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The Examiners: Transparency is Everything in Bankruptcy

ByJ. Scott Victor

When it comes to pre-bankruptcy insider pay, how much disclosure is enough?

Bankruptcy rules require that every company seeking protection from creditors must disclose payments to officers, directors and other insiders for the one year period prior to the filing. Disclosure of insider pay is the third question on the official federal forms all debtors are legally required to complete and a significant issue for stakeholders. Yet, as reported by The Wall Street Journal in several recent articles, some large chapter 11 debtors have refused to provide details of payments to insiders. In the immortal words of tennis great John McEnroe: “You cannot be serious!” Bankruptcy rules were intended to provide transparency throughout the process, and this obvious contravention is a serious matter that warrants further analysis and investigation.

Over the course of my three decades in restructuring, I have been involved in hundreds of chapter 11 cases and can’t remember a single debtor that didn’t disclose insider payments. My cases have involved middle-market companies, which serves to reinforce the dichotomy between mega and large bankruptcy cases and everyone else. The bankruptcy process applies equally to all debtors. Size doesn’t matter when it comes to disclosure, but large debtors seem to be more likely to flout a rule that could result in a public examination of the payments received by insiders who are responsible for the performance of bankrupt companies. The examination that results from requisite full disclosure is a small but fair price for the benefit of bankruptcy protection.

Transparency is the bond that makes chapter 11 work. One of the most important disclosures of interest to creditors as well as the Office of the U.S. Trustee is how much insiders were paid within the year preceding the filing. It is one thing to file a motion seeking to protect public disclosure of insider pay if there can be shown a compelling reason, but disclosure should always be made to the professionals for all constituents and the U.S. trustee. However, in many of the cases reported by WSJ, no motion was ever filed and the debtors’ insiders simply directed counsel to not disclose. This kind of egregious behavior is simply unacceptable and creates a double standard that unfairly benefits large debtors while requiring other debtors to follow the rules. The U.S. trustee is charged with ensuring the integrity of the bankruptcy process and is well within rights to compel debtors to disclose insider payments. This disclosure should be made in every case. Recalcitrant debtors should be forced to file a motion to explain why the disclosure rules don’t apply to them. Transparency is everything in bankruptcy.

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