GIBSON DUNN

August 13, 2019

# DELAWARE BANKRUPTCY COURT RULES THAT LIQUIDATION TRUSTEE CONTROLS THE PRIVILEGE OF BOARD OF DIRECTORS' SPECIAL COMMITTEE

To Our Clients and Friends:

A Delaware bankruptcy court has held that a special committee's advisors cannot withhold privileged documents from a liquidation trustee appointed pursuant to a chapter 11 plan. This decision serves as an important reminder that a bankruptcy trustee, including a trustee appointed to manage a liquidating trust established pursuant to a chapter 11 plan, may have exclusive control over a company's privilege and that executives, board members, and their advisors may be unable to withhold documents from the trustee. Importantly, this decision highlights that even a company's establishment of a special, independent committee with its own advisors may not be effective in shielding otherwise privileged communications from disclosure.

## I. Background

In *In re Old BPSUSH Inc.*,[1] a company's board of directors formed an audit committee (the "Audit Committee"), which investigated questions surrounding senior management's financial reporting. The Audit Committee retained separate legal counsel, and its legal counsel retained financial advisors.[2] The Audit Committee's advisors reviewed millions of documents, conducted multiple interviews, and generated a substantial amount of work product.[3]

The company subsequently filed bankruptcy.[4] In bankruptcy, the company confirmed a chapter 11 plan that created a liquidation trust and vested the trust with all of the company's "rights, titles, and interests in any Privileges," which the plan defined to include "any privilege or immunity" of the company.[5] After the chapter 11 plan was confirmed and a trust was established, the liquidation trustee filed a motion to compel the Audit Committee's legal and financial advisors to turn over all records related to the investigation.[6]

The Audit Committee's advisors objected to the trustee's motion, arguing that the Audit Committee "was organized as an independent body, created and governed by a separate charter, with the right and power to engage independent counsel with separate attorney-client privileges and other protections"; therefore, the advisors argued that the liquidation trustee did not acquire the Audit Committee's privileges.[7] Accordingly, the advisors withheld attorney notes of employee interviews, draft memoranda, the financial advisors' internal analytics and work papers, and communications/emails with Audit Committee members.[8]

## II. Bankruptcy Court's Analysis

The Delaware bankruptcy court began its analysis by recognizing the longstanding principle established by the Supreme Court in *Commodity Futures Trading Commission v. Weintraub*, which held that a "trustee of a corporation in bankruptcy has the power to waive the corporation's attorney-client privilege with respect to prebankruptcy communications."[9]

The Audit Committee's advisors attempted to distinguish *Weintraub*, relying primarily on a Southern District of New York decision in *In re BCE West, L.P.* In *BCE West*, the court held, under similar circumstances, that a trustee appointed pursuant to a chapter 11 plan could not access privileged documents held by the advisors of a special committee appointed by the company's board of directors.[10] The *BCE West* court reasoned that "[i]t is counterintuitive to think that while the Board permitted the Special Committee to retain its own counsel, the Special Committee would not have the benefit of the attorney-client privilege inherent in that relationship or that the Board of Directors or management, instead of the Special Committee, would have control of such privilege."[11] Accordingly, the *BCE West* court determined that the special committee was a "separate and distinct group" from the remainder of the board of directors and that the trustee did not control the privilege."[12]

The Delaware bankruptcy court disagreed with *BCE West* and instead followed a subsequent Southern District of New York case, *Krys v. Paul, Weiss, Rifkind, Wharton, & Garrison LLP (In re China Medical Technologies)*, which addressed a similar situation and refused to follow *BCE West*.[13] In *China Medical*, the court considered whether a foreign representative in a chapter 15 bankruptcy could obtain documents related to an internal investigation conducted by the foreign debtor's audit committee.[14] The court first determined that an audit committee is not completely separate from the board of directors; rather, it is a committee of the board and a "critical component of [the company's] management infrastructure."[15] The court also discussed the policy considerations in *Weintraub* and that "corporate management is deposed in favor of the trustee, and there is no longer a need to insulate committee-counsel communications from managerial intrusion."[16] Based on these considerations, the *China Medical* court rejected *BCE West* and held that the foreign representative controlled the audit committee's privilege.

The Delaware bankruptcy court agreed with the *China Medical* court's reasoning that "it is appropriate to extend the Supreme Court's analysis in *Weintraub* and recognize that the trustee appointed as the representative of a corporate debtor controls the privileges belonging to the independent committee established by the corporate debtor."[17] Accordingly, the court held that the liquidation trustee controlled the Audit Committee's privileges and that its advisors were required to turn over all documents, communications, and work product, including any "draft factual memoranda and draft legal memoranda," but excluding the legal advisor's "firm documents intended for internal law office review and use."[18]

## III. Implications of Decision

It remains to be seen whether other courts will likewise reject *BCE West* and instead follow *China Medical* and *Old BPSUSH*. Although there does not appear to be much case law specifically addressing

the issue, *China Medical* and *Old BPSUSH* serve as a warning that a special committee's documents and communications may very well be discoverable by a trustee (including a trustee of a liquidating trust created pursuant to a chapter 11 plan) and/or company representative in bankruptcy. Therefore, members of a company's board of directors, special committee, management, and all outside advisors should assume that any communications and work product will be discoverable by and subject to the exclusive control of a trustee if the company ultimately files for bankruptcy. More broadly, *Old BPSUSH* serves as a reminder, particularly to companies in financial distress, that communications assumed by the parties to be protected by privilege may ultimately be discoverable by a bankruptcy trustee.

---

[1] *In re Old BPSUSH Inc.*, 2019 WL 2563442, at *1 (Bankr. D. Del. June 20, 2019).

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.* at *4.

[6] *Id.* at *1.

[7] *Id.* at *2.

[8] *Id.* at *8.

[9] *Id.* at *4 (quoting *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 358 (1985)).

[10] *In re BCE W., L.P.*, 2000 WL 1239117, at *3 (S.D.N.Y. Aug. 31, 2000).

[11] *Id.* at *2.

[12] *Id.*

[13] *See Krys v. Paul, Weiss, Rifkind, Wharton, & Garrison LLP (In re China Med. Techs.)*, 539 B.R. 643, 654-55 (S.D.N.Y. 2015).

[14] *Id.* at 646.

[15] *Id.* at 655.

[16] *Id.* at 656.

[17] *In re Old BPSUSH Inc.*, 2019 WL 2563442, at *6.

[18] *Id.* at *7. The court recognized that an exception applies to "documents intended for internal law office review and use" because lawyers must "be able to set down their thoughts privately in order to assure effective and appropriate representation," and such documents "are unlikely to be of any significant usefulness to the client or to a successor attorney." *Id.* (quoting *Sage Realty Corp. v. Proskauer Rose Goetz & Mendelsohn, L.L.P.*, 91 N.Y.2d 30, 37-38 (1997)).

*Gibson, Dunn & Crutcher's lawyers are available to assist with any questions you may have regarding these issues. For further information, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Business Restructuring and Reorganization or Securities Regulation and Corporate Governance practice groups, or the following authors:*

*Michael A. Rosenthal - New York (+1 212-351-3969, mrosenthal@gibsondunn.com)*
*Robert B. Little - Dallas (+1 214-698-3260, rlittle@gibsondunn.com)*
*Matthew G. Bouslog - Orange County, CA (+1 949-451-4030, mbouslog@gibsondunn.com)*

*Please also feel free to contact the following practice group leaders:*

***Business Restructuring and Reorganization Group:***
*David M. Feldman - New York (+1 212-351-2366, dfeldman@gibsondunn.com)*
*Robert A. Klyman - Los Angeles (+1 213-229-7562, rklyman@gibsondunn.com)*
*Jeffrey C. Krause - Los Angeles (+1 213-229-7995, jkrause@gibsondunn.com)*
*Michael A. Rosenthal - New York (+1 212-351-3969, mrosenthal@gibsondunn.com)*

***Securities Regulation and Corporate Governance Group:***
*Elizabeth Ising - Washington, D.C. (+1 202-955-8287, eising@gibsondunn.com)*
*James J. Moloney - Orange County, CA (+1 949-451-4343, jmoloney@gibsondunn.com)*
*Lori Zyskowski - New York (+1 212-351-2309, lzyskowski@gibsondunn.com)*