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Competing Principles: The Independent Audit Committee and Privilege in a Chapter 11 Liquidation

*By Rosa J. Evergreen, Veronica E. Callahan, Kathleen Reilly, and Lucas B. Barrett**

The U.S. Bankruptcy Court for the District of Delaware addressed a developing area of the law related to the attorney-client and work-product privileges and the transfer of any such privileges to liquidation trustees in Chapter 11 proceedings. The authors of this article explain the decision and why this is an area of law that is still developing.

In *In re Old BPSUSH Inc.*,¹ Judge Kevin Carey of the U.S. Bankruptcy Court for the District of Delaware addressed a developing area of the law related to the attorney-client and work-product privileges and the transfer of any such privileges to liquidation trustees in Chapter 11 proceedings. The bankruptcy court held that an audit committee's privileges had transferred to the liquidation trustee upon confirmation, and the effective date, of the Chapter 11 plan.

BACKGROUND

Prior to the bankruptcy, the debtor-corporation's ("Corporation") independent audit committee engaged a law firm, among other professionals, in connection with an internal investigation relating to "whether the [Corporation's] senior financial management could be relied upon with respect to financial reporting and certifications." The Corporation subsequently filed a Chapter 11 petition and, ultimately, the bankruptcy court confirmed a liquidation plan ("Plan"). The Plan conveyed all of the debtor-Corporation's claims and causes of action to a liquidation trust overseen by a trustee ("liquidation trustee").

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¹ *In re Old BPSUSH Inc.*, No. 16-12373 (KJC)(Bankr. D. Del. June 20, 2019).

The Plan also provided that:

On the Effective Date, all of the Debtors' respective rights, titles and interests in any Privileges in respect of any Retained Causes of Action shall automatically vest jointly in the Liquidation Trust and the Reorganized Debtors pursuant to and in accordance with the Plan, and the Liquidation Trustee, as trustee for the Liquidation Trust and in its capacity as the Litigation Representative for the Reorganized Parent Debtors, shall have the sole power and authority to assert or waive such Privileges (subject only to the consent of the Liquidation Trust Advisory Board to the extent required under Section 3.5(b) of the Liquidation Trust Agreement) as further provided in the Plan and the Liquidation Trust Agreement.

After the effective date of the Plan, the liquidation trustee filed a motion under Section 542 of the Bankruptcy Code for entry of an order compelling, among other things, turnover of the records collected by the audit committee's professionals in connection with its investigation. The law firm objected to the relief sought in the motion, asserting that it provided "the Liquidation Trustee with 'all non-privileged factual information' requested by the Liquidation Trustee, and that the remaining materials sought by the Trustee [were] subject to the work product privilege."

ATTORNEY-CLIENT PRIVILEGE AND WORK-PRODUCT DOCTRINE

In analyzing who controlled the attorney-client privilege at issue, the bankruptcy court began by recognizing the applicability of the U.S. Supreme Court case *Commodity Futures Trading Commission v. Weintraub*.²

In that case, the Supreme Court held that a Chapter 7 bankruptcy trustee had the power to waive a debtor-corporation's attorney-client privilege. The case further provided that the control of the privilege passed along with control of the corporation itself. The law firm argued that the situation in *In re Old BPSUSH* was distinguishable from *Weintraub*, as the Corporation's board of directors had granted the audit committee certain powers, including the authority to engage independent counsel.

In making its argument, the law firm cited *In re BCE West, LP*,³ which stated that a special committee is "a separate and distinct group" and that it controlled

² *Commodity Futures Trading Comm'n v. Weintraub*, 471 US 343, 105 S. Ct. 1986, 85 L. Ed. 2d 372 (1985).

³ *In re BCE West, LP*, No. M-8-85 (SDNY Aug. 31, 2000).

its own privilege. Specifically, the court in *BCE West* provided that the “Plan Trustee [could not] waive the Special Committee’s attorney-client privilege” and that “[b]ecause the Special Committee is a separate and distinct group from the Board of Directors . . . the privilege afforded it is not the privilege of the corporation, but rather, is the privilege of the Special Committee.”

The liquidation trustee, however, relied on a 2015 Southern District of New York case, *In re China Med. Tech., Inc.*,⁴ which declined to follow *BCE West*. That case decided the same issue in the opposite direction, ruling that the *Weintraub* analysis extended to an independent audit committee and that control of the committee’s privilege in that case passed to the foreign representative/liquidator.

Ultimately, after considering the arguments of both sides, the bankruptcy court in *In re Old BPSUSH* followed *China Medical*, ruling that, upon confirmation, and the effective date, of the Plan, control over the former audit committee’s privilege passed to the liquidation trustee.

The bankruptcy court then addressed the law firm’s assertion that the work product doctrine protected certain documents and found that (i) in line with extending the Supreme Court’s analysis in *Weintraub* and *China Medical*, the liquidation trustee had stepped into the shoes of the audit committee for the purpose of a work-product analysis and (ii) the work-product doctrine could not be asserted by counsel to withhold documents from a client or former client.

As such, the bankruptcy court ruled that the records were not protected under the work-product doctrine.

Having found that the liquidation trustee was entitled to turnover of the records, the bankruptcy court then examined whether that meant the law firm had to turn over “all” records. The bankruptcy court noted that the “Court of Chancery of Delaware has observed that there is a split in authority regarding an attorney’s duty to release files to a client or former client.”

The bankruptcy court recognized that the majority of jurisdictions follow an “entire file” approach, by which all documents are available to the client with some narrow exceptions, such as documents reasonably intended only for internal law firm review.

The bankruptcy court also identified a minority view, referred to as the “end product” approach, by which clients are only entitled to an attorney’s external

⁴ *Krys v. Paul, Weiss, Rifkind, Wharton & Garrison, LLP (In re China Med. Tech., Inc.)*, 539 B.R. 643 (SDNY 2015).

work product. Noting that the Delaware Court of Chancery has “determined that the ‘cases applying the entire-file approach are more persuasive and consistent with other aspects of Delaware law governing the attorney-client relationship,’” the bankruptcy court ultimately rejected the minority approach and directed the law firm to produce the entirety of the records to the liquidation trustee other than those documents intended only for “internal law office review and use.”

ANALYSIS AND TAKEAWAY

The opinion in *In re Old BPSUSH* demonstrates that the law on the survival of the attorney-client privilege and work-product doctrine post-bankruptcy, when it comes to investigatory records created by attorneys hired by an independent audit committee pre-bankruptcy, is still developing. Independent committees and the professionals engaged by such committees should be cognizant that there is a risk that if the company subsequently files for bankruptcy, a bankruptcy trustee could claim that they hold the privilege.

Notably, trustees may have different perspectives and objectives than the board of directors that originally appointed the independent committee.

Ultimately, if there is a dispute on who controls an independent committee's privileges in a Chapter 11 liquidation proceeding, the resolution of such dispute may depend on both the language in the plan and the confirmation order, as well as the court's interpretation of the law surrounding privilege. This is an area that is still developing, and independent committees and their professionals should continue to follow the cases arising in this area of the law.