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Disclosure in Chapter 11 Reorganizations: The Pursuit of Consistency and Clarity

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NOTES

DISCLOSURE IN CHAPTER 11 REORGANIZATIONS: THE PURSUIT OF CONSISTENCY AND CLARITY

The Bankruptcy Reform Act of 1978[1] requires any party filing a plan of debtor reorganization to include a statement disclosing "adequate information" about the debtor to the voting creditors.[2] This new disclosure scheme replaces the troublesome scheme available under the former reorganization laws.[3] The new Act, however, never formally defines adequate disclosure,[4] forcing the courts to define it on a case-by-case basis.[5]

This Note will survey the case law under section 1125 and identify the standards that have evolved for the adequacy of disclosure. The first section will discuss the role that disclosure plays in the reorganization process and the interests that it is designed to protect.[6] The second section will analyze creditor objections to disclosure statements and will discuss how the courts resolve such objections.[7] The final section will analyze judicial interpretations of the adequate disclosure requirements, focusing on the extent to which they promote or protect policies underlying the disclosure process.[8]

I
The Role of Disclosure in Chapter 11

A. Previous Vehicles for Reorganization and Disclosure

Prior to enactment of the Bankruptcy Reform Act of 1978,[9]

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1 Pub. L. No. 95-598, 92 Stat. 2549 (1978), 11 U.S.C. § 1125(a) (1982):

> "[A]dequate information" means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan . . . .

2 11 U.S.C. § 1125(a)(1) (1982).

3 *See infra* notes 9-24 and accompanying text.

4 *See* Note, *Disclosure of Adequate Information in a Chapter 11 Reorganization*, 94 Harv. L. Rev. 1808, 1808, 1811-15 (1981) (reporting that "adequate information" is not defined in current or previous bankruptcy law or in nonbankruptcy disclosure law).

5 *See infra* notes 34-39 and accompanying text.

6 *See infra* notes 9-51 and accompanying text.

7 *See infra* notes 53-112 and accompanying text.

8 *See infra* notes 113-58 and accompanying text.

9 Pub. L. No. 95-598, 92 Stat. 2459 (1978).

chapters X and XI of the Chandler Act[10] governed debtor reorganizations. Chapter X of the old statute applied only to corporate reorganizations.[11] A trustee controlled the debtor's business and prepared a reorganization plan for the bankruptcy court.[12] The court then held a hearing on the valuation of the business and decided whether to approve the plan.[13] After approval, the judge solicited acceptances from the creditors.[14] The debtor was not required to make a formal disclosure. Instead, once the plan was accepted,[15] the court held a confirmation hearing to make a going concern valuation of the debtor's assets and to determine whether the plan was "fair and equitable."[16] Often the Securities and Exchange Commission evaluated the debtor and reported to the court.[17] Congress enacted the valuation and approval hearing requirements to protect public investors,[18] but the process proved to be often lengthy and complex. The resulting delays frequently caused additional losses for creditors[19] and generated data once described as "an estimate compounded by a guess."[20]

Chapter XI offered a less formal scheme for debtor arrangement with unsecured creditors. It promoted speed and simplicity in the bankruptcy process[21] because only the debtor could file a plan.

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10 Chandler Act of 1938, ch. 575, §§ 101-399, 52 Stat. 840, 883-916 (repealed 1978).

11 *See id.* § 106(5), 52 Stat. at 883 ("'[D]ebtor' shall mean a corporation by or against which a petition has been filed under this chapter . . . .").

12 5 COLLIER ON BANKRUPTCY ¶ 1125.02, at 1125-7 (15th ed. 1979).

13 Chandler Act §§ 169-70, 174, 52 Stat. at 890, 891.

14 *See* Note, *Adequate Disclosure Under Chapter 11 of the Bankruptcy Code,* 53 S. CAL. L. REV. 1527, 1530 (1980).

15 *Id.*

16 Chandler Act §§ 179, 221, 52 Stat. at 892, 897 (repealed 1978).

17 *See, e.g.,* Gardner, *The SEC and Valuation Under Chapter X,* 91 U. PA. L. REV. 440 (1943); Note, *Valuation by the SEC in Reorganization,* 55 HARV. L. REV. 125 (1941); Note, *supra* note 14, at 1530; *see also* H.R. REP. No. 595, 95th Cong., 1st Sess. 225 (1977) [hereinafter cited as H.R. REP.] ("The valuation consists of an estimate of the earning power of the reorganized debtor, and the appropriate market capitalization rate of that estimated income stream. The income stream thus estimated, capitalized as appropriate, is then distributed among the classes of creditors and equity security holders . . . .").

18 H.R. REP., *supra* note 17, at 225.

19 *See id.*; *see also* 5 COLLIER ON BANKRUPTCY, *supra* note 12, at 1125-11; King, *Chapter 11 of the 1978 Bankruptcy Code,* 53 AM. BANKR. L.J. 107, 109 (1979).

20 H.R. REP., *supra* note 17, at 225.

21 One cannot overemphasize the advantages of speed and simplicity to both creditors and debtors. Chapter XI allows a debtor to negotiate a plan outside of court and, having reached a settlement . . . permits the debtor to bind all unsecured creditors to the terms of the arrangement. From the perspective of creditors, early confirmation of a plan of arrangement: first, generally reduces administrative expenses which have priority over the claims of unsecured creditors; second, permits creditors to receive prompt distributions on their claims with respect to which interest does not accrue after the filing date; and third, increases the ulti-

Moreover, the parties could negotiate without judicial involvement. This chapter, however, did not require formal disclosure. Originally, Congress believed that unsecured creditors did not need elaborate disclosure because they were often involved in the debtor's business operation.[22] In enacting the new bankruptcy legislation, Congress recognized that some debtors were soliciting acceptances from creditors who had little or no knowledge of the debtor's business or of the plan itself.[23] Thus, some investor protection appeared necessary.[24]

B. "Adequate Disclosure" Under Chapter 11

The disclosure requirements of the debtor[25] reorganization provisions in the current bankruptcy code contained in section 1125[26] of new chapter 11[27] were designed to further the policies of investor protection and simplicity.[28] A debtor or creditor submitting a reorganization plan[29] must also submit a disclosure statement

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> mate recovery on creditor claims by minimizing the adverse effect on the business which often accompanies efforts to operate an enterprise under the protection of the Bankruptcy Act.

124 CONG. REC. 32,405 (1978); 124 CONG. REC. 34,005 (1978).

22 H.R. REP., *supra* note 17, at 225.

23 *Id.* at 225-26.

24 *Id.* at 226 ("Chapter XI needs some form of investor protection in order to make it a fairer reorganization vehicle.").

25 11 U.S.C. § 109 (1982) provides:

> (a) Notwithstanding any other provision of this section, only a person that resides in the United States, or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.
>
> (b) A person may be a debtor under chapter 7 [liquidation] of this title only if such person is not—
>
> (1) a railroad;
>
> (2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)); or
>
> (3) a foreign insurance company, bank, . . . or credit union, engaged in such business in the United States . . . .
>
> (d) Only a person that may be a debtor under chapter 7 of this title, except a stockholder or a commodity broker, and a railroad may be a debtor under chapter 11 of this title.

Reorganization under chapter 11 is thus available to most individual and corporate debtors.

26 11 U.S.C. § 1125 (1982).

27 11 U.S.C. §§ 1101-74 (1982).

28 *See infra* notes 34-44 and accompanying text. *See also supra* note 9. Chapter 13 of the new bankruptcy code, governing debt adjustment for individual wage earners, contains no similar provisions for disclosure. *See* 11 U.S.C. §§ 1301-30 (1982). The provisions for filing and confirmation of a plan under chapter 13 are contained in 11 U.S.C. §§ 1321-25 (1982).

29 Chapter 11 reorganizations commence with a petition by either the debtor or the

to provide the voting creditors with background on the debtor and

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creditors. 11 U.S.C. § 1121(c) (1982). For 120 days after the filing, only the debtor may file a plan. 11 U.S.C. § 1121(b) (1982). After that time, or after 180 days if the debtor has not filed an accepted plan, or at any time after a trustee has been appointed in the interests of the creditors under 11 U.S.C. § 1104(a) (1982), any party in interest may file a plan. 11 U.S.C. § 1121(c) (1982).

The reorganization plan must classify creditors with substantially similar claims or interests together for purposes of voting on the plan. 11 U.S.C. §§ 1122, 1123(a) (1982). Creditors that would have their legal or equitable rights altered, or that would not be compensated in full under the plan, are deemed to be "impaired" unless they agree to the modification of their rights. 11 U.S.C. § 1124 (1982). The plan must specify the treatment of the impaired classes. 11 U.S.C. § 1123(a)(3) (1982). It must treat each creditor in a class in the same manner, unless a creditor specifically agrees to less favorable treatment. 11 U.S.C. § 1123(a)(4) (1982). Impaired creditors may vote to accept or reject the plan, whereas unimpaired creditors are deemed to have accepted the plan. 11 U.S.C. § 1126(f) (1982).

The party proposing the plan can submit it to the bankruptcy court for approval after he solicits the acceptances of creditors holding two-thirds in value of outstanding claims, or two-thirds in value and one-half in number of the outstanding claims, of each impaired class. 11 U.S.C. §§ 1126(c)-(d), 1129(a) (1982). The court excludes acceptances and rejections from entities that it concludes have not voted in good faith. 11 U.S.C. § 1126(e) (1982). Consequently, it is not necessary for all creditors in every impaired class to accept the plan.

The court holds a hearing on confirmation of the plan. 11 U.S.C. § 1128 (1982). The requirements for confirmation are listed in 11 U.S.C. § 1129 (1982). In short, a plan, submitted in good faith and in conformance with the provisions of chapter 11, will be confirmed if all impaired classes accept it by the required majorities and will receive at least as much as they would have through a liquidation of the debtor. 11 U.S.C. § 1129(a)(7)-(8) (1982). For a complete discussion of the confirmation process, see 5 COLLIER ON BANKRUPTCY, *supra* note 12, ¶ 1129.01; Hopper, *Confirmation of a Plan Under Chapter 11 of the Bankruptcy Code*, 15 IND. L. REV. 501 (1982); King, *supra* note 19, at 129-30.

If the proponent of a plan does not receive acceptances from the required majorities, the plan will normally fail. 11 U.S.C. § 1129 (1982). The proponent may be able to confirm the plan over the dissent of nonaccepting classes if the interests of the dissenters are protected. This is known as "cramdown." *See* Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133, 140-41 & n.65 (1979).

The basic cramdown provision reads:

> [I]f all of the applicable requirements of subsection (a) of this section . . . are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

11 U.S.C. § 1129(b)(1) (1982). There are different conditions of fairuess and equality for classes of secured claims, unsecured claims, and ownership interests. 11 U.S.C. § 1129(b)(2) (1982). Generally, a dissenting creditor must receive the value equal in amount to his claim or interest. Since the "fair and equitable" test is more difficult to meet than the "value at liquidation" test, proponents are well advised to seek the acceptance of each class. *See* King, *supra* note 19, at 130.

For a complete discussion of cramdown, see Klee, *supra*; Miller, *Bankruptcy Code Cram Down Under Chapter 11: New Threat to Shareholder Interests*, 62 B.U.L. REV. 1059, 1076-83 (1982); Pachulski, *The Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code*, 58 N.C.L. REV. 925 (1980).

the plan.[30] The statement must contain "adequate information concerning the debtor's financial status."[31] Proponents may offer different disclosure to different classes of creditors if each statement contains adequate information for the typical investor of that class.[32] The bankruptcy court will hold a hearing to evaluate each disclosure statement and to consider any proposed modifications or objections; both the creditor and the debtor must file any objections to the statement with the court in advance of the hearing.[33]

Congress intended that, under the new disclosure scheme, creditors could independently evaluate the plan without extensive judicial participation in the process.[34] Congress left the standard for evaluating the adequacy of disclosure vague to allow flexibility.[35] The factors that Congress believed the courts should consider are the cost of preparing the statement, the nature and history of the debtor, the condition of the debtor's records, the need for prompt solicitation of votes, and the need to protect the investor.[36] Congress noted, however, that the "[c]ourts will take a practical approach" in each case, considering such factors only when necessary.[37] Furthermore, "otherwise applicable nonbankruptcy law rule[s] or regulation[s]" do not govern the standard of adequacy

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30 11 U.S.C. § 1125(b) (1982). The plan and the disclosure statement may not be separate documents. *In re* Bel Air Assocs., Ltd., 4 Bankr. 168 (Bankr. W.D. Okla. 1980), (plan itself contained "adequate information").

31 11 U.S.C. § 1125(a)(1) (1982).

32 11 U.S.C. § 1125(a) (1982). *See supra* note 2. An "investor typical of holders of claims or interests of the relevant class" is one who (1) has a claim or interest of the relevant class, (2) has a relationship with the debtor similar to that of the other members of the class, and (3) has an ability similar to other members of the class to obtain information sources other than the disclosure. 11 U.S.C. § 1125(a)(2) (1982).

33 FED. R. BANKR. P. 3017(a) (adopted in 1982).

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> 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.

H.R. REP., *supra* note 17, at 226.

The SEC may advise the court on the adequacy of a disclosure statement, but it may not appeal the court's decision. *Id.* at 409; S. REP. No. 989, 95th Cong., 2d Sess.. 121 (1978) [hereinafter cited as S. REP.]. SEC participation in other phases of reorganization is limited. Recently the commissioners voted to reduce active participation in chapter 11 proceedings to traditional matters such as adequacy of disclosure. Critics believe that such a move will endanger the protection of public investors in the reorganization process. *See SEC Votes to Cut Its Role in Bankruptcy Cases,* NAT'L L.J., Jan. 9, 1984, at 5.

35 H.R. REP., *supra* note 17, at 409 ("Precisely what constitutes adequate information in any particular instance will develop on a case-by-case basis."); S. REP., *supra* note 34, at 121 ("The information required will necessarily be governed by the circumstances of the case.").

36 H.R. REP., *supra* note 17, at 409; S. REP., *supra* note 34, at 121.

37 H.R. REP., *supra* note 17, at 409.

under chapter 11,[38] and Congress prohibited the Supreme Court from using its rule-making power to define a standard for disclosure.[39] Thus, Congress has left the bankruptcy courts with little guidance as to what constitutes adequate disclosure.

C. Disclosure and the Protection of the Parties' Interests

In formulating the new chapter 11, Congress changed several of the requirements of the previous law in an attempt to preserve both the advantage of expediency present in the old chapter XI and the advantage of creditor protection present in the old chapter X. Congress retained the use of a hearing from the former chapter X, noting that the hearing is "desigued to protect against end-runs around the disclosure requirement."[40] At the special disclosure hearings, however, the court merely decides whether to approve the disclosure;[41] creditors must approve the plan.[42] Thus, Congress deleted the requirement of a valuation at the disclosure hearing. Although Congress did not prohibit valuations in the new code,[43] it pointed out that "[i]n many smaller cases [in chapter X], and in some of the larger cases that are not found in chapter XI, [the valuation that chapter X required] is an unnecessary process, and far too costly and time-consuming."[44] In theory, then, the new disclosure hearing should protect the creditors' interest in being reasonably informed and all the interests of the parties in minimizing costs of time and money.

The flexible "hypothetical reasonable investor" standard[45] of adequacy of disclosure contained in chapter 11 is also aimed at protecting the parties' interests in expediency and creditor protection. Congress decided that several factors should be considered in determining adequate disclosure, including "the circumstances of [each] case, the relative sophistication of the creditors, and their access to

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38 11 U.S.C. § 1125(d) (1982). The thrust of this provision is to prevent disclosure in chapter 11 reorganizations from being measured by the disclosure requirements of the securities laws. *See* H.R. REP., *supra* note 17, at 409; S. REP., *supra* note 34, at 121-22. An official or agency, such as the SEC, with a duty to enforce other laws pertaining to disclosure, may offer opinions at the hearing concerning the adequacy of the information. 11 U.S.C. § 1125(d) (1982).

39 H.R. REP., *supra* note 17, at 409.

40 *Id.* at 227.

41 *See* FED. R. BANKR. P. 3017(b), (c), (d).

42 11 U.S.C. § 1126 (1982); *see supra* note 29.

43 H.R. REP., *supra* note 17, at 227. Valuations are necessary in cramdown situations to determine sufficiency of the proposed distribution to a dissenting class of creditors or to a dissenting creditor. *See* Pachulski, *supra* note 29, at 951-65.

44 H.R. REP., *supra* note 17, at 227. 11 U.S.C. § 1125(b) (1982) provides that "[t]he court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets."

45 *See supra* note 32 and accompanying text.

other sources of information about the plan."[46] This flexible approach should, for example, allow the debtor to draw up a disclosure statement based on the state of his books rather than stretching his financial means by preparing an unnecessarily detailed statement. As Congress noted, "[f]requently, the debtor's books will be in shambles at the time of bankruptcy, and reconstruction could be a long and costly process. If there is no need for the information under the circumstances, reconstruction may be dispensed with . . . ."[47]

This flexibility also protects the relevant interests of the creditors. For reorganizations involving large public corporations, adequate disclosure is essential for long-run protection of shareholder investments.[48] Formerly, in chapter X cases, stockholders could rely on SEC advisory reports for information on and an evaluation of the plan.[49] Congress recognized that "[t]he public protection policy of the securities laws must be balanced with the protection of creditors [sic] rights in bankruptcy cases, which is frequently facilitated by speed in the reorganization process."[50] Under chapter 11, the courts may require disclosure in great length and detail to protect stockholders. For creditors of nonpublic debtors and for nonshareholders, the flexibility of the process removes the costs in time and money of a lengthy and often unnecessary valuation and disclosure process.

Despite the recognized need for flexibility, the courts have inev-

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46 H.R. REP., *supra* note 17, at 226; *see* S. REP., *supra* note 34, at 121 (circumstances of each case will determine information necessary in disclosure).

47 H.R. REP., *supra* note 17, at 226; *see also* S. REP., *supra* note 34, at 121 ("Subsection (a)(1) expressly incorporates consideration of the nature and history of the debtor and the condition of its books and records into the determination of what is reasonably practicable to supply"); Note, *supra* note 4, at 1817 ("Congress . . . was willing to balance increased information and the possibility of uncovering fraud against increased accounting costs and delays.").

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> [I]nvestor protection is most critical when the company in which the public invested is in financial difficulties and is forced to seek relief under the bankruptcy laws. . . . As public investors are likely to be junior or subordinated creditors or stockholders, it is essential for them to have legislative assurance that their interests will be protected. Such assurance should not be left to a plan negotiated by a debtor in distress and senior or institutional creditors who will have their own best interest to look after.

S. REP., *supra* note 34, at 10.

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> Some have argued that creditors and stockholders simply are unable to make an intelligent or informed decision without the SEC's report, all of the valuation evidence developed at the disclosure hearing, and an order of the court finding the plan worthy of consideration and approving the plan. The purpose of the approval hearing, court approval, and an SEC report in chapter X was public investor protection.

H.R. REP., *supra* note 17, at 225 (footnotes omitted).

50 *Id.* at 229.

itably formulated some definite guidelines as to the quantity and quality of information required to meet the adequacy standard.[51] In evaluating these judicial standards, it is necessary to consider the extent to which they further the congressional purposes of cost-efficient disclosure and investor protection.[52]

II
CREDITORS' OBJECTIONS AND THE COURTS' DETERMINATION OF ADEQUATE DISCLOSURE

If a creditor objects to the contents of a disclosure statement, it must file with the bankruptcy court and voice those objections at the approval hearing.[53] There are three types of objections creditors may raise concerning the adequacy of a disclosure statement. First, a creditor may object to the "quantitative" nature of the information disclosed; the creditor complains that the statement does not contain sufficient information for the hypothetical typical investor of its class to make an informed judgment on the plan.[54] Second, a creditor may claim that the disclosure statement raises both "quantitative" and "qualitative" questions. Here, the creditor objects to factually unsupported opinions in the disclosure statement.[55] Finally, a creditor may object only to the "qualitative" nature of the information. In these cases, the creditor claims that the information is inconsistent, incorrect, or in conflict with the creditor's own independent information.[56]

A. Adequacy and Questions of Insufficient Information

Quantitative questions of disclosure have generally turned on a typical investor's ability to establish information for itself with no strict standard for determining sufficiency.[57] Where a class of creditors is sophisticated and able to garner independent information about the debtor, a bare minimum of disclosure may be sufficient.[58] Where a class of creditors is less sophisticated, courts require more comprehensive and detailed disclosure statements.[59] As the bank-

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51 *See infra* notes 52-113 and accompanying text.

52 One commentator has characterized the scheme for investor protection in chapter 11 as fostering an "every-man-for-himself" attitude. Miller, *supra* note 29, at 1087.

53 FED. R. BANKR. P. 3017(a).

54 *See infra* notes 57-86 and accompanying text.

55 *See infra* notes 87-104 and accompanying text.

56 *See infra* notes 105-12 and accompanying text.

57 In avoiding strict standards of adequacy, the courts are apparently following the will of Congress. *Cf. supra* note 35.

58 *See infra* notes 62-72 and accompanying text.

59 The bankruptcy courts have held, for instance, that the disclosure statement must be more than a summary of the reorganization plan. *See In re* Adana Mortgage Bankers, 14 Bankr. 29, 30 (Bankr. N.D. Ga. 1981). The plan itself may be a sufficient

ruptcy court noted in *In re Northwest Recreational Activities, Inc.*,[60] "[t]he kind and form of information is left to the judicial discretion of the court on a case by case basis."[61]

1. *Sophisticated Creditors and Minimal Adequacy Analysis*

The courts have generally not required highly detailed disclosure statements when the hypothetical reasonable investor is a member of a class of "sophisticated" creditors, whose "ability to obtain . . . information from sources other than . . . disclosure"[62] is substantial. "Sophisticated" creditors may include banks,[63] partners of the debtor,[64] or creditors who have litigated against the debtor in cases that required "vigorous discovery."[65] For instance, in *In re Northwest Recreational Activities, Inc.*,[66] creditors objected to the failure to file any disclosure statement with the plan. The court, in approving a subsequent statement that was "perfunctory and modest in extent,"[67] noted that the debtor could not furnish any information not already available to the objecting creditors.[68]

Although courts generally approve modest disclosure statements offered to sophisticated creditors, they do not waive the dis-

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disclosure statement. *See In re* Bel Air Assocs., 4 Bankr. 168, 175 (Bankr. W.D. Okla. 1980); *see also In re* Forrest Hills Assocs., 18 Bankr. 104, 105 (Bankr. D. Del. 1982), where the court noted:

> [The disclosure] statement together with a plan should give interested parties adequate information so they can make their own determination to accept or reject. The circumstances of each case should control whether the disclosure information and plan are separate documents or one document combining disclosure information with the plan and the amount and kind of information.

For a discussion of the comprehensiveness required of disclosure statements for unsophisticated creditors, see *infra* notes 73-86 and accompanying text.

60 8 Bankr. 10 (Bankr. N.D. Ga. 1980).

61 *Id.* at 11 (footnote omitted).

62 11 U.S.C. § 1125(a)(2) (1982).

63 *See In re* Adana Mortgage Bankers, 14 Bankr. 29, 30 (Bankr. N.D. Ga. 1981).

64 *See In re* Bel Air Assocs., 4 Bankr. 168, 175 (Bankr. W.D. Okla. 1980). In *Bel Air*, the limited partner of the debtor was deemed to have enough access to information, including that which was supplied in the plan, to make an informed decision; no disclosure statement was required.

65 *In re* Northwest Recreational Activities, Inc., 8 Bankr. 10, 11 (Bankr. N.D. Ga. 1980) ("vigorous discovery" in litigation one factor determining adequate disclosure).

66 *Id.*

67 *Id.* at 12.

68 *Id.* The court held:

> [N]othing in § 1125 . . . exempts any debtor from its terms or excuses the filing and requirement for prior approval of a Disclosure Statement under the circumstances now before the court. . . .
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> . . . [T]he filing of a Disclosure Statement to each class of a plan and approval by the court is a prerequisite to solicitation of acceptances . . . of the debtor's plan.

Id.

closure requirement altogether. In *In re Adana Mortgage Bankers*,[69] the bankruptcy court noted that where the disclosure statements were prepared to benefit creditor banks, they need not "be as complete, perhaps, as required to a 'hypothetical typical investor' " of the class.[70] Nonetheless, the court warned that "these sophisticated creditors . . . are not expected to be mindreaders or clairvoyant. The basic financial information must be supplied in the statement."[71] The court did not explain what constituted "basic financial information," but the message is clear: reorganization plan proponents should provide some level of disclosure in all cases.[72]

2. *Unsophisticated Creditors and Extensive Disclosure Analysis*

The bankruptcy courts interpret section 1125(a) as requiring more extensive disclosure when a less sophisticated class of creditors is involved in the proceedings. These courts usually require as much information as possible concerning costs of reorganization, the debtor's history, estimates and projections of the future business, claims, liquidation analysis, and other alternatives. Nonetheless, they have developed no clear standard of quantitative adequacy to evaluate disclosure statements directed at unsophisticated creditors.

In *In re Stanley Hotel*,[73] for example, the court noted:

> [T]he purpose of a disclosure statement is to inform equity holders and claimants, *as fully as possible*, about the probable financial results of acceptance or rejection of a particular plan. [T]he information to be provided should be comprised of all those factors presently known to the plan proponent that bear upon the success or failure of the proposals contained in the plan.[74]

The court also reasoned that the statement should be as simple as possible and not overburdened with information that would be useless to the typical investor.[75] The *Stanley Hotel* court avoided defin-

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69 14 Bankr. 29 (Bankr. N.D. Ga. 1981).

70 *Id.* at 31.

71 *Id.*; *see In re* Egan, 33 Bankr. 672, 676 (Bankr. N.D. Ill. 1983) (quoting *In re* Adana Mortgage Brokers, 14 Bankr. 29 (Bankr N.D. Ga. 1980)).

72 For another discussion of how the bankruptcy courts have developed an approach of leniency of disclosure for sophisticated creditors, see Comment, *Disclosure of "Adequate Information" Under Chapter 11 of the Bankruptcy Code*, in ANN. SURV. BANKR. L. 1983, at 315, 325-27 (1983). The author's analysis hinges on the requirement of a statement for sophisticated creditors, not on the contents of the disclosure statement.

73 13 Bankr. 926 (Bankr. D. Colo. 1981).

74 *Id.* at 929 (emphasis supplied).

75 *Id.* at 933-34. "A disclosure statement must be meaningful to be understood, and it must be understood to be effective. . . . Accordingly, . . . overburdening . . . may ultimately result in reducing the disclosure statement to an overlong, incomprehensible, ineffective collection of words to those whose interests are to be served by disclosure." *Id.* at 933.

ing those "factors" or their scope, however, explaining that Congress intended to provide "flexible disclosure requirements to be administered by the courts."[76]

The flexibility of the adequacy standard leads to confusion among plan proponents regarding the quantity of information the courts will require in a disclosure statement. In *Stanley Hotel,* the court required eleven amendments regarding the future course of the business, prospective financing, claims against the corporation and alternatives available to creditors before finding that the plan provided adequate information to the objecting creditor.[77] In *In re Werth,*[78] a group of creditors, including a leasing company and a bank, questioned the adequacy of a debtor's disclosure statement.[79] The court ordered the proponent to incorporate ten modifications, including information regarding adverse claims, estimates of fair market value, alternatives, and anticipated expenses of litigation.[80]

At least one court has developed a more objective standard for determining the adequacy of disclosure. In *In re A.C. Williams Co.,*[81] two sets of creditors filed objections to a debtor's disclosure state-

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76 *Id.* at 930. The court noted that "§ 1125(a) does not provide a specific list of elements that must be present in order for a disclosure statement to fulfill its purposes . . . ." *Id.* at 929.

77 *Id.* at 934.

78 29 Bankr. 220 (Bankr. D. Colo. 1983).

79 *Id.* at 221.

80 The debtor agreed to eight modifications at the hearing. The court subsequently required the other two changes. *Id.* at 223-24. Other courts have required extensive, detailed disclosure. In *In re* William F. Gable Co., 10 Bankr. 248, 249-50 (Bankr. N.D. W. Va. 1981), the court ordered that a disclosure statement be amended to include information on administrative costs, the debtor's history, claims, accounts receivable, minimum dividends, and return on liquidation. In *In re* Hughes Marina, 16 Bankr. 6 (Bankr. W.D.N.Y. 1980), the court required the debtor to provide extensive financial information, cash flow statements, and details of an arrangement with the proprietor of the debtor's antique business.

These two cases illustrate that creditor sophistication is not the only factor courts use to decide whether adequate disclosure has occurred. In both cases, banking institutions were among the objecting creditors.

One commentator proposing highly inclusive disclosure for unsophisticated creditors suggests several areas of "informational input" to satisfy the needs of solicited creditors. Note, *supra* note 14, at 1551-56. The areas of consideration include management (past and future), debtor's current and historical financial status, liquidation analysis, treatment of claims under the plan, and effectuation. *Id.* The courts have recognized all of these as important facets of disclosure. *See, e.g., In re* A.C. Williams Co., 25 Bankr. 173, 176 (Bankr. N.D. Ohio 1982).

Another commentator has concluded that "the courts have perhaps been over-exacting and over-particular in the quality and quantity of information demanded. . . . It is manifest that compounding and lengthening a document may do more harm than good, in the sense of rendering the document ineffective." Comment, *supra* note 72, at 335-36. Unfortunately, this commentator neither describes the harm nor proposes a remedy.

81 25 Bankr. 173 (Bankr. N.D. Ohio 1982).

ment, claiming that it did not convey adequate information.[82] After noting that the existence of "adequate information under [section 1125] must be determined on a case-to-case basis under flexible standards,"[83] the Bankruptcy Court for the Northern District of Ohio proposed using the following specified criteria to measure the adequacy of disclosure:

> 1) the incidents which led to the filing of the Chapter 11; 2) a description of available assets and their value; 3) the anticipated future of the company; 4) the source of information for the disclosure statement; 5) disclaimer; 6) present condition of the company while in Chapter 11; 7) claims scheduled; 8) the estimated return to the creditors if liquidated; 9) the accounting process used and the identity of the person who furnished the information; 10) future management of the debtor; 11) plan.[84]

The court found that the disclosure statement met the eleven criteria.[85] Although these criteria would be useful in defining the scope of extensive disclosure, the language of the opinion suggests that the court intended a case-by-case analysis with respect to the need for disclosure of each criterion.[86] Thus, these criteria do not provide plan proponents with concrete guidelines concerning disclosure.

B. Adequacy and Questions of Opinion Information

Creditors often object to factually unsupported opinions in the guise of disclosed information because the sufficiency and accuracy of the disclosed information is questionable when phrased in terms of opinion. The bankruptcy courts have held a plan proponent must provide factual support when offering an opinion in a disclosure statement.

1. *Development of the Factual Basis Requirement*

In *In re Civitella*[87] (*Civitella I*), a creditor filed a plan accompanied by a disclosure statement. The creditor contended the new plan would be superior to a forced liquidation of the debtor's assets.[88] The debtor challenged the disclosure statement on the ground that the allegation was an unsupported opinion.[89] Relying

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82 *Id.* at 174-75.

83 *Id.* at 176.

84 *Id.*

85 *Id.* at 177.

86 *Id.* at 176.

87 14 Bankr. 151 (Bankr. E.D. Pa. 1981).

88 *Id.* at 153.

89 *Id.* at 152-53. A debtor is not precluded from objecting to a disclosure statement for a plan that a creditor has filed. FED. R. BANKR. P. 3017(a).

on legislative history,[90] the Bankruptcy Court for the Eastern District of Pennsylvania held that the new Bankruptcy Code requires disclosure statements to contain factual support for all opinions.[91] The court did not, however, specify which allegations it found inappropriate.

In *In re Civitella*[92] (*Civitella II*), the court denied a motion for reconsideration brought by three secured creditors. Listing several allegations found in the creditor's disclosure statement, the court noted that "[n]ot one . . . [was] supported by a scintilla of factual information anywhere in the disclosure statement."[93] The court reiterated its earlier holding that a plan proponent may not include opinions in a disclosure statement without factual support.[94] The court noted that other bankruptcy courts require extensive and specific information as a condition of approval[95] and concluded that "[t]he thrust of these recent decisions has been to require that detailed *factual* information be provided in Chapter 11 disclosure statements."[96]

2. *Applications of the Factual Basis Requirement*

A single instance of unsupported opinion in a disclosure statement requires the application of the same factual basis standard implicated by the broad and repeated opinions found in the *Civitella* cases. In *In re East Redley Corp.*,[97] the debtor objected to a disclosure statement in which the creditor opined that the value of real property was significantly less than the value that the debtor had listed.[98] The Bankruptcy Court for the Eastern District of Pennsylvania found that a factual basis for the creditor's estimate of value was necessary because "[s]uch information is essential for a party weighing the credibility and merits of the plan."[99]

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90 A plan is necessarily predicated on knowledge of the assets and liabilities being dealt with an [sic] on factually supported expectations as to the future course of the business sufficient to meet the feasibility standard in section 1130(a)(11) of [this] title. It may thus be necesasry [sic] to provide estimates or judgments for that purpose. Yet it remains practicable to describe, in such detail as may be relevant and needed, the basis for the plan and the data on which supporters of the plan rely.

S. REP., *supra* note 34, at 121 (quoted in part in *Civitella*, 14 Bankr. at 153).

91 14 Bankr. at 153.

92 15 Bankr. 206 (Bankr. E.D. Pa. 1981).

93 *Id.* at 207.

94 *Id.* at 208.

95 The court cited *In re* William F. Gable Co., 10 Bankr. 248 (Bankr. N.D.W. Va. 1981) and *In re* Hughes Marina, 16 Bankr. 6 (Bankr. W.D.N.Y. 1980). See *supra* note 80 for a discussion of those two cases.

96 *In re* Civitella, 15 Bankr. at 208 (emphasis added).

97 16 Bankr. 429 (Bankr. E.D. Pa. 1982).

98 *Id.* at 430.

99 *Id.* The court rejected the debtor's objection to the accuracy of the value be-

In *In re Egan*[100] the Bankruptcy Court for the Northern District of Illinois recently became the second court to adopt the factual basis requirement. The debtor's disclosure statement relied heavily on the unsubstantiated assertion that a national economic recovery would cure the debtor's problems.[101] The court concluded that "without factual support, statements of opinion or belief are entirely inappropriate in [d]isclosure [s]tatements."[102]

None of the factual basis decisions define the quantity or quality of factual support necessary under section 1125.[103] The courts rely upon the legislative history and the nebulous wording of section 1125 to stress the need for flexibility.[104] Furthermore, the decisions do not discriminate among different degrees of opinion; a disclosure statement puffing "my plan is better than your liquidation" is subject to court ordered modification, as is a statement containing an unsupported appraisal of a piece of property.

C. Adequacy and Questions of Inconsistent Information

Qualitative questions of adequacy arise in challenges to the accuracy of disclosed information. A disclosure statement may contain inconsistent or incorrect information. Despite objections to such statements, courts have accepted them without amendment.

In the leading case of *In re Hughes Marina*,[105] impaired creditors objected to conflicting statements in the debtor's disclosure statement and to projections of the future course of business that were inconsistent with the debtor's tax returns.[106] The bankruptcy court conditionally approved the statement despite the alleged inconsistencies, requiring only that the financial information be completed.[107] The court explained that the alleged errors did not require amendment because "rather than resulting in a denial of the

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cause the creditor had included the value that the debtor had assigned to the property in the disclosure statement. *Id.* The court also noted that the Bankruptcy Code does not require valuation. *Id.* Similarly, in *In re* Fierman, 21 Bankr. 314, 315 (Bankr. E.D. Pa. 1982), the court rejected a disclosure statement in which the debtor valued a piece of property without providing factual support.

100 33 Bankr. 672 (Bankr. N.D. Ill. 1983).

101 *Id.* at 673, 676.

102 *Id.* at 675.

103 *See, e.g., In re* Civitella, 15 Bankr. 206, 208 (Bankr. E.D. Pa. 1981).

104 *See, e.g., In re* Civitella, 14 Bankr. at 152; *In re* Fierman, 21 Bankr. at 315; *In re* Egan, 33 Bankr. at 675.

105 16 Bankr. 6 (Bankr. W.D.N.Y. 1980).

106 *Id.*

107 *Id. See also In re* A.C. Williams Co., 25 Bankr. 173, 176 (Bankr N.D. Ohio 1982) (inconsistencies in plan affecting feasibility more appropriately contemplated at confirmation hearing); *In re* Stanley Hotel, 13 Bankr. 926, 929-30 (Bankr. D. Colo. 1981) (purpose of disclosure statement to provide enough information for reasonable persons to make informed choice regarding plan acceptance).

approval of the disclosure statement, [the inconsistencies and inaccuracies] simply illustrate to the reader . . . why they should not vote for the plan as proposed. That is what a disclosure statement is supposed to do."[108]

Although the bankruptcy courts have been reluctant to weed out inconsistencies and inaccuracies,[109] these deficiencies can be so misleading as to warrant rejection of the disclosure statement. In *In re New Haven Radio,*[110] the bankruptcy court rejected a disclosure statement in which the debtor had "injected . . . innumerable claims and statements which range[d] from inaccurate to misleading and from inappropriate to defamatory."[111] The court reasoned that "the cumulative effect is clearly a sufficient basis for [rejection]."[112] *New Haven Radio* demonstrates that the misleading effect in inaccuracies can be damaging enough to warrant rejection of a disclosure statement. The case does little, however, to define the line between permissible and impermissible inaccuracy.

III
Relevant Interests and the Determination of Adequacy in the Disclosure Process

A. Sophisticated Creditors and Minimal Adequacy Requirements

The requirement of modest disclosure for sophisticated creditors was not unexpected.[113] Congress itself noted that the flexibility of the case-by-case standard "may be used, for example, where a very large class required only limited disclosure, while other classes required more extensive disclosure."[114]

One commentator has suggested that sophisticated creditors may not require the assistance of disclosure at all because creditors such as banks and finance companies can easily protect their own

108 *In re* Hughes Marina, 16 Bankr. at 6.

109 The bankruptcy courts have also been reluctant to allow the hearing to become a discovery process. *See In re* Georgetown of Kettering, 17 Bankr. 73 (Bankr. S.D. Ohio 1981). In *Kettering*, the court determined that the disclosure hearing should operate independently of the discovery rules predating the new bankruptcy code: "The requirement of a disclosure statement . . . should not be read to infer [sic] a corresponding creditor right of a fishing expedition." *Id.* at 75.

110 18 Bankr. 977 (Bankr. D. Conn. 1982).

111 *Id.* at 980-81.

112 *Id.* at 981. *See also In re* Hughes Marina, 16 Bankr. at 6 (noting that inconsistencies illustrate reason for creditors to reject plan).

113 Commentators predicted a lenient standard of disclosure for creditors with sufficient information shortly after the enactment of chapter 11. *See* Note, *supra* note 4, at 1817 n.69; Note, *supra* note 14, at 1548-49.

114 H.R. Rep., *supra* note 17, at 227.

interests.[115] This suggestion ignores the fact that these creditors are impaired and are therefore statutorily entitled to judicial approval of a disclosure statement before they vote on a reorganization plan.[116] Some information, such as projections or other estimates, may not be available even to a sophisticated creditor.[117] Congress recognized that the former chapter XI scheme of little or no valuation and disclosure left even sophisticated creditors who were very familiar with the debtor "in the dark."[118] Congress thus sought to protect against "end-runs"[119] around disclosure by requiring a disclosure statement with each plan. Thus, some form of disclosure is necessary to protect all creditors.[120]

Requiring only a minimum of disclosure for sophisticated creditors offers significant advantages. Such disclosure promotes expediency and financial savings because debtors spend less time and money preparing a disclosure statement and creditors spend less time waiting for disclosure.[121] A minimal disclosure requirement for sophisticated creditors also fills the information gap created by the elimination of the valuation requirement of the old chapter X.[122]

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115 *See* Note, *supra* note 14, at 1549 ("[sophisticated creditors] will be able to obtain whatever information from the debtor that they deem necessary, and should be able to interpret that information without the assistance of the bankruptcy provisions requiring disclosure.") (footnote omitted).

116 11 U.S.C. § 1125(b) (1982).

117 *In re* Adana Mortgage Bankers, 14 Bankr. 29, 30-31 (Bankr. N.D. Ga. 1981) (court found inadequate disclosure statement that contained no information as to valuations, projections, or risks); *In re* William F. Gable Co., 10 Bankr. 248 (Bankr. N.D.W. Va. 1981) (court ordered disclosure statement amended to include estimates concerning certain costs and accounts receivable).

118 H.R. REP., *supra* note 17, at 225.

119 *Id.* at 227.

120 *See* cases cited *supra* note 117; *supra* notes 69-71 and accompanying text; *see also In re* Northwest Recreational Activities, Inc., 8 Bankr. 10 (Bankr. N.D. Ga. 1980). As the court in *In re Northwest Recreational Activities, Inc.* explained:

> Although it is clear that this . . . case is unlike the situation where a Disclosure Statement is necessary to inform and protect the unsophisticated creditor, Congress made no distinction between types of Chapter 11 cases. . . . The § 1125 requirement of a Disclosure Statement applies to all debtors, large, small, complicated, simple; many or few creditors or classes.

Id. at 12 (footnote omitted).

121 The court in *In re* Northwest Recreational Activities, Inc., 8 Bankr. at 11 n.1, observed that Congress had suggested a "balancing of interests" among such things as "the cost of preparation of the statements, the need for the relative speed in solicitation and confirmation, and, of course, the need for investor proection" (quoting H.R. REP., *supra* note 17, at 409). The court determined that the objecting creditors had "access to the kind of information necessary to form an informed decision on a proposed plan or reorganization." *Id.* at 11. The court approved a disclosure statement which was "perfunctory and modest in extent." *Id.* at 12; *see supra* notes 66-68 and accompanying text.

122 H.R. REP., *supra* note 17, at 227.

B. Less Sophisticated Creditors and a More Extensive Disclosure Requirement

When impaired creditors are less sophisticated or are not in a position to discover relevant information on their own, the courts tend to require a detailed disclosure statement.[123] Because chapter 11 eliminates the valuation requirement, this extensive disclosure requirement for less sophisticated creditors furthers the legislative purpose of creditor protection.[124]

Nonetheless, little guidance exists as to what belongs in more extensive disclosure statements.[125] Both courts and commentators have expressed concern that disclosure statements are often overburdened with unnecessary information.[126] Nevertheless, the courts have not attempted to provide more concrete disclosure guidelines. For example, in *In re Stanley Hotel,*[127] the court was dissatisfied with the debtor's disclosure statement but did not explain what "factors . . . bear upon the success or failure" of a plan.[128] Similarly, in *In re Adana Mortgage Bankers,*[129] the court failed to explain what would comprise "basic financial information."[130] Finally,

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123 *See, e.g., In re* Werth, 29 Bankr. 220, 223-24 (Bankr. D. Colo. 1983) (court lists specific ways in which statement must be revised for greater accuracy); *In re* Stanley Hotel, 13 Bankr. 926, 934 (Bankr. D. Colo. 1981) (court sets out specific corrections, explanations, and clarification in statement).

124 Congress noted that there would be cases, usually involving the restructuring of large, publicly owned debtors, where a valuation would be an essential part of a disclosure hearing. H.R. REP., *supra* note 17, at 227. The bankruptcy court is not, however, required to appraise the debtor's assets. 11 U.S.C. § 1125(b) (1982). Furthermore, the bankruptcy code requires disclosure only "as far as reasonably practicable." 11 U.S.C. § 1125(a)(1) (1982). This suggests that disclosure may depend in large part on how well the debtor kept its books. *See* Miller, *supra* note 29, at 1088 ("Presumably, if the debtor's books and records are a shambles and the history of the debtor shows a great wavering of fortunes, no one need sort it all out before disclosing that things are in a mess and proposing a plan.").

125 One suggestion is that debtors follow the disclosure guidelines for the drafting of a securities prospectus. Phelan & Cheatham, *Would I Lie to You?—Disclosure in Bankruptcy Reorganizations,* 9 SEC. REG. L.J. 140, 156-59 (1981). Although securities law is inapplicable to the determination of adequate disclosure, 11 U.S.C. § 1125(d) (1982), as a practical matter prospectus rules would provide an outline for complete disclosure, especially for a reorganization involving the issuance of securities. Phelan v. Cheatham, *supra,* at 158; *see* 11 U.S.C. § 1125(e) (1982) (good faith provision concerning issuance of securities in reorganizations).

126 *In re* Werth, 29 Bankr. 220, 223 (Bankr. D. Colo. 1983) ("[I]t is unnecessary to overburden the Disclosure Statement with information which might be helpful and comprehensible to lawyers but incomprehensible to lay people."); *In re* Stanley Hotel, 13 Bankr. 926, 933 (Bankr. D. Colo. 1981) ("What [we] regard as useful . . . might be meaningless verbiage to a 'typical investor' "); Comment, *supra* note 72, at 335.

127 13 Bankr. 926 (Bankr. D. Colo. 1981).

128 *Id.* at 929.

129 14 Bankr. 29 (Bankr. 1981).

130 *Id.* at 31.

in *In re Werth,*[131] the court did not define "meaningful" information.[132]

Objective criteria for evaluating disclosure would alleviate the uncertainty problem to some extent.[133] Such criteria put debtors on notice that they must supply certain information in the statement. Because the proponent of a plan is only required to disclose information that is "reasonably practicable"[134] to obtain, the courts can determine on a case-by-case basis whether the plan proponent has supplied all the necessary obtainable information.[135] This approach should also promote expediency because the criteria will help the debtor prepare a streamlined disclosure statement, free from overburdening and unnecessary information. The criteria may also aid creditors by providing them with information to which they may reasonably be entitled.

C. The Factual Support Requirement for Opinions

Creditor objections to disclosure based solely on unsupported opinions have spawned a requirement that all statements include factual support for all assertions. Bankruptcy law is not unique in requiring factual support for opinions. The SEC also requires projections in a prospectus to have a reasonable basis.[136]

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131 29 Bankr. 220 (Bankr. D. Colo. 1983).

132 *Id.* at 223.

133 The case and criteria are discussed at *supra* text accompanying notes 81-86 (listing 11 objective criteria). *See In re* A.C. Williams Co., 25 Bankr. 173 (Bankr. N.D. Ohio 1982). Recently, in *In re* Malek, 35 Bankr. 443, 443-45 (Bankr. E.D. Mich. 1983), the bankruptcy court delineated several areas of information which the disclosure statement should include so that it might conform to "the letter and spirit of the Code." *Id.* at 443. The court outlined eleven areas of necessary information, including the debtor's history, a description of the reorganization plan and its execution, liquidation analysis, projection of operations, and tax consequences. Although the *Malek* criteria are not identical to the *A.C. Williams* criteria, both schemes require similar disclosure. Unlike the *A.C. Williams* court, however, the *Malek* court issued particularized and detailed descriptions of the disclosure necessary to make each criterion "adequate." *Id.* These descriptions may be useful barometers for determining case-by-case adequacy of disclosure.

In *In re* Metrocraft Publishing Servs., 39 Bankr. 567 (Bankr. N.D. Ga. 1984), however, the court listed nineteen "[r]elevant factors for evaluating the adequacy of a disclosure statement," including the eleven criteria offered in *A.C. Williams*. *Id.* at 568. As did the *A.C. Williams* court, the *Metrocraft* court listed their criteria in skeletal form. The court stated that the criteria would guide in determining what information "may be mandatory, under the facts and circumstances of a particular case, to meet the statutory requirement of adequate information . . . . The Court will address . . . objections with an eye toward these enumerated factors as they pertain to (a) debtor's business and the proposed Chapter 11 plan of reorganization." *Id.* at 568.

134 11 U.S.C. § 1125(a)(1) (1982).

135 The *A.C. Williams* court suggested a case-by-case examination of the criteria. *See supra* notes 83-86 and accompanying text.

136 SEC Securities Act Release No. 5699, FED. SEC. L. REP. (CCH) ¶ 80,461, at 86,202-03 (1976); *see also* Straus v. Holiday Inns, Inc., 460 F. Supp. 729, 734 (S.D.N.Y. 1978); Phelan & Cheatham, *supra* note 125, at 160.

The legislative history of chapter 11 supports this requirement. The Senate report accompanying chapter 11 states that "[a] plan is necessarily predicated . . . on factually supported expectations as to the future course of business"[137] and, therefore, the factual basis standard arguably could be limited to factually unsupported opinions concerning the future course of business of the reorganized debtor. Congress also observed, however, that all disclosure should be "in such detail as may be relevant and needed."[138] Thus, the requirement of factual support for opinions and allegations should not be limited to estimates or opinions on the future course of business, especially for less sophisticated creditors.

The courts have not developed the concept of factual basis beyond citing the requirement of factual support for opinions and estimates. Courts have disapproved disclosure statements where a plan proponent has not factually supported an estimate of the value of property[139] or an assertion that the proposed plan is superior to a forced sale of property.[140] These opinions provide very little guidance to a plan proponent regarding the degree of support necessary to constitute adequate disclosure.[141] Consequently, the plan proponent is left to decide how much factual support to include in the disclosure statement.

Although these guidelines are brief, courts should be willing to invoke them to fill the gaps left by the elimination of the old valuation requirement. The factual basis requirement serves creditors' interests by allowing them to make an informed choice regarding the plan.[142] Also, the factual basis requirement promotes expediency by informing plan proponents that unsupported opinions are not allowed in disclosure statements.[143] A case-by-case analysis of

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137 S. REP., *supra* note 34, at 121.

138 *Id.*

139 *See In re* Fierman, 21 Bankr. 314, 315 (Bankr. E.D. Pa. 1982); *In re* East Redley Corp., 16 Bankr. 429, 430 (Bankr. E.D. Pa. 1982); *supra* notes 97-99 and accompanying text.

140 *See, e.g., In re* Civitella, 15 Bankr. 206, 207 (Bankr. E.D. Pa. 1981).

141 *See, e.g., id.* at 208 ("Adequate information [for support of opinions] is not strictly defined . . . ."); *In re* Fierman, 21 Bankr. 314, 315 (Bankr. E.D. Pa. 1982) ("The proponent must set forth a factual basis for the purported value of the real property."); *In re* East Redley Corp., 16 Bankr. 429, 430 (Bankr. E.D. Pa. 1982) (value of property must be documented by "factual support"). Any development that shapes the definition of disclosure is helpful to all parties. *Cf.* Comment, *supra* note 72, at 321 ("[I]t is reasonable to assume that after the Code has been in effect for a substantial period of time, there will evolve a body of judicial decisions to offer guidance as to what standard of adequate information the courts will require . . . .").

142 *See In re* East Redley Corp., 16 Bankr. at 430 ("The proponent must set forth a factual basis for the purported value of the property. Such information is essential for a party weighing the credibility and merits of the plan . . . . This data will provide the parties entitled to vote on the plan with necessary information.").

143 One student commentator argues that any opinion, even if supported by fact, is

adequacy should not be undermined because the courts must ultimately determine what factual basis is adequate under the circumstances of each case.[144]

D. Approval of Inconsistent Disclosure

The courts have generally approved disclosure statements without addressing objections to inconsistent or contradictory information.[145] This approach is generally consistent with the concerns of maximizing creditor protection and minimizing costs. There are instances, however, where the courts should resolve such inconsistencies at the approval hearing, rather than passing the problems on to the parties voting on the plan.

There are three situations in which the problem of inconsistent disclosure arises. First, there are inconsistencies between the disclosure statement and evidence incorporated within the disclosure statement.[146] One rationale for defending the courts' rejection of objections to such inconsistencies is that the creditors may find the plan unsuitable because of the inconsistent statements. This is precisely what a disclosure statement is supposed to reveal.[147] A second justification for allowing the inconsistencies is to view the objectionable claims as "opinions" or "estimates" and the incorporated evidence as "factual basis." The creditor is suitably protected under the factual basis standard because he is given a basis for the debtor's claims with which he can make an informed judgment.[148] When this basis is inconsistent with the assertion, creditors may reject the plan.

The courts' refusal to reject plans with inconsistencies furthers the goal of expediency because the creditors may negotiate outside of court to settle differences on the plan, thus saving time and money that would have been spent on judicial resolution of the mat-

improper. Comment, *supra* note 72, at 323. The student concludes that "[t]his line of cases . . . acknowledges that the disclosure statement is not the place for a bottom-line opinion. It is inappropriate to lobby, even if supporting facts are present." *Id.* The legislative history of § 1125 refutes this position. *See In re* Egan, 33 Bankr. at 676.

144 *See* S. REP., *supra* note 34, at 121 (estimates of future course of debtor's business should be factually supported in as much detail as is relevant and necessary; kind and form of information are left to court's discretion).

145 *See supra* notes 105-12 and accompanying text; *see also* Comment, *supra* note 72, at 334 ("Courts have allowed inconsistencies and contradictions in disclosure statements.").

146 This may have been the problem in *In re* Hughes Marina, 16 Bankr. 6 (Bankr. W.D.N.Y. 1980) (claims regarding future business prospects inconsistent with tax returns).

147 *Id.*

148 For a discussion of how factual basis for opinions and estimates may protect the parties' interests, see *supra* notes 142-44 and accompanying text.

ter.[149] Moreover, it may be easier for the parties to resolve the inconsistencies in the cooperative atmosphere of negotiation rather than in the adversarial setting of the courtroom.

A second inconsistency problem occurs when the disclosed information contradicts the creditors' own independently gathered information.[150] Again, the courts have found that a creditor needs to be informed only to the extent that he may make a judgment on the plan. A sophisticated creditor brings his own information to the disclosure process and can spot potential problems. A difficulty arises, however, when a creditor is unsophisticated and does not have access to information with which to evaluate the disclosure. In furtherance of the policy of creditor protection, courts should be ready to require the plan proponent to remedy the inconsistency when unsophisticated creditors are involved.

The third type of problem may be termed "pure contradiction," in which one statement or figure in the disclosure statement directly contradicts another statement or figure in the same disclosure.[151] If the creditor who confronts this "pure contradiction" is sophisticated in the sense that he has the information to determine which statement is correct, then the creditor can make an informed judgment and, under the earlier analysis, the objections may rightfully be dismissed. Nevertheless, the objecting creditor is not always sophisticated and may depend solely on the disclosure statement for his information. Absent resolution of these conflicts at the approval hearing, a court's approval of the plan does not enhance these creditors' understanding of the statement.[152]

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149 The approval hearing for the disclosure statement does not consider or determine the feasibility of the plan and is not a venue for consideration of the plan. *See In re* A.C. Williams, 25 Bankr. 173, 176 (Bankr. N.D. Ohio 1982) (feasibility of plan is considered at confirmation hearing, not at approval hearing); *In re* Stanley Hotel, 13 Bankr. 926, 929-30 (Bankr. D. Colo. 1981) (approval hearing is designed to determine whether disclosure statement contains adequate information; "merits" of plan are considered at confirmation hearing).

150 This may have been the problem in *In re* A.C. Williams, 25 Bankr. at 176 (objecting creditors attempted to prove inconsistency at hearing).

151 This may have been the case in *In re* Stanley Hotel, 13 Bankr. at 930 (creditor objections to "internal inconsistencies").

152 One student commentator concedes that "it might seem a bit myopic to expect creditors to sift through these contradictions since this puts a premium on disinformation . . . ." Comment, *supra* note 72, at 323. Moreover, once the prerequisites are achieved, a plan that includes such an approved disclosure statement may be crammed down over the dissent of the minority creditors. *See supra* note 29. Cramdown is beyond the scope of this Note, but one recent development deserves mention. In *In re* Union County Wholesale Tobacco & Candy Co., 8 Bankr. 442, 443 (Bankr. D.N.J. 1981), the court intimated that, where a plan leaves a class unimpaired, that class is deemed to have accepted the plan under § 1126(f), and the debtors can proceed to cramdown without filing a disclosure statement. *See* Miller, *supra* note 29, at 1090-91 n.200. If indeed a proponent may proceed to cramdown merely by leaving one class unimpaired, it is a

Honest mistakes that could be easily corrected may cause creditors to reject the entire plan. Because a debtor does not have an obligation to disclose further information once the disclosure statement is approved, a creditor, unaware of the character of the error, may reject a plan because of a contradiction resulting from a typographical error or an honest miscalculation.[153]

Nothing in the Rules of Bankruptcy Procedure[154] nor in the code prohibits a court from resolving such disputes at the hearing.[155] Moreover, courts have the option of conducting asset valuations to verify disclosure accuracy.[156] In an approval hearing, however, the judge is only an arbiter with limited supervisory capabilities.[157] Because he must depend on the litigants for the facts, it is unclear whether he should take an affirmative role in resolving these contradictions at the disclosure hearing. To prevent creditors from rejecting plans with honest miscalculations appearing as inconsistencies and to protect unsophisticated creditors from misinterpreting these inconsistencies, courts should require the plan proponent to amend the disclosure statement when this action is readily feasible. If the proponent shows that the inconsistencies are the result of miscalculations or typographical errors, courts should return the disclosure statement for amendment or clarification.[158]

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short step to the situation in which a creditor may propose a reorganization plan, leave *itself or its class* unimpaired, and proceed to cramdown its plan against the other creditors.

153 One commentator has noted that the parties may feel pressure to get a plan approved as quickly as possible.

> The legislative history suggests that Congress considered disclosure a response to . . . the need for "some form of investor protection in order to make it a fairer reorganization vehicle." The flaw in this reasoning is that, under Chapter XI . . . . there was no compulsion to get a plan ready—no four to six month framework. "HURRY UP PLEASE IT'S TIME!" is a phenomenon of the new Code.

Miller, *supra* note 29, at 1091 (footnotes omitted).

154 *See* FED. R. BANKR. P. 3017(b) (court is charged only to determine adequacy of disclosure statement).

155 Bankruptcy courts may have an independent duty to ensure that the requirements for confirmation, including adequate disclosure, are met despite creditor apathy. *See In re* Landscaping Servs., Inc., 39 Bankr. 588, 590 (Bankr. E.D.N.C. 1984) ("Even in the absence of creditor objections, the court has an independent duty to determine that the confirmation requirements of 11 U.S.C. 1129 are met and the duty to ascertain the debtor's 'good faith.' ").

156 *E.g.*, 11 U.S.C. § 1125(b) (1982); H.R. REP., *supra* note 17, at 227.

157 *See* Miller, *supra* note 29, at 1099-1101.

158 In *In re* Stanley Hotel, 13 Bankr. at 934, the court required the debtor to amend the disclosure statement to correct all typographical errors. It may be that these errors contributed to the"internal inconsistencies" to which the creditors objected and that the court indeed adopted a remedial approach to this type of inconsistency. One student suggests that this approach might perhaps be justified "[if] the typographical errors significantly altered the meaning of the information. However, because the [*Stanley Hotel*] decision is silent as to the rationale and facts, the precedential value of this decision is questionable." Comment, *supra* note 72, at 334.

The time and money saved by having the debtor amend quickly, rather than risking unnecessary rejection, and the added creditor protection provided by clarification outweigh any benefits of letting the reorganization proceed with a contradictory disclosure statement.

CONCLUSION

In handling the spectrum of objections to the adequacy of disclosure, the bankruptcy courts have generally furthered the aims of chapter 11's new disclosure scheme. The requirements of extensive disclosure and factual support for opinions promote creditor protection. Guidelines for disclosure, including the brief opinions interpreting the factual support requirement and the *A.C. Williams* criteria for determining the extent of the disclosure, promote expediency by giving all parties an indication of the required contents of a disclosure statement.

The courts' general refusal to uphold objections to inconsistent statements is also likely to promote the interests of expediency and creditor protection. Where feasible, courts should recognize that unsophisticated creditors may not possess the resources accurately to judge the disclosure and may reject it for inconsistencies. Thus, when a plan proponent shows that an inconsistency is easily correctible, courts should require resolution at the approval hearing.

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