities, of course, that parties still must follow for general solicitation. First and foremost, one cannot solicit creditors and shareholders to accept or reject a plan until creditors and shareholders have received the proposed plan of reorganization and a disclosure statement which has been approved by the bankruptcy court.[130] Furthermore, even the mere expression of a "hope" respecting a vote on a debtor's plan, made in the course of negotiations, may be improper if made prior to the court's approval of the disclosure statement.[131]

With regard to the approval of a disclosure statement, however, the First Amendment requires at least as much flexibility on subse-

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[128] *See* Reporter's Transcript, *In re* Colonial Commercial Corp., No. 811312341 (Bankr. S.D.N.Y. June 25, 1982) at 3, 4.

[129] *See also In re* Gulph Woods Corp., 83 B.R. 339 (Bankr. E.D. Pa. 1988); *cf. In re* East Rudley Corp., 16 B.R. 429 (E.D. Pa. 1982) (in an Act case, the court appeared to imply that a creditor must have plan approved prior to dissemination). *But see In re* Temple Retirement Community, 80 B.R. 367 (Bankr. W.D. Tex. 1985) (limiting solicitations only to those materials approved by the court).

[130] 11 U.S.C. § 1125(b). Specifically, after the disclosure statement is approved, the following are mailed to creditors and shareholders: (1) the disclosure statement and plan (or court approved summary of the plan); (2) notice of time for filing acceptances or rejections of the plan; (3) notice of confirmation hearing date and time; (4) form of ballot for voting; and (5) any other material the court may direct. *See* FED. R. BANKR. P. 3017. For cases illustrating these principles, see *In re* Apex Oil Co., 11 B.R. 245 (Bankr. E.D. Mo. 1990), *alter proceeding*, 122 B.R. 559 (Bankr. E.D. Mo. 1990), *aff'd in part, rev'd in part on other grounds*, 131 B.R. 712 (E.D. Mo.), and *rev'd on other grounds*, 132 B.R. 613 (E.D. Mo. 1991); *In re* Snyder, 51 B.R. 432 (Bankr. D. Utah 1985); *In re* Nautilus of New Mexico, 83 B.R. 784 (Bankr. D. N.M. 1988).

[131] *In re* Gilbert, 104 B.R. 206 (Bankr. W.D. Mo. 1989).

quent communications as expressed in *In re Apex Oil Co.* There the court attempted to set wider limits of acceptable communications following dissemination of the plan and disclosure statement. In that court's view creditors may:

> 1) offer a narrative, evidence, conclusions, or opinions contrary to that enunciated in the plan or disclosure statement;
> 2) assert positions, evidence, conclusions, or opinions of relevant matters which are not contained in the plan or court-approved disclosure statement;
> 3) offer evidence or opinions of an alternative liquidation analysis, since the debtors have a liquidation analysis as part of their disclosure statement.[132]

Indeed, the sole restriction in solicitation relates back to the need for adequate disclosure. The bankruptcy court encourages communications related to the plan under consideration but restricts soliciting votes until the disclosure statement has been approved.[133]

Court approval for a debtor's modified disclosure statement is also required.[134] Thus, in *In re Media Cent. Inc.*, it was held improper for the debtor to solicit votes on one plan which had been filed and two competing plans which had not been filed. These are some of the restrictions placed upon the First Amendment rights of parties to a bankruptcy proceeding.

C. *Commercial Speech or Political Speech*

Part of the fallout from the Supreme Court's renewed interest in commercial speech during the 1980s was a debate as to whether prior restraints imposed on bankruptcy solicitation, or imposed by SEC regulations, are constitutional. Although courts have in the past rejected the argument that proxy statements and other SEC filings are not to be afforded the full protection available to political speech,[135] some commentators have promoted the view that certain forms of commercial speech cannot and should not be treated differently than political speech.[136]

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132 *Apex Oil*, 111 B.R. at 250.

133 *Id.*

134 *See In re* Cramer, Inc., 100 B.R. 63 (Bankr. D. Kan. 1989); *In re* Media Cent., Inc., 89 B.R. 685 (Bankr. E.D. Tenn. 1988).

135 *See, e.g.*, Dunn and Bradstreet, Inc. v. Green Moss Builders, Inc., 472 U.S. 744, 759 (1985) (citing Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 456); SEC v. Texas Gulf Sulfur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) (SEC can regulate exchange of information regarding securities); Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970) (regulation of corporate proxy statements permissible without offending First Amendment).

136 Wolfson, *supra* note 82, at 300-01. For material on the *Lowe* case, see *Sympo-*

For example, in *Central Hudson Gas*, the three concurring opinions all expressed dissatisfaction with the concept of commercial speech as it was presented to the Court. Justice Blackmun's concurrence stated that the only relevant distinction between commercial speech and non-commercial speech was not in its ability or inability to influence people nor in its protectability under the First Amendment, but rather, in its treatment of the reasonableness of time, place and manner restrictions placed upon the speech. The concurrence of Justice Stephens argued that there are two types of commercial speech, and that, in certain situations, just because speech appeals solely to the economic interests of the speaker and its audience does not mean that it is beyond the First Amendment. Justice Stephens gave as examples labor leaders who call a strike, or economists who discuss money supply, as parties who deserve full First Amendment protection despite the fact that they appeal to the economic interests of a party. Justice Stephens also stated that too broad a ban on "promotional advertising" itself might infringe First Amendment rights. Specifically, this kind of ban would curtail "expression by an informed and interested group of persons' point of view on questions relating to the production and consumption of electrical energy — questions frequently discussed and debated by our political leaders."[137]

Similarly, in the aftermath of the Supreme Court's decision in *Lowe*, Nicholas Wolfson, in his article, "The First Amendment and the SEC,"[138] wrote a thorough and detailed analysis of the distinctions between political and commercial speech. According to Wolfson, there is little philosophical distinction between an ad for shampoo itself, and an ad that is part of a corporate campaign to cut shampoo taxes and eliminate regulations on the product, even though the former is clearly commercial speech and the latter is without doubt a part of First Amendment protected political speech. Wolfson also differentiated between advertising and a corporate proxy statements, in which restraints of speech may also, on close analysis, appear to be a First Amendment violation. Namely, where much of our economy is based on the function of

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sium — The First Amendment and Federal Securities Regulation, 20 CONN. L. REV. 261 (1985); Note, *The Federal Securities Laws, The First Amendment, and Commercial Speech: A Call For Consistency*, 59 ST. JOHN'S L. REV. 57 (1984).

137 Central Hudson Gas v. Public Service Comm'n, 447 U.S. 557, 580 (1980) (Stephens, J., concurring).

138 *See supra* note 82.

various large public corporations, the information they provide in proxy statements clearly is important to the public at large.

IV. CONCLUSION

Until recently, courts granted no First Amendment protection to commercial speech. Now that the Pandora's box of constitutional protection for commercial speech is firmly opened, new standards need to be defined. The constitutional statutes of prior restraints on solicitation of votes on approval of disclosure statements can now be questioned. In the bankruptcy context, while speech is commercial in one sense of the word, with the politicalization of bankruptcy proceedings and the important public issues that arise therefrom, a valid question remains as to whether solicitation and disclosure statements are advertisements or a form of economically motivated political speech, and, if the latter, whether the current restraints imposed by disclosure requirements of the Bankruptcy Code are compatible with the requirements of the First Amendment.