AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
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News at 11

By Camisha L. Simmons[1]

Can Subchapter V Trustees Invoke the Common-Interest Doctrine?

Coordinating Editor
Camisha L. Simmons
Simmons Legal PLLC
Dallas

Camisha Simmons is the managing member of Simmons Legal PLLC in Dallas.

The Small Business Reorganization Act of 2019 created subchapter V[2] of chapter 11, which became effective on Feb. 19, 2020. Courts and practitioners are now actively interpreting and applying the subchapter's provisions. One issue that is sure to arise during the discovery phase of litigation is whether the debtor or subchapter V trustee, as applicable, may successfully assert an evidentiary privilege to withhold information received by the trustee from the debtor and/or its agents or professionals.

During a subchapter V case, the debtor may share information with the subchapter V trustee that is privileged, which is usually protected from disclosure under the attorney/client or work-product privilege. By disclosing the information to the subchapter V trustee, the debtor, absent application of the common-interest doctrine, would lose the protective effect of the privilege. The information would then be subject to disclosure by the debtor and trustee in litigation commenced against the debtor and/or the estate. The common-interest doctrine, which "provides an exception to the general rule that an evidentiary privilege is waived when the party asserting the privilege shares the communication with a third party,"[3] might provide the debtor and trustee with a basis to withhold the privileged information disclosed to the trustee and/or his/her professionals.

This article discusses several points: (1) the appointment, role and scope of authority of the subchapter V trustee; (2) the attorney/client and work-product privileges and common-interest doctrine, in general; and (3) relationships analogous and/or akin to the subchapter V trustee and subchapter V debtor relationship in which the court, through application of the common-interest doctrine, protected from disclosure in litigation certain information that the debtor had disclosed to or shared with a third party.

Appointment, Role and Scope of Authority of the Subchapter V Trustee

The subchapter V trustee is appointed by the U.S. Trustee,[4] and if necessary, the U.S. Trustee may serve as a subchapter V trustee.[5] The trustee's duties include the following components: (1) facilitating the development of a consensual reorganization plan; (2) ensuring that the debtor commences making timely payments under its confirmed plan; (3) being accountable for all property received; (4) examining proofs of claim and objecting to the allowance of improperly asserted claims; (5) opposing the debtor's discharge, if advisable; (6) furnishing information concerning the estate and the estate's administration requested by a party in interest, unless the court orders otherwise; and (7) making a final report and filing an account of administration of the estate.[6]

Moreover, a subchapter V trustee "act[s] as a fiduciary for creditors, in lieu of an appointed creditors' committee."[7] Similar to a creditors' committee appointed under § 1102 of the Bankruptcy Code, the subchapter V trustee assists with the formulation of a reorganization plan[8] and "investigate[s] the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such busi-

1 This article represents the author's views, which should not necessarily be imputed to Simmons Legal PLLC or its respective affiliates and clients.
2 *See* 11 U.S.C. §§ 1181-1195.
3 *See, e.g., In re Infinity Bus. Grp. Inc.*, 530 B.R. 316, 322 (Bankr. D.S.C. 2015).
4 *See* 11 U.S.C. § 1183(a).
5 *Id.*
6 *See generally id.*; *see also* 11 U.S.C. § 1183(b).
7 *See, e.g., In re Ventura*, 615 B.R. 1, 13 (Bankr. E.D.N.Y. 2020) (citing 11 U.S.C. § 1183(a), (b)).
8 *See* 11 U.S.C. § 1103(c)(3).

ness, and any other matter relevant to the case or to the formulation of a plan."[9]

Furthermore, the subchapter V trustee's role, as opposed to other bankruptcy trustees, is typically nonadversarial *vis-à-vis* the debtor. For example, "the subchapter V trustee is the only trustee directed to 'facilitate the development of a consensual plan of reorganization.'"[10] A subchapter V trustee does not take on a potentially adverse position to the debtor unless the debtor is removed and the subchapter V trustee takes over management of the debtor's property and/or operations,[11] or in those instances where, upon request of a party, for cause, the subchapter V trustee is ordered to investigate the debtor's financial affairs and any other matter relevant to the formulation of a plan.[12]

The Attorney/Client and Work-Product Privileges and Common-Interest Doctrine

There are two primary privileges that the common-interest doctrine safeguards: the attorney/client privilege and work-product privilege. Moreover, Rule 501 of the Federal Rules of Evidence provides that federal common law or state law, as applicable, determines whether a party is authorized to withhold information due to application of a privilege.[13]

Generally, "a client holds a privilege to refuse to disclose, and to prevent any other person from disclosing, confidential communications between the client and the client's attorney when the communications were made to facilitate the rendition of professional and legal services to the client."[14] The work-product privilege, in contrast to the attorney/client privilege, as a rule (with some exceptions) protects from disclosure documents and tangible things prepared by a party in anticipation of litigation by or for a party to the anticipated and/or subsequently commenced litigation.[15] Bankruptcy is considered "litigation" for the purpose of asserting the privilege.[16] This privilege is governed by the uniform federal standard embodied in Rule 26(b)(3) of the Federal Rules of Civil Procedure, which is made applicable to bankruptcy cases through Rule 7026 of the Federal Rules of Bankruptcy Procedure.[17]

The attorney/client privilege is waived upon the disclosure of privileged information to third parties outside the attorney/client relationship.[18] In contrast, "[b]ecause the purpose of the work-product doctrine is to prevent disclosure of privileged documents to an adversary, the privilege is only waived when disclosure enables 'an adversary to gain access to the information.'"[19]

However, under both state and federal law, the common-interest doctrine operates as an exception to waiver of privilege by a party's disclosure of otherwise privileged information to a third party.[20] Once a party demonstrates that the information, communications and/or tangible things (hereafter referred to as "protected information") are protected by privilege, the privilege extends to the third party that received the protected information if the party seeking to withhold the information from disclosure in litigation establishes that "(1) the communication was made by separate parties in the course of a matter of common interest, (2) the communication was designed to further that effort, and (3) the privilege has not been waived."[21]

A common interest among the parties exchanging protected information typically exists in those instances in which the parties have similar legal interests, although their interests may not be in complete accord and conflict-free.[22] One court further explained that the crux of the doctrine "is not whether the parties *theoretically* share similar interests, but rather whether they demonstrate actual cooperation toward a common legal goal."[23] The privilege extends to protected information that is shared with respect to their common legal interests and only at the time their interests were in alignment.[24] The common-interest privilege does not apply to safeguard protected information relating to matters as to which the parties hold opposing interests.[25]

In addition, parties are not required to memorialize the common-interest arrangement in writing,[26] nor is participation in or commencement of litigation a requisite to application of the doctrine.[27] The common-interest privilege applies and is not waived as long as the requirements for application of the doctrine are met, and there is a "meeting of the minds" and a reasonable understanding between the parties that the protected information exchanged is to be held in confidence.[28]

Analogous Relationships Invoking Application of Common-Interest Privilege

Under § 1183(b)(7) of the Bankruptcy Code, the subchapter V trustee is tasked with the duty to facilitate the development of a consensual reorganization plan.[29] A creditors' committee and other committees appointed under § 1102 likewise may (and often do) participate in the formulation of a reorganization plan.[30] The trustee also "act[s] as a fiduciary for creditors, in lieu of an appointed creditors' committee."[31] Like a committee, the trustee provides "needed checks and balances in the reorganization process,"[32] and

9 *See* 11 U.S.C. §§ 1103(c)(2), 1183(b)(2), 1106(a)(3).
10 *See, e.g., In re 218 Jackson LLC*, 6:21-BK-00983-LVV, 2021 WL 3662377, at * 6 (Bankr. M.D. Fla. Aug. 17. 2021) (quoting 11 U.S.C. § 1183(b)(7)). *See also* Patricia Redmond & Ashley D. Champion, "Come Together: The Unique Role of Subchapter V Trustees and the Cautionary Tale of *218 Jackson*," XL *ABI Journal* 10, 12, 51-53, October 2021, *available at* abi.org/abi-journal.
11 *See* 11 U.S.C. §§ 1185 (removal of debtor in possession); 1183(b)(5) (trustee's duties upon removal of debtor).
12 *See* 11 U.S.C. § 1183(b)(2).
13 In federal proceedings, federal common law governs a claim of privilege, except "in a civil case, [where] state law governs privilege regarding a claim or defense for which state law supplies the rule of decision." *See* Fed. R. Evid. 501. *See also* Fed. R. Evid. 502(g) (generally defining attorney/client privilege and work-product protection); *In re Starkweather*, 20-10717-T7, 2021 WL 1521512, at *5 n.6 (Bankr. D.N.M. April 16, 2021) (slip copy) (explaining that "[i]n all federal question matters, including bankruptcy, courts must apply the privileges that exist under the federal common law. Some bankruptcy courts have applied a federal common-interest doctrine") (internal citations omitted).
14 *See, e.g., In re Economou*, 362 B.R. 893, 896 (Bankr. N.D. Ill. 2007).
15 *See* Fed. R. Civ. P. 26(b)(3).
16 *See In re Superior Nat. Ins. Gr.*, 518 B.R. 562, 567 (Bankr. C.D. Cal. 2014).
17 *See* Fed. R. Civ. P. 26(b)(3); Fed. R. Bankr. P. 7026.
18 *See, e.g., In re Quigley Co. Inc.*, No. 04-15739 SMB, 2009 WL 9034027, at *3 (Bankr. S.D.N.Y. April 24, 2009), *supplemented*, No. 04-15739 (SMB), 2009 WL 2913450 (Bankr. S.D.N.Y. June 19, 2009).
19 *See, e.g., Superior Nat. Ins. Gr.*, 518 B.R. at 575 (citations omitted).
20 *See, e.g., id.* at 568.
21 *See, e.g., In re Trib. Co.*, No. 08-13141 (KJC), 2011 WL 386827, at *4 (Bankr. D. Del. Feb. 3, 2011) (quoting *In re Mortg. & Realty Trust*, 212 B.R. 649, 653 (Bankr. C.D. Cal. 1997)); *In re Leslie Controls Inc.*, 437 B.R. 493, 496 (Bankr. D. Del. 2010)).
22 *Leslie Controls*, 437 B.R. at 496-97.
23 *See, e.g., N. River Ins. Co. v. Columbia Cas. Co.*, No. 90 Civ. 2518 (MJL), 1995 WL 5792, at *4 (S.D.N.Y. Jan. 5, 1995) (emphasis added).
24 *See, e.g., Leslie Controls*, 437 B.R. at 497; *In re Maxus Energy Corp.*, 617 B.R. 806, 821 (Bankr. D. Del. 2020).
25 *Id.*
26 *See, e.g., In re Cherokee Simeon Venture I LLC*, Case No. 12-12913 (KG), 2012 WL 12940975, at *2 (Bankr. D. Del. May 31, 2012).
27 *See, e.g., id.*, n.12.
28 *Id.*
29 11 U.S.C. § 1183(b)(7).
30 11 U.S.C. § 1103(c)(3).
31 *See, e.g., Ventura*, 615 B.R. at 13.
32 *Mortg. & Realty Trust*, 212 B.R. at 653 (describing committee's role, which is analogous to subchapter V trustee's role) (internal citations omitted).

"[w]ithin this context, it investigates, it appears, it negotiates, it may litigate, and it is at all times intimately involved in the reorganization."[33] Therefore, the trustee's role in a subchapter V case is most analogous to that of the role of a creditors' committee.

Given the myriad duties of a trustee that are similar to or the same as the roles and powers of a creditors' committee, the trustee's duties, by extension, must also include the common interest of ensuring maximization of the debtor's estate for all creditors. Courts have concluded on numerous occasions[34] that the common goals of formulating and confirming a plan and maximizing the debtor's estate justify application of the common-interest doctrine. The *Mortgage & Realty Trust* court explained that "[i]n order to permit the committee to carry out these duties, the debtor must be able to provide information to the committee free of the risk that the committee may be forced to disgorge such information to adverse third parties."[35] The common-interest doctrine should likewise safeguard from forced disclosure during discovery the debtor's protected information disclosed to the subchapter V trustee in furtherance of the trustee's and debtor's common goals.

In subchapter V cases, the hope is that the trustee will merely serve as a mediator and/or facilitator of a consensual orderly restructuring process. However, the court will order removal of the debtor as a debtor in possession for "cause" pursuant to § 1185 of the Bankruptcy Code. In that event, the subchapter V trustee will step into the debtor's shoes to manage business operations and the restructuring process under the authority granted to him/her under § 1183(b)(5). At that point, the trustee and his/her professionals may withhold the debtor's protected information during litigation by asserting that the common-interest doctrine applies to all exchanges of protected information between him/her and his/her professionals and the debtor prior to the debtor's removal from management. The trustee may also assert that the trustee became the holder of the debtor's privilege once the trustee took over the reins of managing the estate and business operations. This is the case because a corporation acts through its management and its agents.[36] In addition, "the trustee's role is 'most analogous to that of a solvent corporation's management,' consequently, the right to assert or waive the attorney/client privilege of the debtor corporation rests with the trustee in a bankruptcy situation."[37]

Conclusion

The question of whether the subchapter V trustee and/or debtor may successfully assert the common-interest doctrine to protect otherwise privileged information disclosed to the trustee and/or his/her professionals is an issue bound to be litigated at some point. Based on existing case law, the subchapter V trustee and debtor have legs to stand on when invoking the common-interest doctrine.

As a best practice, the debtor and subchapter V trustee should consider entering into a common-interest agreement at the outset of a subchapter V case and maintain a privilege log throughout the subchapter V case. Courts may consider the promulgation of local rules, orders and/or procedures regarding subchapter V litigation matters, including application of the common-interest doctrine. Alternatively, courts might leave it up to parties to negotiate common-interest agreements and only get involved on an *ad hoc* basis. abi

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33 *Id.*

34 *See, e.g., Superior Nat. Ins. Gr.*, 518 B.R. at 577; *In re Hardwood P-G Inc.*, 403 B.R. 445, 461 (Bankr. W.D. Tex. 2009); *In re Kaiser Steel Corp.*, 84 B.R. 202, 205 (Bankr. D. Colo. 1988). *See also Leslie Controls*, 437 B.R. at 502 (finding that debtor, *ad hoc* committee of asbestos plaintiffs and debtor's proposed future claimants' representative "shared a common interest in maximizing the asset pool").

35 *Mortg. & Realty Trust*, 212 B.R. at 653 (internal citations omitted).

36 *Hardwood P-G Inc.*, 403 B.R. at 456.

37 *Id.* at 455 (concluding that "[a]ll of the debtors' assets (including those causes of action that had been asserted on behalf of the debtor estate by the Committee) were transferred to the Litigation Trust under the sole management and control of the Trustee[, thus] the Trustee became the holder of the debtors' attorney/client privilege") (quoting *Official Comm. of Unsecured Creditors of Hechinger Inv. Co. of Del. v. Fleet Retail Fin. Grp., et al. (In re Hechinger Inv. Co. of Del.)*, 285 B.R. 601, 611 (D. Del. 2002)).