CONFERENCE ON EUROPEAN RESTRUCTURING AND INSOLVENCY LAW

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Date: February 2021
Re: CERIL Preliminary Study on Confidentiality, secrecy and privilege in Corporate Insolvency and Bank Resolution

Related Working Party: WP 13 on Confidentiality, secrecy and privilege, co-chaired by prof. Ignacio Tirado and prof. Bob Wessels

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CERIL Preliminary Study

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Confidentiality, secrecy and privilege in Corporate Insolvency and Bank Resolution

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Introduction

In 2021, Prof. Bob Wessels and Dr. Shuai Guo published a book entitled: 'Confidentiality, secrecy and privilege'. This book examines confidentiality, secrecy and privilege issues in insolvency proceedings for corporates and banks. It attempts to fill the gap that the authors have identified. Bankruptcy and insolvency legal research, in particular, seem to lack clear definitions, incomplete laws and cases with respect to the application of these three themes in corporate insolvency and bank resolution proceedings. Moreover, there are still inconsistent views and opinions of judicial authorities across different jurisdictions about these topics. The study deliberately has a focused aim by arranging a unique collection of rules and court cases, approached from different perspectives of relevant stakeholders. It provides a mapping exercise with sources and commentary aimed at practitioners and scholars of insolvency law, which will come to more light and depth in legal environments that in themselves present a legal framework. Also, this book will serve as a preliminary research for additional research projects and other publications.

The following provides the summary and conclusions from the study that was published here:

> Bob Wessels and Shuai Guo, Confidentiality, Secrecy and Privilege in Corporate Insolvency and Bank Resolution, European and International Law Studies Nr 6, Eleven International Publishing, The Hague, 2020

11 Summary and Conclusions

Confidentiality, secrecy and privilege, particularly in the context of resolution, restructuring and insolvency, have been the subject of our study. As set out in Chapter 1, we deliberately focus on arranging a very first collection of rules and court cases. This book, as mentioned in Chapter 1, describes and analyses a legal domain that is close to a *terra incognita* and attempts to fill the gap in the current scholarship regarding confidentiality, secrecy and privilege matters in insolvency proceedings. As defined in Chapter 2, we limit our discussions to the confidential information created, communicated and transferred before, in and after insolvency proceedings (Chapter 2). The methodology we apply in this book is a stakeholder approach. Generally, we distinguish corporate debtors (Chapter 3) and banks in distress (Chapter 9). Chapters 3 to 7 focus on corporate debtors, and Chapters 8 to 10 are about banks. In particular, we cover insolvency practitioners (IPs) (Chapter 4), courts (Chapter 5), creditors (Chapter 6), bidders/acquirers (Chapter 7), clients (Chapter 7), professional service providers (Chapter 8) and resolution authorities and other agencies (Chapter 10). In some parts, individual debtors are mentioned as a comparison for better illustration and analysis.

Chapter 2 commences with a thorough analysis of the concepts of confidentiality, secrecy and privilege. These terms are often intertwined and their constitutive elements may overlap, while their core meaning comes to light only in the given context, e.g. national legislation, a national ethical rule of practice or an international standard.

Confidentiality is the broadest term among the three, normally an act of keeping information, shared between two individuals, secret from a third one. It is distinguished from privacy, which refers to the element of one's personal autonomy over information and requires no confidentiality. In the legal field, confidentiality is crucial in the way that a lawyer is under a special obligation not to disclose such information obtained from his or her client. This duty has been codified in many civil and common law jurisdictions, where it is commonly called professional secrecy (in civil law jurisdictions) and attorney-client privilege (in common law jurisdictions), respectively.

On the one hand, confidentiality functions as an obligation that enables lawyers to proceed with their clients' best interests in mind, and it strengthens the clients' faith in their lawyers apart from having other human rights considerations that are discussed at length. On the other hand, mostly used in the sense of privilege, it is an immunity enjoyed by lawyers from being forced to disclose information concerning their clients, especially in court proceedings.

However, the duty of confidentiality/professional secrecy/attorney-client privilege is not absolute and is subject to several exceptions. Chapter 2, for example, concludes with a comparative analysis (Table 2.1) of the various statutory regulations governing professional secrecy across civil law jurisdictions in Europe along with the various exceptions to legal professional secrecy. The general exceptions are mostly those of waiver of duty of secrecy by a client, in proceedings brought by the client against its lawyer, or for the purpose of other higher values of public policy such as prevention of felony offences. In some jurisdictions, for example Germany, Lithuania, Netherlands and Switzerland, entering into insolvency proceedings can also be an exception to legal professional secrecy, in that lawyers need to disclose a client's information when the client is put into an insolvency proceeding.

Starting from Chapter 3, a specific stakeholder is discussed in each different chapter.

Chapter 3 is about corporate debtors and starts with a general observation on debtor's duty of disclosure and, subsequently, raises two issues: the survival/application of debtor's pre-insolvency attorney-client privilege and the protection of debtor's confidential information.

At the time of filing an insolvency petition, the debtor is under an obligation to make disclosure relating to his or her financial affairs and details of assets and liabilities as required by the relevant statutes. In many jurisdictions this means full disclosure. But the question is whether this duty also obligates the debtor to disclose communications that are otherwise protected by attorney-client privilege or that were made in confidence. There are two schools of thought on this question that examine the extent to which initiation of insolvency proceedings affects pre-insolvency legal relations. One opinion strongly favours court-appointed IPs exercising control over privilege in order to ensure they obtain all necessary information. This situation is particularly applicable in cases of corporate debtors in insolvency proceedings where an IP is deemed, based on the succession theory, as the successor to a debtor and succeeds the debtor's privileges and can therefore assert or waive the privilege. Since a corporation as such is a separate inanimate entity, privilege is exercised by its agents, namely its management. Thus, the corporation's privilege passes on to the IP, as the new agent of the corporation. However, this is mostly the case in a reorganization proceeding when an IP actually assumes the businesses and operation of the corporate debtor. On the contrary, in liquidation proceedings, the IP is tasked with maximizing the debtor's assets for the benefit of creditors and it is questionable whether he is working as an agent of the corporate debtor or not.

Another opinion holds that attorney-client privilege is a fundamental human right, the deprivation of which requires express statutory powers and cannot be said to pass to an IP as part of the debtor's estate. This is particularly the case for individual debtors who should not be deprived of their basic human rights. According to this school of thought, the debtor's duty to disclosure does not include confidential communications between client and attorney. In order to prevent a bankrupt from utilizing such a privilege to avoid investigations and conceal assets from discovery, US courts have adopted a 'balancing approach' on a case-by-case basis, whereby the trustee can waive privilege when such wavier is beneficial to the debtor. Alternatively, in this chapter other less radical solutions are suggested, such as voluntary wavier by debtor, compelling statutory disclosures and exploring other sources such as third-party stakeholders for information.

A second issue discussed in Chapter 3 is protection of confidential information. In this regard, certain information, such as trade secret or confidential research, or commercial information, can be petitioned not to be disclosed. Also, other information concerning personal identifiable information or privacy should be not disclosed.

Chapter 4 turns to IPs and defines them as those with functions of admission and verification of claims, administration and liquidation of assets and acting overall in the creditors' interests. In general, IPs are vested with a broad range of powers, including collection of information in relation to debtors, subject to statutory rules that balance it with the debtor's right to privacy. For example, in the UK, the balancing test developed by courts provides that an IP's power to order production of documents or obtain evidence extends to all documents that he reasonably requires to carry out his functions. While a requirement of obtaining evidence or admissions for the purpose of deciding on the merits of an action qualifies as reasonable, the use of confidential, secret or privileged documents or other information for an action may not be considered as reasonably required. There are, however, a series of conflicting judgments in the UK about whether this power has extraterritorial effect.

In addition, various statutory rules across jurisdictions on insolvency law also impose a duty of confidentiality on IPs not to disclose information acquired in the course of the insolvency proceedings. This duty immunizes information even from a succeeding trustee when the IP is the privilege holder. Modelled around the UNCITRAL Legislative Guide on Insolvency Law, many jurisdictions have codified these rules under codes of ethics or legal professional rules in cases where a lawyer acts as an IP and performs acts that are essentially indistinguishable from that of a lawyer. However, this duty also has its limitations. Certain jurisdictions allow for disclosure of information by IPs in matters of public interest such as anti-money laundering and combating the financing of terrorism.

Another arguable exception to the duty of confidentiality is the cross-border sharing of relevant information among IPs to establish effective coordination and promote cooperation such as between the US and Canada under the Mosaic Protocol of 2003. Nevertheless, these cross-border communications are subject to applicable laws and the confidentiality arrangements, pertaining to the nature of the information that is protected and the standards to be maintained. Several best practices and guidelines have been published in this regard. For example, in laying down the principles for facilitation of cross-border insolvency proceedings, the European Insolvency Regulation (EIR) provides for the duty to communicate between courts in the EU and their obligations to protect confidential information. The EIR also provides for the appointment of a coordinator who may supervise such communications impartially and with due care.

Chapter 5 focuses on courts and insolvency authorities that exercise supervisory jurisdiction over insolvency proceedings and concludes that information forming part of the court record is made accessible to the public to ensure fairness, accountability and public scrutiny of the judicial system. To mitigate the risk posed by public access, the US Bankruptcy Code provides for statutory exceptions for the protection of trade secrets, confidential research or scandalous or defamatory matter. However, these exceptions are invoked on a case-by-case analysis. For instance, while a client list qualifies as confidential commercial information, settlements with claimants, proposals from potential investors or reports indicating counsel's breach of fiduciary duty do not.

Alternatively, out-of-court restructuring proceedings are immune from public access as they fall outside the usual statutory rules governing insolvency proceedings. A debtor may also prefer private out-of-court workouts that take the form of bilateral agreements with the creditors to restructure its debts. Also, a debtor may propose mediation to reach a compromise with their creditors supervised in a private manner. However, with the minimization of transparency, these approaches have been anticipated to reinforce mistrust between the company and its own investors, unduly protect the company's financial difficulties, encourage undue transfers of wealth and cause undervalued sale of the debtor's assets.

Chapter 6 examines the extent to which creditors can access the debtor's information. The creditors may particularly act through a representative committee of creditors to ensure required disclosure, active participation and fairness and integrity in the proceedings. They enjoy a wide range of powers to investigate the affairs of the debtor's business and to access information to that effect. For example, in the USA, a creditors' committee can have access to debtor's Key Employee Retention Plan and information on potential sale of assets.

However, creditors are also bound by the duty of confidentiality. They are precluded from accessing documents protected by attorney-client privilege, which survives bankruptcy. The creation of a creditors' committee may be conditional on the establishment of a protocol preventing conflict of interest among the creditors and ensure protection of the debtor's information. The scope of their power, however, depends largely on such a committee's functions. For instance, in the USA, while a committee responsible to unsecured creditors bears no duty for secured creditors, a trustee has duties to all constituents of the corporation.

Further, this chapter evaluates the various regulations to protect a debtor's confidential information from being used by creditors for competitive gains. For instance, the EU Market Abuse Regulation ensures that creditors receiving non-public/inside information in insolvency proceedings do not utilize it for insider dealing, unlawful disclosure of inside information and market manipulation. In the USA, a trading wall can be designed to prevent creditors from receiving non-public committee information and information regarding the creditor's trading. A debtor may even seek a protective order from a court prohibiting creditors from disseminating or misusing confidential information obtained from insolvency proceedings.

Chapter 7 argues that, since restructuring plans involve a going-concern sale of the debtor's business, the several bidders that participate in the auction and thereby obtain sensitive information concerning the debtor are required to sign a confidentiality agreement that prohibits unauthorized use of such information.

For sectors where the clients' records contain confidential information subject to non-bankruptcy laws such as patient records in healthcare business, specific regulations ensure that the trustee does not compromise the clients' privacy in the performance of her functions.

Chapters 8 to 10 address the case of banks.

Chapter 8 starts with the basic notion of bank secrecy. This duty, on the one hand, arises from the contractual relationship between banks and their customers even when it is not expressly provided in the contract. To qualify for such protection, the information must have the necessary quality of confidence, be imparted in circumstances importing an obligation of confidence, and its unauthorized use must be to the detriment of the party originally communicating it. On the other hand, the duty of confidentiality is also codified as a statutory obligation in several jurisdictions such as Switzerland.

However, this duty is not absolute. Its exceptions include waiver by a customer or statutory exemptions such as a bank's obligation to give evidence in civil and criminal cases, especially those involving tax fraud and tax evasion. For example, the US Foreign Accounts Tax Compliance Act requires participating foreign financial institutions entering into an agreement with the US Inland Revenue Service to annually report on US account holders. The Third Schedule of Singapore Banking Act provides specific circumstances where banks can disclose information to specific third parties (Table 8.1), for example, when disclosure is permitted by the customer, or, if he is deceased, his appointed representative, or in matters connected with an application for grant of probate or letters of administration.

Such exceptions also exist in insolvency cases, where the duty of disclosure prevails over bank secrecy mostly by virtue of statutory rules. For example, in Singapore, disclosure is allowed, subject to certain conditions in cases of both individual and corporate debtors and restructuring of share capital or credit facilities.

Although in conflict with traditional bank secrecy laws, several jurisdictions have opened channels for information sharing through cooperation to prevent economic offences like money laundering and financing of terrorism. For instance, in a UK case, the court ruled that the powers of an IP in a cross-border insolvency subject to the EIR are not affected by bank secrecy laws and that therefore any disclosure by a Latvian bank would not be a breach of Latvian law unless it were manifestly contrary to Latvian public policy.

Chapter 9 analyses the law from the perspective of banks as debtors. A first point to summarize is that financial institutions, including insurance undertakings, banks, credit institutions and investment firms, are often excluded from general corporate insolvency proceedings for companies. This is because, for banks, they hold highly liquid liabilities and long-term assets, which makes them vulnerable to delayed loan repayment, thereby causing severe socio-economic ramifications. Furthermore, since banks are interconnected with other financial institutions, a failure of one bank will create a contagion effect and affect the market confidence. The failure of the Lehman Brothers, for instance, was, in fact, a result of subjecting the financial conglomerate to the general US Bankruptcy Code, which lacks the tool to stabilize a financial market that has lost confidence owing to the failure of one large institution. Moreover, it is felt that judges, commonly acting in commercial cases, and private IPs cannot adequately take into account the public interests and macroeconomic variables involved with banks.

In response to the global financial crisis in 2007-2008, jurisdictions across the globe adopted special resolution regimes for financial institutions, following the Key Attributes proposed by the Financial Stability Board. Unlike proceedings available under general corporate insolvency laws, resolution serves for general public interests of maintaining financial stability and public accountability and is carried out by administrative resolution authorities instead of courts. These resolution authorities can transfer the debtor's assets and dismiss creditors' claims without the latter's consent.

Banks also have a unique duty to provide information to the authorities, for facilitation of smooth resolution. However, this duty may conflict with banks' professional secrecy. The Single Resolution Mechanism Regulation in the EU resolves this by ensuring that professional secrecy is not an obstacle to supplying information while deeming disclosure to the resolution authorities as non-infringement of secrecy.

In addition, as part of resolution, a recovery and resolution plan are prepared. A recovery plan includes credible options to cope with both idiosyncratic and market-wide stress, capital shortfalls and liquidity pressures and the processes to ensure timely implementation of resolution. A resolution plan includes suitable options for the preservation of essential financial and economic functions and charts out the actions to be carried out towards effective resolution by mitigating potential barriers. The confidentiality of these plans is also protected under various laws.

Lastly, as explained in Chapter 3, the assertion and waiver of attorney-client privilege for financial institutions depends on the new trustee's role. For instance, in the USA, while the resolution authority normally does not succeed to the failed entity's privilege, in cases of fraud or the creation of bridge institutions, the attorney-client privilege is also transferred to the receiver or the bridge institution in accordance with the succession theory.

Chapter 10, to conclude our summary, discusses the powers and duties of resolution authorities. During the process of resolution, administrative resolution authorities are designated to decide and implement resolution measures. For instance, in the United States, resolution authorities are differentiated by the type of financial institutions that come within their scope. Within the EU, on the other hand, the Single Resolution Board (SRB) functions as the resolution authority for large banks and cross-border banks, while national resolution authorities are also designated for smaller domestic banks. For the smooth execution of their duties, resolution authorities are entrusted with a broad range of powers, which includes getting information from banks in distress. The recovery and resolution plans submitted for review by resolution authorities also include a large volume of debtor's information. For instance, the SRB can request information from the employees of the failing institution and third parties, to fulfil their duties.

The sensitive nature of the information requires a strong duty of confidentiality for resolution authorities. This duty is required to safeguard the sensitive data of a failing institution that may be of commercial value. The process of resolution decision making should also remain confidential in order to avoid negative impacts on the market. Article 84 of the Bank Recovery and Resolution Directive specifies the persons who are subject to a duty of confidentiality, including resolution and other authorities, special managers and temporary administrators, bridge or third institutions that take over the failing bank, and professional service providers.

Certain requirements for compliance with the duty of confidentiality are also stipulated. These include, first, upholding the internal rules to secure secrecy of information involved in the resolution process. Second, such persons shall be prohibited from disclosing confidential information except during the course of their function, or in a summary form that conceals the identity of the people, or with the express and prior consent of the authority. Breach of such duty may lead to civil liability. However, as communication and cooperation are a vital component in the course of resolution, Article 84 attempts to balance communication and confidentiality of information. It allows for the sharing of the information among the component authorities subject to strict confidentiality. A similar mechanism is also available under the SRM.

In particular, special rules are imposed on Deposit Guarantee Schemes (DGSs), which are designed to protect the depositors and ensure that their deposits are protected when a bank fails to avoid bank runs in such situations. This mechanism, which is also referred to as deposit insurance, is regulated at the international level by the International Association of Deposit Insurers (IADA). Deposits insurers are responsible for the reimbursement of insured deposits and can later, as a right, recover its claim against the failing bank. Deposit insurers, such as the FDIC in the USA and DGS authorities in the EU, are obliged to keep the information in confidence. While the FDIC has a dual role as a resolution authority and a deposit insurer, the EU established a different DGS from resolution authorities. While the European Banking Authority (EBA) regulations and DGS Directives subject them to professional secrecy, such compliance requirement does not hamper cooperation between authorities.

We conclude our browsing among the complex themes of confidentiality, secrecy and privilege, particularly in the context of resolution, restructuring and insolvency with a few general observations.

We believe we have demonstrated throughout our study that a principal conflict can be seen in different chapters, namely disclosure versus confidentiality. For corporate debtors, this conflict is manifested as the duty of debtors, including banks as debtors, to disclose information to IPs and courts and the need to protect their confidential information (Chapters 3 and 10). For IPs, creditors, bidders/acquirers or resolution authorities, the conflict lies in their powers to obtain information from debtors, including failing banks, and an additional duty not to randomly disclose the information to third parties (Chapters 4, 6, 7 and 9). For courts, there is the conflict of the general principle of public access to courts/courts transparency versus the special need to keep certain information in confidence (Chapter 5). For professional service providers, like attorneys and banks, the ethics rule on professional secrecy may also be incompatible with the request from an IP or resolution authorities to disclose certain information about their clients (Chapters 3 and 8).

When these conflicts occur, different solutions have been sought.

First, legislators can enact statutory rules to clarify the requirements for disclosure or non-disclosure. In common law jurisdictions, this includes precedent cases that can also be the primary sources. This is the most direct and clear way to regulate confidentiality, secrecy or privilege issues. For instance, debtors have the obligation to report their information but can also be allowed to hide sensitive data such as personally indefinable information (e.g. ID numbers). In resolution proceedings, the Banking Recovery and Resolution Directive (BRRD) requires information to be disclosed, but individual institutions need not be identified.

For another example, regarding the question of whether an IP has a proper designation to access communications between a debtor and his or her attorney or information held by the debtor's bank, some jurisdictions, such as the UK and Switzerland, make it clear in statutory insolvency laws that attorney-client privilege or bank secrecy rules do not hinder IPs from exercising their powers or duties. The USA, in the landmark case *CFTC v. Weintraub*, set out the rule that a trustee in a corporate reorganization case can succeed to the debtor's privilege and therefore assert or waive the privilege.

And more commonly, the duty of confidentiality is imposed on different stakeholders in different situations, for instance, where clients are patients, or in relation to bio-information, or where recovery and resolution plans contain sensitive commercial information.

Second, judges are empowered with the discretion to make decisions, and they have the role of balancing different values and trying to reach a fair outcome. For example, the US judges can decide to conceal certain information such as 'trade secrets', 'confidential research, development, or commercial information', or 'scandalous or defamatory matters'. Also in the USA, on the question of IPs' power to access individual debtors' documents protected by attorney-client privilege and bank secrecy, a balanced approach is adopted, for the balance of values of disclosure versus non-disclosure.

Third, private solutions could also be in place. This is the case when bidders are required to sign a confidentiality agreement to prohibit them from disclosing information sent to them in bidding procedures. This could also be proposed by creditors to set up a trading wall in order to prevent them from disclosing inside information when sitting in a creditors' committee.

These approaches should supplement each other as no single one can envisage all possible scenarios that may involve confidentiality, secrecy or privilege issues.

A second general observation concerns the cross-border and comparative law perspective. Throughout the study we have tried to collect materials from as many jurisdictions as possible, yet have found that many of them have not systemically considered the issues of confidentiality, secrecy or privilege in insolvency proceeding. In many cases the approach is rather ad hoc, although it is also highly likely that we missed a large proportion of substances owing to the limitations of language or knowledge. As can be seen in the previous chapters, the UK and the USA are still the pioneers in this field, given their complex and mostly advanced insolvency systems.

The blank in this issue may or may not be an obstacle to cross-border insolvency. Under the EIR context, this issue has been considered several times and was subject to the public policy exception (Art. 33) consideration. However, there still exists the applicable law issue; a choice still needs to be made among, at least, *lex fori*, the place where evidence is introduced, the place where the discovery proceeding is taking place, or the place where the establishment of the attorney is (attorney-client privilege) located. Also, increasingly, a host of cross-border insolvency cases rely on cooperation, coordination or communications, between courts, between IPs or between courts and IPs. Usually, there exist the requirements of information sharing, which should also be subject to the duty of confidentiality under national laws. However, these requirements have been formulated in rather broad terms, and, in addition, it is possible that national laws are different with regard to what confidential information is and to whom the information can be disclosed, which may be another obstacle to cross-border insolvency.

To conclude, we believe this book could well be the start of a new field that has not been fully explored and could lead to additional projects as we proposed in Chapter 1, including confidentiality, secrecy or privilege issues in cross-border bank resolution or in the context of EU Restructuring Directive. Additional efforts could be made by international organizations, national legislators, judges and other insolvency experts towards a joint initiative with regard to the clarification of (certain aspects of) confidentiality, secrecy and privilege matters for both domestic and international insolvency cases.