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Feature

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The Privilege Is Mine

What Can Happen After a Corporation Files for Bankruptcy



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It is well settled that once a petition for bankruptcy protection is filed, a debtor in possession or bankruptcy trustee obtains control over the debtor's pre-petition attorney/client privilege, including control over whether to assert or waive the privilege. Similarly, reorganization plans often transfer the debtor's privilege to a litigation trust, which vests the litigation trustee with similar control over the debtor's pre-petition privilege. While seemingly straightforward, the application of these principles in post-reorganization settings is still taking shape.

For example, in *In re Tribune Co. Fraudulent Conveyance Litig.* (hereinafter the "Tribune action"),² Hon. Richard J. Sullivan recently considered whether a litigation trustee — to whom a debtor's attorney/client and work-product privilege is assigned under a confirmed reorganization plan — also inherits the privilege of a former special committee of the debtor's board of directors that was represented by its own counsel. Judge Sullivan answered that question in the affirmative.

The Attorney/Client Privilege in Bankruptcy: The Basics

The modern attorney/client privilege exists to "protect ... the confidentiality of communications between [an] attorney and [a] client made for the purpose of obtaining legal advice."³ While there are various policy rationales underlying the attorney/client privilege, the most fundamental is the promotion of frank communication between a client and his or her attorney, in order to help ensure that an advocacy on behalf of his/her client is not impaired

by the client's lack of disclosure.⁴ Typically, the privilege belongs to — and thus, can only be waived by — the client.⁵

Where the client is a corporate entity rather than an individual, the attorney/client privilege is held by the corporation itself, and the rules surrounding the protection of individual communications made by corporate officers, directors or employees are more nuanced.⁶ For example, the effect of the privilege remaining with the corporation allows a board of directors to waive the attorney/client privilege over discussions between a prior board and its counsel, or discussions between a senior officer and the corporation's counsel.⁷ In addition, where a corporation is sold, the purchaser could become the new owner of the corporation's privilege regarding matters predating the sale.⁸

In bankruptcy cases, the debtor's pre-petition privilege becomes part of the estate and, like all estate assets, must be used to maximize recovery for stakeholders. The U.S. Supreme Court has made it clear that upon the commencement of a bankruptcy case, the debtor's pre-petition privilege is controlled by the debtor in possession, who simply "retains" the privilege, or by a bankruptcy trustee, who steps into the debtor's shoes.⁹

In *CFTC v. Weintraub*, the Commodity Futures Trading Commission (CFTC) filed a complaint against a corporation for violating the Commodity Exchange Act.¹⁰ Thereafter, the corporation's sole director and officer executed a consent decree with the CFTC, which required a

1 The authors acknowledge the assistance of counsel William Mongan, associates Elise Bernlohr and Cristina Thrasher, and law clerk Sean Nolan for their assistance in the drafting and research of this article.

2 No. 11-cv-02296 (RJS) (S.D.N.Y. 2012). Akin Gump Strauss Hauer & Feld LLP is co-counsel for Marc S. Kirschner, the litigation trustee in the *Tribune* action.

3 *Genentech Inc. v. U.S. ITC*, 122 F.3d 1409, 1415 (Fed. Cir. 1997).

4 *See Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981) ("[The] purpose [of the attorney/client privilege] is to encourage full and frank communication between attorneys and their clients, and thereby promote broader public interests in the observance of law and administration of justice.")

5 *United States v. Amodeo*, 71 F.3d 1044, 1052 (2d Cir. 1995).

6 *See Upjohn Co.*, 449 U.S. at 390-97.

7 *See CFTC v. Weintraub*, 471 U.S. 343, 349 (1985).

8 *See, e.g., Tekni-Plex Inc. v. Meyner & Landis*, 674 N.E.2d 663, 670-71 (N.Y. 1996).

9 *Weintraub*, 471 U.S. at 358.

10 *Id.* at 345.

receiver's appointment to file for bankruptcy on the corporation's behalf.¹¹ The receiver was subsequently appointed as the trustee in bankruptcy.¹²

The CFTC served a subpoena on the debtor's former attorney, seeking the attorney's testimony regarding various potentially fraudulent acts perpetrated by the debtor.¹³ After the former attorney refused to respond to certain questions on the grounds that they were subject to the attorney/client privilege, the CFTC moved to compel the former attorney's responses and requested that the trustee waive the attorney/client privilege.¹⁴ The trustee agreed to waive the privilege, and the court ordered the former attorney to testify over the objection of the debtor's sole officer, who argued that the attorney/client privilege belonged to the debtor.¹⁵

The issue was contested on appeal and eventually reached the Supreme Court, which held that the trustee "should control the privilege in bankruptcy," as he is "directed to investigate the debtor's financial affairs ... and is empowered to sue officers, directors, and other insiders ... on behalf of the estate."¹⁶ In so holding, the Court reasoned that allowing "the debtor's directors [to] have this power ... would frustrate an important goal of the bankruptcy laws" of "maximiz[ing] the value of the estate."¹⁷

Attorney/Client Privilege: Pre-Petition Committees of the Boards of Directors

In certain circumstances, a corporation's board of directors might designate a special committee to manage and/or oversee some part of the corporation's affairs, and authorize this committee to retain its own legal counsel.¹⁸ Outside of bankruptcy, it is fairly clear that communications between a special committee of this nature and its counsel are protected by an attorney/client privilege that belongs to the special committee and is separate from the attorney/client privilege belonging to the corporation itself.¹⁹

However, once a bankruptcy petition has been filed, the rule is not so clear. Courts are split over whether a special committee's pre-petition attorney/client privilege transfers to a trustee standing in a debtor's shoes or to whom the debtor has assigned its attorney/client privilege.

In *In re BCE West LP*, the debtors' confirmed reorganization plan created a litigation trust in order to pursue the debtors' claims post-confirmation.²⁰ However, the plan did not expressly assign the debtors' privileges to the trustee. When the trustee issued a subpoena for documents to counsel of a former special committee of the BCE board, counsel to the former special committee objected, arguing that communications between the former special committee and its counsel were protected by the former special committee's attorney/client privilege, which was controlled by the former special committee, not the trust-

ee.²¹ Hon. Richard Casey of the U.S. District Court for the Southern District of New York agreed, holding that the special committee was intended to be a separate entity from the board of directors, and that the special committee's privilege was thus distinct from the corporation's and did not transfer to the litigation trustee.²² In so finding, Judge Casey acknowledged the holding in *Weintraub*, but noted that *Weintraub* specifically exempted from its holding the privileges of parties that are legally distinct from the corporation or its board.²³

[S]takeholders in corporate bankruptcies should be aware that the pre-petition privileges of any special committees of the debtors' boards of directors might vest automatically upon a bankruptcy filing in the debtors in possession or a bankruptcy trustee, and might be assigned to a litigation trustee....

The issue was revisited by Hon. Ronnie Abrams, also of the U.S. District Court for the Southern District of New York, in *In re China Medical Technologies Inc.*²⁴ In this case, a liquidator appointed in the debtor's chapter 15 proceedings sought discovery of privileged communications between the debtors' pre-petition audit committee and the audit committee's law firm.²⁵ Relying in part on *BCE West*, the law firm argued that the communications were protected by a privilege distinct from that belonging to the debtor.²⁶ Judge Abrams rejected the *BCE West* holding, finding that *BCE West* failed to adequately address the policy considerations that were crucial to the Supreme Court's decision in *Weintraub*.²⁷

Although Judge Abrams acknowledged that the audit committee "was 'independent' in some sense," she also found that the committee was merely a representative of the board of directors, and that it ceased to exist upon the debtor's bankruptcy.²⁸ Therefore, Judge Abrams held that the considerations articulated by the Supreme Court in *Weintraub* dictated that the former audit committee's attorney/client privilege transferred to — and thus could be waived by — the liquidator.²⁹

Weintraub's Application to the Tribune Special Committee

Judge Sullivan's recent ruling in the *Tribune* action further addresses the question of whether a special committee's pre-petition privilege transfers to a bankruptcy or litiga-

11 *Id.*

12 *Id.* at 346.

13 *Id.*

14 *Id.*

15 *Id.*

16 *Id.* at 352.

17 *Id.* at 353.

18 See, e.g., Del. Code Ann. tit. 8, § 141(c)(2).

19 *Moore Bus. Forms Inc. v. Cordant Holdings Corp.*, Nos. 13911, 14595, 1996 WL 307444, at *6 (Del. Ch. June 4, 1996); *Ryan v. Gifford*, No. 2213-CC, 2007 WL 4259557, at *3 (Del. Ch. Nov. 30, 2007).

20 *In re BCE West LP*, No. M-8-85, 2000 WL 1239117, at *1 (S.D.N.Y. Aug. 31, 2000).

21 *Id.* at *1.

22 *Id.* at *2.

23 *Id.*

24 *In re China Med. Techs. Inc.*, 539 B.R. 643, 655 (S.D.N.Y. 2015).

25 *Id.*

26 *Id.* at 646-47.

27 *Id.* at 654-55.

28 *Id.* at 655.

29 *Id.*

tion trustee.³⁰ In *Tribune*, the confirmed reorganization plan provided for the appointment of a litigation trustee in order to pursue certain preserved causes of action relating to the debtors' pre-petition leveraged buyout (LBO). The plan referenced an "Agreement Respecting Transfer of Documents, Information, and Privileges from Debtors and Reorganized Debtors" (the "transfer agreement"), which defined the Tribune Co. to include its board and any special committees thereof, and assigned the Tribune Co.'s various privileges to the litigation trustee.³¹

The Tribune litigation trustee served document requests on the former members of a special committee of the Tribune Co.'s board of directors (which had been formed approximately two years prior to the debtors' bankruptcy filing to evaluate potential transactions) and its counsel. The special committee ultimately approved the LBO and was dissolved approximately one year before the debtors filed for bankruptcy.³² The board resolutions establishing the special committee provided for the special committee's engagement of independent counsel, and that "all statutory and common law privileges shall be available with respect to legal advice rendered to, and documents prepared by counsel to assist, the Special Committee in its deliberations."³³

The former members of the special committee and their former counsel objected to the litigation trustee's document requests to the extent that they called for communications subject to the special committee's attorney/client privilege. The litigation trustee moved to compel the production of such documents, arguing that the confirmation order approving the transfer agreement transferred the special committee's attorney/client privilege to the litigation trustee and was *res judicata*, and that even in the absence of such an order, the special committee's attorney/client privilege belonged to the litigation trustee under the Supreme Court's ruling in *Weintraub*.³⁴

In response, the former special committee members and their counsel argued that the transfer agreement was ineffective to transfer the special committee's privilege, as it was signed only by the debtors, which did not control the special committee's privilege.³⁵ The special committee also cited Delaware cases outside of the bankruptcy context in which special committees were found to have attorney/client privileges that could not be waived by the corporations whose boards of directors had appointed them.³⁶

Judge Sullivan ruled in favor of the litigation trustee on each of these arguments, and held that the special committee's attorney/client privilege belonged to the litigation trustee. He also ruled that the transfer agreement was binding on the former members of the special committee, given that they participated in the *Tribune* bankruptcy proceedings and failed to object to the relevant portions of the transfer agreement before the confirmation order approving it was entered.³⁷

More generally, Judge Sullivan rejected the argument that the former members of the special committee continued to maintain an attorney/client privilege that was not transferred to the *Tribune* debtors upon the commencement of their bankruptcy filing.³⁸ He found that the Delaware cases addressing the attorney/client privileges of special committees outside of bankruptcy were inapposite because they dealt with solvent companies and special committees that remained in existence and functional. Judge Sullivan noted that "while there are obviously sound reasons for recognizing an independent attorney/client privilege while a special committee is tasked with performing crucial core managerial and oversight functions for the corporation, the rationale of a distinct privilege disintegrates when the special committee has been dissolved and the corporation itself becomes insolvent."³⁹

By contrast, Judge Sullivan found that a rule transferring the special committee's privilege to the debtors — and thus to the litigation trustee — was practical and supported by prior case law, including *Weintraub* and *China Medical*. Judge Sullivan stated "the Supreme Court determined that an insolvent corporation's bankruptcy trustee controlled the corporation's attorney/client privilege because 'the trustee plays the role most closely analogous to that of a solvent corporation's management.'"⁴⁰ The *Tribune* special committee, Judge Sullivan found, "was integral to management, meaning that its privilege could be assigned by Tribune-as-debtor to the Trustee in the Transfer Agreement."⁴¹

Given the decisions in *Weintraub*, *China Medical* and *Tribune*, stakeholders in corporate bankruptcies should be aware that the pre-petition privileges of any special committees of the debtors' boards of directors might vest automatically upon a bankruptcy filing in the debtors in possession or a bankruptcy trustee, and might be assigned to a litigation trustee appointed to pursue estate claims post-confirmation. Creditors will be well served to address this issue expressly in a reorganization plan in order to minimize or avoid disputes over privileged communications in post-confirmation litigation of estate claims brought by litigation trustees. **abi**

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30 See *In re Tribune Co. Fraudulent Conveyance Litig.*, No. 11-cv-02296 (RJS) (S.D.N.Y. 2012) ("Tribune").

31 *Tribune*, Order, ECF No. 7245, at 3.

32 *Id.* at 2.

33 *Tribune*, Ex. B to Decl. of William F. Mongan, Oct. 18, 2006, minutes of a meeting of the Tribune Board of Directors, ECF No. 7209-2.

34 See *Tribune*, Mem. of Law in Supp. of Pl.'s Mot. to Compel, ECF No. 7208.

35 *Tribune*, Indep. Dirs. Mem. of Law in Opp'n to Litig. Tr.'s Mot. to Compel, ECF No. 7216, at 11-14.

36 *Id.* at 6-8.

37 *Tribune*, Order, ECF No. 7245 at 4.

38 *Id.* at 6-7.

39 *Id.*

40 *Id.* (citing *Weintraub*, 471 U.S. at 353).

41 *Id.* at 8.