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Attorney-Client Privilege: Issues in Bankruptcy-Related Proceedings

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In the current economic climate, many corporate officers and directors are facing tough decisions. Faced with the potential for insolvency and bankruptcy proceedings, issues implicating various privileges can rise to the forefront, and must be given careful consideration to avoid waiver. Such issues commonly include:

- Who holds the corporation's attorney-client privilege once the corporation files for bankruptcy?
- What is the scope of the attorney-client privilege in communications involving creditors' committees and committee counsel?
- Are communications between a debtor and any of its creditor constituencies during settlement negotiations discoverable?
- Does the inclusion of financial advisors in board or creditors' committee meetings waive the attorney-client privilege?
- If a subsidiary files for bankruptcy, and the parent company is adverse to its subsidiary, can the subsidiary invade its parent's privileges?
- Are documents and information shared with counsel in anticipation of a bankruptcy filing discoverable?
- What protections are afforded to valuation materials?

If not properly considered, these issues can adversely impact a corporation during a Rule 2004 examination or document request, or in bankruptcy-related litigation. This article analyzes the current case law implicated by each of these situations, and suggests practical steps to mitigate the risk of waiver.

Who Holds the Corporation's Attorney-Client Privilege?

Generally, the attorney-client privilege applies to (1) a communication; (2) made between persons having a privileged relationship; (3) in confidence; (4) for the purpose of seeking, obtaining, or providing legal assistance for the client.¹ The attorney-client privilege of a corporation typically is held by its board of directors.²

¹ See, e.g., Restatement (Third) of Law Governing Lawyers § 68 (2000); *In re Mortgage & Realty Trust*, 212 B.R. 649, 652 (Bankr. C.D. Cal. 1997); *In the Matter of Baldwin-United Corp.*, 38 B.R. 802, 804 (Bankr. S.D. Ohio 1984). Bankruptcy Rule 9017 provides that the Federal Rules of Evidence apply in cases brought under the Bankruptcy Code. "Federal Rule of Evidence 501 provides that federal courts are to apply state rules of evidentiary privilege 'with respect to an element of a claim or defense as to which State law supplies the rule of decision.'" *In the Matter of Int'l Horizons Inc.*, 689 F.2d 996, 1003 (11th Cir. 1982) (affirming that "because the bankruptcy proceeding did not yet involve state claims, the Bankruptcy Court was not required to apply Georgia's accountant-client privilege"). If the bankruptcy proceeding does not involve state law claims, then the bankruptcy court is not required to apply state privilege laws. *Id.* (citing Fed. R. Evid. 501). See also *In re Bazemore*, 216 B.R. 1020, 1023 (Bankr. S.D. Ga. 1998) ("the question of privilege asserted in bankruptcy court is a procedural question and existing federal law is to be used"); *In re Hillsborough Holdings Corp.*, 132 B.R. 478, 481 (Bankr. M.D. Fla. 1991) (applying state law in an action to pierce the corporate veil, because "the rule of decision of corporate veil-piercing issues is clearly law of Florida").

² See, e.g., *King v. Deutsche Bank Ag*, No. CV 04-1029-HU, 2005 WL 611954, *12 (D. Ore. Mar. 8, 2005) ("The power to waive the corporate attorney-client privilege rests with the corporation's management, and is normally executed by its officers and directors.")

Once a corporation files for bankruptcy, the board continues to hold that privilege, with one very important caveat.

Corporate counsel, who often develop ties to management or the board of their corporate clients, are often surprised to learn that privileged communications with those persons may not remain privileged once the corporation files for bankruptcy. Instead, the determination of whether to waive the privilege may rest with the bankruptcy trustee.

The U.S. Supreme Court recognized a bankruptcy trustee's ability to waive the attorney-client privilege in *Commodity Futures Trading Commission v. Weintraub*.³ In *Weintraub*, the Commodity Futures Trading Commission ("CFTC") subpoenaed a bankrupt corporation's former counsel, seeking evidence about suspected misappropriation of funds by company insiders. When the attorney asserted the corporation's attorney-client privilege, the CFTC obtained a waiver of that privilege from the bankruptcy trustee. The Supreme Court found that the waiver was valid, holding that the bankruptcy trustee controls the corporation's attorney-client privilege after bankruptcy proceedings are initiated. Accordingly, the trustee may waive the attorney-client privilege of the corporate debtor, including with respect to pre-bankruptcy communications.⁴

The court's rationale behind this decision was that a trustee most closely resembles "management" of the corporate entity, and like other corporate successors, the succeeding management obtains the right to assert or waive the privilege. The court explained:

When the corporation is solvent, the agent that controls the corporate attorney-client privilege is the corporation's management. Under our holding today, this power passes to the trustee because the trustee's functions are more closely analogous to those of management outside of bankruptcy than are the functions of the debtor's directors.⁵

The Court also rejected the notion that the interest against self-incrimination of former officers and directors trumps the trustee's capacity to waive the privilege.⁶ The trustee thus has the power to waive the privilege over the objections of the original management whose activities may be under investigation.⁷

³ 471 U.S. 343 (1985).

⁴ *Id.* at 348.

⁵ *Id.* at 356.

⁶ The Court noted that the goal of uncovering insider fraud "would be substantially defeated if the debtor's directors were to retain the one management power that might effectively thwart an investigation into their own conduct." *Id.* at 353-54.

⁷ Note that the *Weintraub* decision, which involved a Chapter 7 trustee, does not stand for the proposition that the trustee is the sole holder of the attorney-client privilege in all bankruptcy-related proceedings. Unlike in Chapter 7, in most Chapter 11 cases a trustee is not appointed and the debtor remains in possession and control of the debtor's property, as the "debtor in possession." The debtor in possession has the rights and powers of a bankruptcy trustee, and thus generally controls the privilege in bankruptcy. See *In re Am. Metrocomm Corp.*, 274 B.R. 641, 654 (Bankr. D. Del. 2002) ("In this Chapter 11 case, AMC is a debtor-in-possession. Therefore, AMC controls the attorney-client privilege with respect to both its pre- and post-petition communications with Defendants.") (citing *Weintraub*); *In re Williams*, 152 B.R. 123, 127 (Bankr. N.D. Texas 1992) ("Although management of the corporation in a Chapter 11 case remains in control of the debtor in pos-

Scope of Attorney-Client Privilege That May Be Asserted By Creditors' Committees

Generally, a creditors' committee is entitled to assert an attorney-client privilege pertaining to protected communications between the committee and its counsel.⁸ "Given its duties and responsibilities, a creditors' committee needs competent and effective representation. Counsel for a creditors' committee is best able to serve his or her client if the attorney can engage in 'full and frank communications' [with the committee]."⁹

However, this privilege is not without limits. For example, the privilege "may not be asserted as a shield to protect against disclosure of fraud or other misconduct on the part of the committee or its attorneys."¹⁰ To establish the right to assert a privilege, just as any other party must, the creditors' committee must demonstrate under the applicable standards that the privilege exists and has not been waived. Moreover, "the privilege does not attach simply by reason of the attorney/client relationship, but depends on the specific contents of the [communication]."¹¹

The decision in *In re FiberMark Inc.* clearly frames these important issues in the context of that company's Chapter 11 proceeding.¹² In that case, a stalemate on various corporate governance issues derailed progress in the reorganization proceedings.¹³ Allegations of breached fiduciary obligations by members of the creditors' committee and insiders of the debtor arose, ultimately culminating in the appointment of an examiner. The examiner filed a report which included conclusions that two members of the creditors' committee and the committee's counsel had breached certain fiduciary duties. The court was asked to determine whether the examiner had improperly included in his report information protected under the attorney-client privilege.¹⁴

Turning to the question of the privilege itself, the court found that only those communications made in confidence to the committee for the purpose of obtain-

session, it must exercise control of the corporation's evidentiary privileges consistently with its fiduciary obligation to the entire bankruptcy estate, specifically including the creditors. Consequently, the debtor in possession as a fiduciary for the bankruptcy estate obtains control of the debtor's prepetition evidentiary privileges." (relying on *Weintraub*); *In re Winom Tool and Die Inc.*, 173 B.R. 613, 622 (Bankr. E.D. Mich. 1994) ("The debtor in possession is a trustee. See 11 U.S.C. §§ 323(a) and 1107(a).")

⁸ See, e.g., *In re FiberMark Inc.*, 330 B.R. 480, 498 n.6 (Bankr. D. Vt. 2005); *Matter of Baldwin-United Corp.*, 38 B.R. at 804-05 ("The purposes underlying the privilege have no less applicability to a creditor's committee than they do to any other entity, at least when disclosure of privileged communications is sought by those who are not represented by the committee, or who stand in an adversarial relationship with it.") See also *In re Drexel Burnham Lambert Group Inc.*, 133 B.R. 13, 31 (Bankr. S.D.N.Y. 1991) (fee application of committee counsel need not disclose privileged material).

⁹ *In re Subpoenas Duces Tecum Dated Mar. 16, 1992*, 978 F.2d 1159, 1161 (9th Cir. 1992) (quoting *Upjohn Co. v. United States*, 449 U.S. 383, 389) (1981)).

¹⁰ *Matter of Baldwin-United*, 38 B.R. at 805, n.1.

¹¹ *In re Blier Cedar Co. Inc.*, 10 B.R. 993, 1002 (Bankr. D. Me. 1981) (letter containing vague description of transaction and not referring to legal advice is not privileged).

¹² *In re FiberMark Inc.*, 330 B.R. at 498 n.6.

¹³ *Id.* at 489.

¹⁴ *Id.* at 492.

ing or providing legal advice are protected.¹⁵ If a communication was merely to aid the committee in making a business decision, it falls outside the scope of the attorney-client privilege.¹⁶ Thus, the court declined to redact from the examiner's report sections referring to discussions in which committee counsel conferred with co-counsel, committee advisors, or individual committee members about their divergent opinions on the topic of the debtor's post-confirmation corporate governance because the court did not view the corporate governance questions as raising "legal issues on behalf of its client," the committee.¹⁷ By contrast, where the committee's counsel communicated with the committee chair or co-counsel with regard to the obligation of the committee to disclose suspicions of violation of the trading order, that activity was a duty of the committee and the court therefore deemed it privileged.¹⁸

Are Communications Between Debtors and Creditor Constituencies Privileged?

Debtors and creditors regularly engage in communications and exchange confidential information in the course of bankruptcy proceedings. Relatedly, the resolution of litigation claims in bankruptcy cases can often have a major impact on the ultimate distribution to creditors and equityholders, and control over the settlement of litigation claims can thus become a divisive issue both within the creditor constituencies and between creditors and the debtor. In these situations, parties to a bankruptcy matter and their counsel often seek to protect these communications from disclosure to outside parties.

Settlement Negotiations. In addressing disclosure and confidentiality issues that arise in settlement negotiations, bankruptcy courts routinely look to Rule 408 of the Federal Rules of Evidence, which states that evidence of conduct or statements made in compromise negotiations is not admissible. Rule 408's protection of settlement communications is limited, however, and allows evidence of settlement negotiations if offered for other purposes, such as impeaching a witness.¹⁹ Moreover, settlement communications, although generally not admissible at trial, may nevertheless be discoverable under Federal Rule of Civil Procedure 26, so long

as they are not privileged and appear reasonably calculated to lead to the discovery of admissible evidence.²⁰

In the *Goodyear Tire & Rubber Co. v. Chiles Power Supply Inc.* decision, the U.S. Court of Appeals for the Sixth Circuit announced a "settlement privilege" that protects settlement communications from discovery.²¹ Although *Goodyear* did not arise in bankruptcy, the decision may have implications on settlement negotiations among bankrupt debtor corporations and their constituencies. The *Goodyear* decision addressed whether statements made in furtherance of settlement between two parties in an action are discoverable by a third party in another action. The court applied a balancing test to determine whether statements made during settlement negotiations are discoverable. The court considered several factors, including public policy favoring the confidentiality of such discussions, the need for confidentiality to promote effective negotiations, and the "inherent questionability of the truthfulness of any statements made [during settlement discussions]."²²

In reaching its decision, the *Goodyear* court emphasized the importance of confidentiality in settlement negotiations, holding that exceptions to confidentiality occur only in rare circumstances and require a significant showing of proof. However, some federal district courts have refused to acknowledge this settlement privilege.²³ The possible disclosure of settlement communications therefore must be carefully considered when a bankrupt entity engages in settlement negotiations, and a few steps may help preserve the confidentiality of settlement materials when corporate counsel is negotiating and crafting a settlement. To ensure the confidentiality of a settlement agreement, counsel should, at a minimum, insist that it contain a standard confidentiality provision. In the course of settlement discussions, attorneys are well advised to explain the need and importance of confidentiality. More importantly, corporate counsel should likely caution its settling client that despite best efforts, the settlement materials may eventually be discoverable.

Common Interest Privilege. The joint defense, or common interest rule, may also come into play in the context of protecting privileged information communicated between debtors and creditors' committees. Generally, when a communication between a client and an attorney occurs in the presence of third parties, the attorney-client privilege is waived. Similarly, the general rule for the work-product doctrine is that it is deemed waived

¹⁵ *Id.* at 498.

¹⁶ *Id.* at 499-500.

¹⁷ *Id.* at 499 ("Many of the passages in the Report . . . deal with the inter-creditor disputes involving the post-confirmation governance issues. Many of the provisions of the Report . . . relate to conflicts among members of the Committee, strategy for maneuvering other members to one's perspective and the various governance issues. These matters are not protected from disclosure by the privilege because (a) they are not communications with the Committee . . . and (b) they are not directed at protecting the interests of the Committee or its constituents, but rather at advancing or reconciling the needs of individual Committee members.")

¹⁸ *Id.*

¹⁹ See, e.g., *In re Blue Water Land Dev. LLC*, Nos. 08-00842-8-JRL, 08-00856-8-JRL, 2008 WL 4186895 at *1 (Bankr. E.D.N.C. Sept. 4, 2008) (although Rule 408 renders "settlement negotiations inadmissible if offered to prove liability, invalidity, or amount of a claim" settlement documents "are subject to discovery if they are relevant and likely to lead to the discovery of admissible evidence").

²⁰ See Fed. R. Bankr. P. 7026, which adopts Fed. R. Civ. P. 26 in adversary proceedings. See also *In re Adelpia Commc'ns Corp.*, No. 02-41729 (REG), 352 B.R. 592, 599 (Bankr. S.D.N.Y. Sept. 21, 2006) (agreeing that conduct or statements made in connection with the settlement negotiations is generally inadmissible, but stating that "Rule 408 does not require exclusion when the evidence is offered for another purpose.")

²¹ 332 F.3d 976, 980 (6th Cir. 2003).

²² *Id.* at 981.

²³ See, e.g., *In re Subpoena Issued to CFTC*, 370 F. Supp. 2d 201, 210 n.11 (D.D.C. 2005) (refusing to recognize the settlement privilege and explaining that Rule 408 cannot be used to curtail discovery rights); *In re Initial Public Offering Sec. Litig.*, No. 21 MC 92 (SAS), 2004 WL 60290, *1 (S.D.N.Y. Jan. 12, 2004) (concluding that "Wells submissions are not protected from discovery merely because they may contain an offer of settlement").

when an attorney reveals his or her materials prepared in anticipation of litigation to third parties. The joint-defense privilege acts as an exception to these general waiver rules in order to facilitate cooperative efforts among parties who share a common legal interest.

Bankruptcy courts have discussed the joint defense rule in a variety of circumstances. In determining the extent of the “common interest” required to invoke the joint-defense privilege, the U.S. Bankruptcy Court for the Northern District of New York in *In re Megan-Racine Associates Inc.* explained:

[I]n the bankruptcy context, the joint-defense privilege could lead to strong-arming and collusive efforts which frustrate the Code’s fundamental purposes. Thus, the Court finds that although total identity of interest is not necessary, the parties asserting the privilege must have a common *legal* interest. A common *legal* interest exists where the parties asserting the privilege were co-parties to litigation or reasonably believed that they could be made a party to litigation.²⁴

Discussing the joint defense rule in connection with the underlying attorney-client privilege, the *Megan-Racine* court further held that the joint defense privilege is only applicable where the party asserting it can demonstrate: (1) “an agreement between the parties privy to the communication that such communication will be kept confidential;” and (2) that “each communication was made in the course of the joint-defense effort and was designed to further that effort.”²⁵

In bankruptcy proceedings, the most common application of the joint defense privilege is to cloak certain communications between the debtor and creditors’ committees in the attorney-client privilege.²⁶ Likewise, privileged materials shared by various creditors’ constituencies in bankruptcy proceedings maintain their privileged protection because the creditors all have a common interest in the outcome of the proceeding.²⁷ Finally, any work product of the creditors’ committee may be protected from disclosure to third parties even in litigation against the debtor because the creditors’ committee and the debtor have a common interest in

²⁴ *In re Megan-Racine Assocs. Inc.*, 189 B.R. 562, 573 (Bankr. N.D.N.Y. 1995).

²⁵ *Id.* at 571 and 573.

²⁶ In an action to set aside a post-petition transfer, the bankruptcy court in *In re Mortgage & Realty Trust*, 212 B.R. 649 (Bankr. C.D. Cal. 1997) confronted the question of whether a three-way conversation between the debtor’s executive vice-president, bankruptcy counsel for the debtor, and counsel for a creditors’ committee was protected by the attorney-client privilege under the common interest doctrine. The court held that the communication was privileged because the communication related to a common interest between the debtor and the creditors’ committee. As a result, the common interest exception to the waiver of the attorney-client privilege applied, and the communication was privileged. *Id.*

²⁷ *Id.* See also *In re Circle K Corp.*, Nos. 96 Civ. 5801 (JFK), 96 Civ. 6479 (JFK), 1997 WL 31197 (S.D.N.Y. Jan. 28, 1997) (In a chapter 11 case, members of the creditors’ committee and non-member creditors, such as the debenture holders, shared a common interest—that of receiving some distribution under the plan of reorganization—and as a result, the court affirmed the bankruptcy court’s finding that documents shared among them were entitled to work-product protection.)

seeking “to maximize the assets in the debtor’s estate.”²⁸

In light of these various holdings, the common interest privilege may be a valuable tool for corporate attorneys to protect information communicated among debtors and creditors, so long as a “common interest” can be adequately demonstrated. Nonetheless, counsel must always be mindful that some courts may not be receptive to extending the joint defense rule to these oftentimes complex relationships among parties to a bankruptcy proceeding.

Does Presence of Financial Advisors Waive Privileged Nature of Communications?

Investment bankers, accountants, and other financial advisors frequently provide guidance to insolvent corporations and their creditors’ committees on a wide range of matters. Privilege issues frequently arise when the financial advisors are privy to privileged communications between the corporation or the creditors’ committee and counsel, and where the financial advisors directly communicate with counsel.

In jurisdictions employing the “facilitator” standard for determining whether communications with third parties are privileged, the court focuses on the subject matter of the attorney-client communications and the consultant’s relation to the lawyer’s giving of legal advice.²⁹ Under this approach, the attorney-client privilege is not waived so long as confidentiality is maintained and the advisor is facilitating the provision of legal advice to the client. For example, in holding that communications with an accountant can be subject to the attorney-client privilege, in the *Kovel* case, the U.S. Court of Appeals for the Second Circuit recognized that “the complexities of modern existence prevent attorneys from effectively handling their clients’ affairs without the help of [other professionals].”³⁰ The Court set out four factors that must be met for the attorney-client privilege to extend to third parties: (1) the third party must be an agent of the client’s attorney; (2) the third party must facilitate the communication between the attorney and the client for legal advice; (3) communications with the third party must be kept confidential; and (4) the privilege must not otherwise be waived.

In re FiberMark Inc. applied this “facilitator” standard in the bankruptcy context in holding that the presence of a financial advisor during creditors’ committee meetings does not destroy the claim of an attorney-client privilege:

the presence of an accountant or financial advisor, whether hired by the lawyer or the clients, does not

²⁸ *In re Kaiser Steel Corp.*, 84 B.R. 202, 205 (Bankr. D. Colo. 1988) (debtor entitled to object to production of an accounting firm’s leveraged buyout analysis because preparation of “the report was for the benefit of the estate, whether at the instigation of the [debtor or the committee]”).

²⁹ Various jurisdictions employ an alternative “functional equivalent” standard for determining whether communications with a third party are privileged which in this context most often provides for narrower protection for communications with a third party finance advisor. *In re Bieter Co.*, 16 F.3d 929, 936, 938-40 (8th Cir. 1994) (client and client counsel communications with real estate consultant were subject to attorney/client privilege where consultant was “in all relevant respects the functional equivalent of an employee”).

³⁰ 296 F.2d 918, 921 (2d Cir. 1961).

destroy the privilege, any more than would the presence of a linguist when needed to translate legal papers in a foreign language. If the financial advisor's presence is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit, according to the *Kovel* court, then the presence of the financial advisor in the communication loop does not negate the protection.³¹

This approach focuses primarily on the nature of the information that is being exchanged and extends the privilege to important communications between the client and the financial advisor.³²

The same standard can be applied to protect communications between the debtor and financial advisors hired by the debtor.³³ In *In re Hardwood P-G Inc.*, for instance, the debtors retained forensic accountants A & M to investigate the debtors' potential causes of action for preferential and fraudulent transfers.³⁴ The accountants prepared a report for the debtors discussing its specific findings as to the debtors' possible claims. The report was shared among the debtors, the unsecured creditors' committee, and lender banks so that a joint plan of liquidation could come to fruition. The court, relying on *Kovel*, held that "A & M was specifically tasked with investigating possible estate causes of action," and that its "role was analogous to that of an interpreter between the" debtors' counsel and the debtors.³⁵ The court concluded that "[b]arring a waiver of the privilege on some other basis, the A & M Report, prepared to aid the communications between the debtor and its counsel in evaluating potential causes of action, is a privileged attorney-client communication. Moreover, any disclosures made to A & M do not constitute a waiver of the privilege."³⁶

The court in *Hardwood* squarely rejected the argument that the accountants' report "cannot be privileged because it was the debtors, and not their counsel, who hired them."³⁷ Such an argument "misapprehends the reason for allowing such communications in the first place—to facilitate communications. It has, literally, nothing to do with who hired them."³⁸ The court explained that "[t]his proposition is especially true in the bankruptcy context because, pursuant to 11 U.S.C. §§ 327, 330, third party professionals such as financial

advisors, must be hired by the bankruptcy estate, or risk not being compensated for their services."³⁹

The decision in *In re G-I Holdings Inc.* serves to reinforce the *Kovel* principle that a bankruptcy advisor's communications can be privileged only so long as the advisor's role is to clarify communications between the attorney and client.⁴⁰ Here, the debtor's in-house counsel sent various documents to an accountant, and the debtors subsequently sought to protect these documents from disclosure. Because the record suggested that the accountant "was a consultant, not a translator or facilitator," the court held that these documents were not privileged and therefore discoverable.⁴¹ There was no evidence that the debtor hired the accountant "to sit with [the debtor's] employees and define tax concepts to attorneys unschooled in tax and accounting, or vice versa."⁴² Citing *Kovel*, the court concluded that "[s]uch consultants or tax advisors who do not interact with clients . . . are not protected by an attorney-client privilege."⁴³

Parent-Subsidiary Relationship and Attorney-Client Privilege

Attorney-client privilege implications also frequently arise in the context of jointly-represented corporate entities, particularly where a bankruptcy attorney provides legal advice to both the parent corporation and its subsidiaries. When the interests of a parent and subsidiary begin to diverge in the face of insolvency and restructuring, questions concerning the existence and preservation of the attorney-client privilege often arise. The U.S. Court of Appeals for the Third Circuit's decision in *In re Teleglobe Communications Corporation* provides significant rulings concerning the application and scope of the attorney-client privilege in this context.⁴⁴

Teleglobe involved litigation arising from the decision of a parent corporation, Bell Canada, to stop funding the operations of its Teleglobe subsidiaries. Within a matter of weeks, the parent and its subsidiaries filed for bankruptcy. In Delaware bankruptcy proceedings, the subsidiaries sued the parent company for fraud and breach of fiduciary duty in connection with the parent company's decision to stop funding their operations. During the course of the litigation, numerous discovery disputes arose as the subsidiaries sought access to documents containing the legal advice provided jointly to the parent and the subsidiaries prior to the funding termination. The subsidiaries contended that as a result of the joint representation between the parent and the subsidiary, and because the entities all shared the same corporate counsel, the documents were not protected under the attorney-client privilege.

³⁹ *Id.* at *9. Notably, the court also held that the common interest doctrine protected the accountants' report from disclosure: "[t]he common legal goal of investigating and recovering the debtors' assets existed between the debtors, the Committee, and the Banks—the only parties who saw the A & M Report—the common interest doctrine applies in this case." *Id.* at *11.

⁴⁰ *In re G-I Holdings Inc.*, 218 F.R.D. 428 (D.N.J. 2003).

⁴¹ *Id.* at 436.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ 493 F.3d 345 (3d Cir. 2007).

³¹ *FiberMark*, 330 B.R. at 499.

³² See also *In re Tri-State Outdoor Media Group Inc.*, 283 B.R. 358, 363 (M.D. Ga. 2002) (valuation work done by financial consultant to creditors' committee is subject to attorney-client privilege where the work "was necessary [for counsel] to effectively communicate with [the committee] as to what legal options were available").

³³ This protection is waived in the event the debtor has potential disputes against its individual officers. See *In re Asia Global Crossing Ltd.*, 322 B.R. 247, 263 (S.D.N.Y. 2005) (any work product privilege arising from individual officers' communications with debtor's financial advisor were waived as a result of the debtor's potential claims against those officers).

³⁴ *In re Hardwood P-G, Inc.*, No. 06-50057-LMC, —B.R.— 2009 WL 1037571 (Bankr. W.D. Tex. Apr. 10, 2009).

³⁵ *Id.* at *10.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

The *Teleglobe* court agreed that the subsidiaries were entitled to this information. The court explained that the joint-client, or co-client, relationship arose when the parent and its subsidiaries hired the same attorney to represent them on the same matter.⁴⁵ In a later dispute between those parties, communications made during and within the scope of the joint representation become discoverable as between them while at the same time remaining privileged as to third parties.⁴⁶ In other words, documents and communications within the scope of a joint representation are discoverable, whereas those outside of the scope are not. Whether a parent and its subsidiaries have jointly agreed to seek legal advice from counsel, and whether counsel represented both corporate affiliates on the issue on which they are now adverse, are both questions of fact that must be examined on a case-by-case basis.

The *Teleglobe* decision provides an important roadmap for corporate counsel to follow to ensure the preservation of the attorney-client privilege in cases of potential adversity between a parent corporation and its subsidiaries. The court emphasized that it was permissible for the members of the corporate family and the in-house attorneys “to limit the scope of a joint representation in a sophisticated manner; nothing requires construing the scope of a joint representation more broadly than the parties to it intend.”⁴⁷ Moreover, because it is inevitable that parent and subsidiary companies may find that their interests have diverged, particularly in situations involving insolvency, the parent should consider securing separate representation for the subsidiary, as creating a joint representation could risk the waiver of privileged communications in adverse litigation.⁴⁸

Are Draft Bankruptcy Filings Privileged?

The expectation that documents and information shared with counsel (including drafts) in anticipation of a bankruptcy filing remain protected by the privilege—even after the final pleading is filed—does not always hold true. Important issues concerning the scope of the attorney-client privilege may arise where counsel assists a client in a public bankruptcy filing, because some of these communications and the exchange of draft documents in preparation for the filing may not be protected by the attorney-client privilege.

The question of what precisely constitutes confidential communications protected by the attorney-client privilege becomes complicated in the context of filing a bankruptcy petition.⁴⁹ For example, the communication of facts intended for inclusion in bankruptcy filings, as well as documents provided by the client to its attorney revealing details underlying past or future filings, may

⁴⁵ *Id.* at 362.

⁴⁶ *Id.* at 363.

⁴⁷ *Id.* at 373.

⁴⁸ See also *In re Grand Jury Subpoena #06-1*, 274 Fed. Appx. 306, 310-11 (4th Cir. 2008) (“the scope of the joint client or co-client privilege is circumscribed by the ‘limited congruence of the clients’ interests,’” therefore, no joint privilege existed where the “Subsidiary failed to demonstrate that the withheld communications pertained to a matter in which both Parent and Subsidiary shared a common legal interest.”) (citing *Teleglobe*, 493 F.3d at 362-63).

⁴⁹ *U.S. v. Naegele*, 468 F. Supp. 2d 165, 169-70 (D.D.C. 2007).

not be communicated in confidence, and if so, are not privileged.⁵⁰ For the same reason, draft filings do not constitute confidential communications between a client and an attorney.⁵¹ Only confidential client communications and attorney advice are privileged.⁵²

The reasoning for this flows from the definition of attorney-client privilege, which requires that such communications be “confidential.” “When information is transmitted to an attorney with the intent that the information will be transmitted to a third party . . . such information is not confidential.”⁵³ In *U.S. v. White*, a U.S. Attorney subpoenaed the debtor’s attorney seeking production of draft pleadings, witness interview notes and other information in connection with investigating the debtor for failing to disclose certain assets in a bankruptcy petition.⁵⁴ The court rejected the debtor’s claim of privilege, stating that “[w]hen information is disclosed for the purpose of assembly into a bankruptcy petition and supporting schedules, there is no intent for the information to be held in confidence because the information is to be disclosed on documents publicly filed with the bankruptcy court.”⁵⁵ Therefore, the draft bankruptcy filings and interview notes in the attorney’s possession were not shielded under the attorney-client privilege.⁵⁶

The cases in this area all involve individual debtors charged with bankruptcy crimes. The dearth of case law makes it unclear how applicable those precedents may be to the normal course commercial bankruptcy filing. Corporate counsel should be aware of these cases and recognize that client communications relating to factual information to be disclosed in the bankruptcy petition may not be privileged.⁵⁷

Protecting Valuation Materials

Corporate attorneys often are faced with the daunting task of shielding their clients’ confidential financial and strategic business plans and valuation information from being disclosed in the course of bankruptcy matters. Strategies relying on the work product doctrine and business strategy immunity can be employed to avoid disclosure of this information until it is absolutely necessary in the proceeding.

Work Product Doctrine. Valuation materials and analyses prepared in bankruptcy proceedings are generally considered privileged work product. In *In re Celotex*

⁵⁰ *Id.* at 169.

⁵¹ *Id.* at 171.

⁵² *Id.*

⁵³ *U.S. v. Lawless*, 709 F.2d 485, 487 (7th Cir. 1983).

⁵⁴ 950 F.2d 426 (7th Cir. 1991). See also *In re French*, 162 B.R. 541, 547-48 (Bankr. D.S.D. 1994) (“[t]here is no expectation that information disclosed for the purpose of assembling a bankruptcy petition and supporting schedules will be held confidential.”)

⁵⁵ *U.S. v. White*, 950 F.2d at 430.

⁵⁶ *Id.* See also *In re Hillsborough Holdings Corp.*, 118 B.R. 866, 869-70 (Bankr. M.D. Fla. 1990) (Material prepared for subsequent public dissemination is not privileged.)

⁵⁷ *Naegele*, 468 F. Supp. at 171 (“Correspondence, bills, ledgers, statements, and time records which also reveal the motive of the client in seeking representation, litigation strategy, or the specific nature of the services provided [. . .] fall within the privilege,” in the bankruptcy context as elsewhere.)

Corp.,⁵⁸ for example, the bankruptcy court held that valuation documents prepared in anticipation of litigation by the debtor's financial consultants were not discoverable because the documents were protected by the work product doctrine.

Corporate and bankruptcy counsel must take care not to waive or defeat the protections of the work product doctrine. Waiver may be found in circumstances where the party acts under the assumption that the protected material will be made public, or where the subject of the valuation is directly placed at issue in the proceedings. In *Granite Partners v. Bear, Stearns & Co. Inc.*,⁵⁹ for example, Chapter 11 debtors-investment funds brought an action against broker-dealers based on the allegation that they liquidated the funds' securities at below market prices. A bankruptcy trustee investigated the cause of the hedge funds' losses. During the investigation, the trustee and his counsel, accountants, and other experts interviewed witnesses, collected and reviewed documents, and performed various analyses for the purpose of publishing a report on the causes of the funds' collapse. Defendants moved to compel plaintiffs to produce the witness interview notes, valuations, and analyses upon which the trustee's report was based. The *Granite Partners* court found that plaintiffs had impliedly waived any work product privilege with respect to these documents, because: (1) the trustee's published report made selective use of interview notes and expert analyses; (2) the trustee's interview notes were used to impeach witnesses for the defendants; and (3) the report relied on analysis by the trustee's expert which "placed the accuracy of his data and the validity of his analyses at issue and, thus, waives [the] privilege on the supporting documents [for the expert's analysis]."⁶⁰

The bankruptcy court in *In re Tri State Outdoor Media Group Inc.* reached a similar conclusion. The Chapter 11 debtor in that case brought a motion to compel an employee of the creditors' committee's financial advisors to testify and provide documents on a valuation issue. The court held that the committee had waived any work product protection it could have received in the materials provided to the expert because the committee had offered him as "a testifying expert" on the valuation issue.⁶¹ The court stated that disclosure of information to an expert witness "assumes that privileged or protected material will be made public" and effectively works as a waiver of any privilege.⁶²

⁵⁸ 196 B.R. 596, 599 (Bankr. M.D. Fla. 1996). Parties seeking discovery of valuation information must show a "substantial need" to avoid the work product doctrine. Relying on Federal Rule of Civil Procedure 26(b)(3), the bankruptcy court in *Tri-State Outdoor Media* explained that "[d]ocuments and tangible things created in anticipation of litigation are only subject to discovery if the party seeking discovery can show a substantial need for the materials and cannot without undue hardship get a substantial equivalent of the materials." 283 B.R. at 364 (citing Fed. R. Civ. P. 26(b)(3)).

⁵⁹ 184 F.R.D. 49, 55 (S.D.N.Y. 1999).

⁶⁰ *Id.* The court further held that the defendants had shown substantial need for the material sought, because the interview notes and financial analyses on which the trustee relied in producing the final report were "essential" to defendants' ability to prepare an adequate defense. *Id.* at 55-56.

⁶¹ *Tri-State*, 283 B.R. at 365.

⁶² *Id.* (internal quotations omitted)

Courts may also order production of valuation materials where the circumstances surrounding the preparation of the documents create the appearance of impropriety. In *In re Asousa Partnership*, the debtor brought a motion to compel the production of a creditor's documents in an adversary proceeding.⁶³ The court held that the draft appraisal report authored by the creditor's valuation consultant addressed to creditor's outside counsel was discoverable because the law firm's involvement in the valuation work "was artifice, used solely to create the appearance of the now-asserted attorney-client privilege."⁶⁴ To preserve work product protection over such materials is important to ensure that outside counsel's involvement be real and substantial.

Business Strategy Immunity. Several federal courts have recognized a limited evidentiary privilege known as the "business strategy" or "white knight" privilege.⁶⁵ This privilege initially arose in the context of target companies defending against hostile contests for corporate control and protects against the disclosure of business plans, proposals, or alternatives actively under consideration by the target company or the acquirer. It is designed to protect the party's ongoing deliberations against the risk that the information disclosed will undermine the party's competitive position in ongoing negotiations.⁶⁶ To invoke this doctrine, federal courts rely upon the protections of Rule 26(c) of the Federal Rules of Civil Procedure and balance "the importance of the matter sought to be discovered to the party seeking it; the risk of nonlitigation injury that might occur to the [other party] if discovery is permitted; and the stage of the company's efforts, as well as the stage of the litigation."⁶⁷

The business strategy doctrine is really not a privilege, but an immunity from production at certain times and under limited circumstances.⁶⁸ The privilege lasts only as long as the court determines it to be necessary in light of the balancing test. In other words, the party

⁶³ *In re Asousa P'ship*, No. 04-1012, 2005 WL 3299823 (Bankr. E.D. Pa. Nov. 17, 2005).

⁶⁴ *Id.* at *5. The court explained: "[w]hile the appraisal report states [the valuation consultant's] belief that it will be used as a basis for, *inter alia*, 'potential litigation purposes,' this reference is too vague to support a claim of work product. . . . Moreover, the assertion conflicts with [the consultant's] proposal letter, which states only that the report will be used only for 'management planning' purposes. . . . Given the artifice surrounding the . . . appraisal, I find it more likely that the reference to 'potential litigation,' like [the law firm's] involvement, was added solely to give rise to a colorable claim that the report is a protected document." *Id.* at *6.

⁶⁵ The privilege has been recognized in several federal cases. See, e.g., *Parsons v. Jefferson-Pilot Corp.*, 141 F.R.D. 408, 418-20 (M.D.N.C. 1992); *Temple Holdings Ltd. v. Sea Containers Ltd.*, 131 F.R.D. 360, 360-61 (D.D.C. 1989); *BNS Inc. v. Koppers Co. Inc.*, 683 F. Supp. 454, 457-58 (D. Del. 1988). Some state courts also recognize the privilege. See, e.g., *Grand Metro. PLC v. Pillsbury Co.*, Nos. 10319, 10323, 1988 WL 130637, at *2 (Del. Ch. Nov. 22, 1988); *Dedde v. Orrox Corp.*, No. 6409, 1981 WL 15121 (Del. Ch. Apr. 8, 1981).

⁶⁶ See *Grand Metro. PLC*, 1988 WL 130637.

⁶⁷ *Id.* at *2.

⁶⁸ *Id.* ("the 'business strategy privilege' or 'white knight privilege' is not technically a privilege in the sense that proof of certain elements creates something akin to an entitlement, but is in the nature of a qualified immunity to discovery similar to the attorney's work product doctrine.")

seeking discovery “will not be denied the documents forever.”⁶⁹ Once the documents become relevant to the litigation, as when valuation becomes an actively litigated issue at a later stage of the proceedings, the documents may become subject to production.

The business strategy immunity has not yet been widely invoked in the context of bankruptcy proceedings. Nevertheless, corporate counsel seeking to shield valuation materials from being disclosed may consider using this doctrine as an additional method of protecting its clients’ confidential business information.

Conclusion

Each of the above situations illustrate the complexities of applying privileges in the context of bankruptcy related proceedings. In short, the traditional rules of attorney-client privilege can be transformed in bankruptcy related litigation as a result of constantly shifting party alliances and disputes. In evaluating privileges, care must be taken to identify who the attorney represents, what alliances or disputes the attorney has with other parties, and what consultants are reasonably necessary to facilitate legal advice to the client. Counsel in these situations should also be aware of privileges beyond the basic attorney-client privilege that can protect their clients’ confidential information in these situations, such as attorney work-product privilege, the settlement privilege, and business strategy immunity. Finally, counsel must always be attentive at every stage of the proceedings to waiver, which destroys the protection of a clients’ confidential information.

As a practice guide, the short-answers to the questions posed in the introduction are as follows:

- Once a corporation files for bankruptcy, the board of directors of a corporation continues to hold that privilege, with the caveat that the bankruptcy trustee may waive the privilege over the board’s objection.
- Creditors’ committees have a privileged relationship with their counsel.
- Sometimes communications between a debtor and its creditor constituencies during bankruptcy are discoverable; however, certain jurisdictions, such as the Sixth Circuit, have found that settlement communications are protected from discovery.
- The inclusion of financial advisors in board or creditors’ committee meetings is often necessary for the provision of legal advice. Introducing a third party into the privileged communication creates a possibility of waiver, but corporate counsel can take appropriate steps to avoid waiver by lay-

ing a record that the professional advisor is reasonably necessary for the provision of legal advice.

- In the subsidiary-parent situation, there is a risk that prior joint representations of the parent and the subsidiary may lose their privileged character in the event of disputes arising in a bankruptcy proceeding between the parent and subsidiary.
- Documents and information provided to an attorney for purposes of filing a bankruptcy petition are not privileged. The precise scope of this doctrine, which has arisen in the context of individual petitioners charged with bankruptcy fraud, is unclear.
- Valuation materials prepared in anticipation of litigation should be afforded work product protection. Similarly, valuation materials prepared in connection with ongoing negotiations and litigation between the debtor and creditor constituencies should be afforded business strategy immunity. Both of these privileges to some extent will be waived once the issue of valuation becomes ripe during later stages of the bankruptcy proceeding.

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⁶⁹ *BNS*, 683 F. Supp. at 458.