

THE ATTORNEY CLIENT PRIVILEGE IN CHAPTER 11 REORGANIZATIONS

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I. OVERVIEW

The attorney client privilege of a corporate debtor passes to the trustee in any bankruptcy proceeding. In a chapter 11 proceeding, the debtor, as debtor-in-possession, often acts as trustee. Since a corporate entity is inanimate, it must act through agents, which are generally the directors and officers of a corporation. A debtor-in-possession and its attorney-client privilege will therefore generally be controlled by pre-bankruptcy management. However, in the event that some other person or group of persons comes into functional control of the corporate entity, the control of the entity's attorney-client privilege can and likely (but not in all cases) will pass with it. The corporate debtor's attorney-client privilege can also be passed to a litigation trust by operation of a chapter 11 plan, even if that trust is more accurately a successor-in-interest to a creditors' committee than to the debtor—in fact, a trust may inherit control of both the committee's and debtor's attorney-client privilege.

II. WEINTRAUB AND CORPORATE PRIVILEGE IN BANKRUPTCY GENERALLY

Control of the attorney client privilege passes with the control of a corporate entity, and when a trustee takes control of a bankrupt corporate debtor's assets, it is considered such a change in control. This is the principal lesson of *Commodity Futures Trading Com. v. Weintraub*, 471 U.S. 343 (1985). The *Weintraub* Court embraced a functional analysis of where control of the attorney-client privilege passes in a bankruptcy case:

In light of the lack of direct guidance from the Code, we turn to consider the roles played by the various actors of a corporation in bankruptcy to determine which is most analogous to the role played by the management of a solvent corporation. See *Butner v. United States*, 440 U.S. 48, 55 (1979). Because the attorney-client privilege is controlled, outside of bankruptcy, by a corporation's management, the actor whose duties most closely resemble those of management should control the privilege in bankruptcy, unless such a result interferes with policies underlying the bankruptcy laws.

Weintraub at 351-52.

While this case involved a chapter 7 debtor, it has been applied more broadly, including in the chapter 11 context. The *Weintraub* court also clearly contemplated such broader application because, while not mentioning chapter 11 specifically, it discussed debtors in possession, a concept foreign to chapter 7, *id.* at 355, and cited various provisions of 11 U.S.C. § 1106 (duties of a chapter 11 trustee) in listing the extensive powers and duties of a bankruptcy trustee that led to the conclusion that the trustee, not the debtor, controls the corporate entity. *Id.* at 352.

However, *Weintraub* involved a comparatively simple fact pattern: A defunct chapter 7 debtor with no operating successor. Applying the *Weintraub* Court's analogous-duties rule in more complex bankruptcy cases can get correspondingly more complex.

III. LIQUIDATION/LITIGATION TRUSTS

Liquidation or litigation trusts are a common feature of chapter 11 reorganizations. The trustees of such liquidation trusts can sometimes invoke (and waive) the privilege of both the debtor *and* the official committee of unsecured creditors—intentionally or inadvertently.

Official Committee of Unsecured Creditors of Hechinger Inv. Co. of Del. v. Fleet Retail Fin. Group (In re Hechinger Inv. Co. of Del., Inc.), 285 B.R. 601 (D. Del. 2002):

The law firm of Chadbourne and Park represented the debtors prior to their bankruptcy with respect to certain transactions in 1997. Later, two attorneys from Chadbourne moved to Gibson Dunn & Crutcher, which later represented the individual defendants. They took with them certain documents related to those 1997 transactions when they switched firms. Chadbourne never represented the individual directors and officers; Gibson Dunn never represented the corporate entities.

Hechinger filed for bankruptcy in 1999. The assets of Hechinger Investment Company were liquidated in a liquidating chapter 11 plan. There was no operating successor; all assets of the debtors, including causes of action, were transferred to a liquidation trust formed as a successor to the official committee of unsecured creditors pursuant to the plan.

The trust brought an adversary proceeding against Hechinger's former directors and officers regarding pre-bankruptcy transactions. They sought discovery of the documents related to the 1997 transactions from Gibson Dunn. Gibson Dunn argued that the documents were privileged and that the privilege was still held by the directors and officers of the corporation, arguing that *Weintraub* "only held that a trustee succeeding to the management of a ... debtor had the right to waive the attorney-client privilege," implying that the liquidation trustee, as a successor to the committee, was not, even though it held all assets of the debtor.

Two other defendants then responded and argued that if the privilege passed to the trust, then the trust had waived it (or, perhaps, the debtors had waived it even prior to the formation of the trust, though this is not directly explored in the decision) and the documents should be discoverable by all parties, not just turned over to the liquidation trustee: the fact that the directors and officers were adverse parties and were in possession of the documents meant that the confidentiality necessary to preserve privilege had been broken.

The Court held that (1) the trust held the privilege, and (2) the trust had waived the privilege because the documents sought had been in possession of the individual directors and officers since at least the beginning of the adversary litigation (in 2000) and possibly since the beginning of the bankruptcy case (in 1999).

Therefore, Gibson Dunn was ordered to disclose the formerly-privileged communications to *all* defendants.

Am. Int'l Specialty Lines Ins. Co. v. NWI-I Inc., 240 F.R.D. 401 (N.D. Ill. 2007):

This decision arising in the Fruit of the Loom bankruptcy is the rare example of a case in which a court held a plan provision expressly purporting to assign the attorney-client privilege was held unenforceable. Critically, (1) the plan purported to assign the corporate debtor's attorney-client privilege to *multiple* successor entities, and (2) there was an actual operating successor entity carrying on the business of the old debtor.

The confirmed joint plan of reorganization in the FTL bankruptcy designated six separate successor entities to the old FTL debtors. Two of these entities were a Custodial Trust (CT) and Successor Litigation Trust (SLT). Neither one of these took over the operating assets of FTL's apparel business; the CT existed to hold seven properties that were the subject of environmental litigation by the EPA and a pollution exclusion in a \$100 million insurance policy covering those properties, and the SLT existed mostly to liquidate assets to fund the CT. FTL's apparel business was taken over by a new entity that purchased substantially all of the old debtors' assets and continued to operate that business. In addition, the old FTL was reorganized as a wholly-owned subsidiary of the SLT.

The plan purported to give control of the attorney client privilege to both trusts:

In connection with the rights, claims and causes of action that constitute the [Successor Liquidation Trust Assets or the Custodial Trust Assets], any attorney-client privilege, work-product privilege, or other privilege or immunity attaching to any documents or communications (whether written or oral) transferred to the [SLT or CT] shall vest in the [SLT or CT] and

its representatives, and the Parties are authorized to take all necessary actions to effectuate the transfer of such privileges.

However, analyzing the “practical consequences” of the multiple transactions undertaken pursuant to the plan, the court concluded that the only entity that acquired the right to assert or waive the old debtors’ privilege was the operating successor, relying on an earlier case holding:

If the practical consequences of the transaction result in the transfer of control of the business and the continuation of the business under new management, the authority to assert or waive the attorney-client privilege will follow as well.

Id. at 406 (quoting *Soverain Software LLC v. Gap, Inc.*, 340 F. Supp. 2d 760, 763 (E.D. Tex. 2004)).

The court noted that a plan provision vesting the privilege is not necessarily dispositive, and was also highly reluctant to “allocat[e] the attorney-client privilege based on the division of a debtor’s assets to multiple successor entities.” Therefore, the CT and SLT were not entitled to assert or waive the privilege as it pertained to documents or communications, pre- or postpetition, between the old debtors and their attorneys.

In re FLAG Telecom Holdings Secs. Litig., 2009 U.S. Dist. LEXIS 124061, 2009 WL 5245734 (S.D.N.Y. Jan. 14, 2009):

If you ever find yourself citing *NWI-I*, above, in support of control of the attorney-client privilege being simply an incident of control of the corporation, consider a “*but see*” citation for *Flag Telecom*, and vice versa.

In this chapter 11 case, the confirmed plan created (a) a reorganized debtor that emerged from bankruptcy free and clear as FLAG Telecom’s successor, and (b) a litigation trust, which held only the debtors’ “claims for relief, causes of action, debts, losses, and liabilities.” The litigation trust agreement expressly granted the trust the authority to “collect documents relating to the transferred causes of action and [to control] related [attorney client] privileges.” *Id.* at 5. The litigation trust brought causes of action against the former directors and officers of the debtors, and a dispute arose between the litigation trustee and a former in-house counsel for the debtor (who was by that time an attorney for the reorganized debtor) over who controlled the old debtor’s privilege.

The court distinguished both *Weintraub* and *NWI-I*, and held that the provision of the trust empowering the trustee to hold the attorney-client privilege related to the documents was valid and enforceable, and that the trustee, not the reorganized debtor, had sole control of the privilege with respect to the old debtor’s documents and communications related to the transferred causes of action.

Distinguishing *Weintraub*, the court first noted that there was no express plan provision vesting the attorney-client privilege in that case (there wouldn't be, given that it was a chapter 7 case). The *FLAG Telecom* court further held that the *Weintraub* functionalist/"close resemblance" language leaned in favor of the litigation trust holding the privilege with respect to the documents, since the function of the litigation trust—bringing actions against the directors and officers of the old debtor—was a function that would have belonged to the corporation, just as much as operating the business.

Distinguishing *NWI-I*, the court held that dividing up the attorney-client privilege was a less complex matter in *FLAG Telecom* than it would have been in *Fruit of the Loom*, because there were only two entities, the transactions that created them were less complex, and the assets transferred to the litigation trust were sufficiently discrete. In addition, the court held that the nature of the litigation claims transferred was relevant as well: in *NWI-I*, the cause of action involved environmental liability; in *FLAG Telecom*, it involved D&O liability, and the "practical consequences" of denying the litigation trustee the ability to waive the attorney-client privilege of the debtor corporation would deny the litigation trustee one of the "arrows in its litigation quiver" that the debtor itself would have enjoyed had it never filed bankruptcy and brought the action against the directors and officers itself.

Query whether those grounds for distinguishing *Weintraub* and *NWI-I* should actually stand up to scrutiny.

Osherow v. Vann (In re Hardwood P-G, Inc.), 403 B.R. 445 (Bankr. W.D. Tex. 2009):

Note that litigation trusts can be successors in interest to committees as well as debtors, and therefore can inherit the attorney-client privileges of both.

The debtors in this case employed a forensic accounting firm to investigate the debtors' potential causes of action for preferential and fraudulent transfers. The committee's counsel also prepared a report for the committee regarding preferential and fraudulent transfers. The committee counsel was later (but pre-confirmation) also appointed special counsel to the debtor to pursue certain of those preference claims.

Upon confirmation, the plan provided for the creation of a litigation trust, expressly stated to be successor to the committee, and assignee of the avoidance actions:

In addition to the Litigation Trust being the assignee of the Avoidance Actions and Litigation Claims, the Litigation Trust shall be deemed to be a successor-in-interest to the Committee ...

Id. at 451. The committee ceased to exist on the effective date of the plan, and the trust retained the committee's prior counsel.

An avoidance action defendant sought discovery from the trustee of the forensic accounting report originally performed by the debtor's accountant and the litigation report originally prepared by committee counsel. The trustee asserted the debtor's attorney-client privilege with respect to the accounting report and the committee's attorney-client privilege with respect to the litigation report (along with other theories as to why the documents should not be produced, including the common-interest doctrine and work-product doctrine). The court agreed: "The Trustee is now the holder of the privilege of both the debtors and the Committee and may thus assert such privilege as to both Reports." *Id.* at 461.

IV. CONCLUSION AND BEST PRACTICES

At the start of a chapter 11 bankruptcy case, the trustee controls the corporate debtor's privilege; if the trustee is the debtor-in-possession, then little will change as a practical matter. The central question is whose duties are most analogous to those of the pre-bankruptcy corporate management's. An appointed committee will not share the debtor's privilege.

However, the operation of a confirmed plan, particularly one that creates both an operating successor of the debtor and a litigation trust to pursue causes of action belonging to the debtor, can muddy the waters considerably. Confirmed plans can result in one post-confirmation entity controlling the attorney-client privilege of two or more pre-confirmation entities, and can even result in two or more post-confirmation entities dividing up the privilege previously controlled by a single pre-confirmation entity, though the latter is less favored. Express language in a plan vesting control of the attorney-client privilege post-confirmation in a particular entity is persuasive but not controlling and there are differences among courts as to how much weight such language should be accorded.

Therefore, counsel should the following in mind:

- When representing a prospective purchaser of substantially all of the assets of a bankrupt corporation, keep in mind that the privilege attached to some or all of the communications might pass to a litigation trust and not to your client. To the extent that control of the privilege matters to your client, it should ideally be stated expressly in the plan, though if the plan is merely silent on it, the default rule is likely in your favor.
- When representing a corporation in bankruptcy, be mindful of the fact that there are multiple potential future entities that could obtain the right to waive the privilege in your communications with your client, and that in a *FLAG Telecom* scenario, it is possible that some of your communications' privilege might be controlled by one post-confirmation entity and some by another. That said, be mindful that you still also need to represent your client in the here and now (potentially even against the individual directors and officers).

- Directors and officers of corporations considering filing for bankruptcy should have their own counsel separate from the corporation's counsel. (This should be the case even if the company is not in financial distress, of course, but it acquires more urgency in a distressed-enterprise context.) If you are that counsel, be sure that communications regarding potential director and officer liability pass through you and not through general corporate channels outside the circle in which you can claim the directors' and officers' personal privilege.
- When representing a committee with the strength to shape a chapter 11 plan, particularly if considering action against the debtor's individual directors and officers, you will very likely want a plan that creates a litigation trust that succeeds simultaneously to both the debtor and the committee and acquires (and can waive) the privilege of both.