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Bankruptcy Settlements and the **Common Interest Privilege**

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This article examines whether and when the common interest privilege attaches to communications among co-proponents of a plan of reorganization under Chapter 11 of the Bankruptcy Code. Co-proponents of reorganization plans—such as an official committee of unsecured creditors (a committee) and financial institution lenders—often would be adversaries if the estate's causes of action were litigated. But once an agreement is reached to settle such claims in a negotiated plan, the former adversaries share a common interest in having the settlement approved and achieving confirmation. In the large, heavily-litigated Chapter 11 cases that have become increasingly common in recent times, months or even years can pass between the time adversaries agree in principle on a settlement and entry of an order confirming a plan of reorganization that implements the settlement. As that time period has grown, so too has the degree of coordination and communication among formerly-adverse plan co-proponents, and there is a need for clarity about whether those interactions are fair game for discovery.

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Negotiations may not be protected from discovery.

Recent decisions in the bankruptcy proceedings of LyondellBasell Industries[1] (Lyondell) and Tribune Company[2] (Tribune)—two hotly contested "mega-cases"—have addressed this issue with opposite results. In *Lyondell*, the debtors and parties that had financed Lyondell's leveraged buy-out transaction reached an agreement in principle to settle the estate's fraudulent transfer claims and other causes of action. The committee, which was not a party to the agreement, initially challenged the settlement and sought discovery concerning communications among the debtors and settling parties. Judge Robert E. Gerber of the U.S. Bankruptcy Court for the Southern District of New York held that the debtors and the settling parties remained "adverse" to one another unless and until the court approved the settlement, and that any communications among them were not privileged.[3]

In *Tribune*, Chief Judge Kevin J. Carey of the U.S. Bankruptcy Court for the District of Delaware confronted the same issue and reached a different conclusion. There, the

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debtors, the committee and a group of senior lenders had reached a mediated settlement of estate fraudulent transfer claims against the senior lenders. The settlement was first reduced to a term sheet, and later embodied in a plan of reorganization. Certain creditors challenged the settlement and sought discovery of the communications among the plan proponents. Carey denied the discovery motion and ruled that the settling parties shared a common interest and that the communications therefore were privileged.[4] Moreover, Carey held that the common interest began not when a settlement agreement or plan of reorganization had been finalized, but as early as the date the material terms of the settlement had been agreed, evidenced in that case by the date a term sheet had been filed with the court.[5]

As discussed below, the outcome of this issue may significantly influence the conduct and strategic choices of proponents of a plan of reorganization as they prepare for a contested confirmation hearing.

The Common Interest Privilege

The protections of the attorney client privilege generally are waived if the protected communications are made or shared outside the attorney-client relationship. Similarly, the protections of the attorney work product doctrine are lost by disclosures "inconsistent with the adversary system."[6] As an exception to these rules, the common interest privilege extends the protections of the attorney client privilege and work product doctrine to communications among separate clients and their separate attorneys "on matters of common legal interest, for the purpose of preparing a joint strategy."[7] It applies if "(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 was not otherwise waived."[8] A common interest can arise among clients who are or might be codefendants in litigation or from "parties who have a community of interests with respect to the subject matter of the communication."[9]

Common interest communications are privileged to the extent they would have been privileged if made within a traditional attorney-client relationship.[10] Put differently, the common interest doctrine is not an independent basis for withholding communications from discovery. It is instead an exception to the general rule that sharing confidential information outside the attorney-client relationship waives the protections of the attorney-client privilege and work product doctrine.[11] Like the traditional application of those rules, the common interest privilege "encourage[s] full and frank communication between attorneys and their clients" to achieve a common legal purpose.[12]

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Does a Common Interest Exist?

A common interest privilege only applies when the parties' interests are sufficiently aligned. The Chapter 11 reorganization process often turns adversaries into allies, as negotiations about the estate's claims lead to settlement. In both *Lyondell* and *Tribune*, the committee asserted fraudulent transfer claims and other estate causes of action against certain parties that had financed the leveraged buyouts in each case. As is increasingly common in bankruptcy proceedings of this magnitude, protracted and contentious negotiations led some (but not all) of the adverse parties to settle their disputes. In *Lyondell*, the parties negotiated a settlement agreement that was presented to the court for approval in advance of a plan of reorganization. In *Tribune*, the parties first reduced their agreement in principle to a term sheet and later incorporated the terms into a plan of reorganization. In each case, the settlement was contested and the former adversaries worked together—including on strategy and briefing—over a significant period of time to achieve approval of the settlement and plan confirmation.

In the course of challenging the settlement, the parties opposing confirmation in both cases sought discovery of the communications among the adversaries-turned-allies. The settling parties resisted production, claiming that the communications were protected by the common interest privilege because the parties were aligned in urging the court to approve the contested settlement and confirm the plan. The opponents argued that plaintiffs and defendants in lawsuits filed on the estate's behalf could not possibly share a common interest sufficient to prevent discovery. After considering the privilege claims, the *Lyondell* and *Tribune* courts reached opposite conclusions.

In *Lyondell*, Gerber held that communications among the settling parties were not protected by the common interest privilege.[13] He reasoned that until the settlement was approved after a Rule 9019 hearing, "the estate…and the financing party defendants are adverse" and therefore did not share a common legal interest.[14] Gerber stated that the common effort to approve a settlement was not the sort of common legal interest protected by the privilege doctrine, but instead reflected "private commercial objectives."[15] Gerber specifically dismissed "concerns in protecting communications between people who were and still are legally adverse who have decided to settle a controversy if [the settlement is approved], but who will once more be in an adversarial position" if it is not.[16]

By contrast, in *Tribune*, Carey ruled that certain communications among the debtors, the committee and the senior lenders were protected from disclosure since the parties shared a common interest in seeking approval of the settlement.[17] Analogizing to cases finding a common interest among parties engaged in a merger negotiation,[18] Carey held that the settling parties "share the common legal interest of obtaining approval of their settlement and confirmation of the… Plan, thereby resolving the legal disputes between and among them."[19]

One difference between *Lyondell* and *Tribune* is the procedural approach the parties took to gain approval of their respective settlements. In *Lyondell*, the parties did not reduce their agreement to a term sheet, nor did they embody the settlement in a plan of reorganization. Instead, the parties exchanged drafts of a settlement agreement, which ultimately became the document submitted to the court for approval. From the perspective of the court, the lack of a term sheet or at least a joint effort in support of a plan may have been insufficient evidence of a definitive agreement among the parties. By

contrast, in *Tribune*, the parties immediately reduced their agreement to a term sheet, which the court held contained the "material terms" of the agreement. Even though the term sheet was not formally binding, the court appears to have found the term sheet to be sufficient evidence that the parties had agreed to settle their differences. The parties' subsequent work to encompass the fully developed settlement in a plan of reorganization served as further confirmation of the common interest.

When Does Common Interest Attach?

In addition to determining that a common interest exists among formerly-adverse plan co-proponents, Carey also addressed the question of when the privilege attaches.

The debtors, committee, and senior lenders argued that they shared a common interest beginning on the date they reached an agreement in principle and resolved to become proponents of a common plan of reorganization, and that any communications thereafter were not discoverable. This occurred, they said, on the date the court-appointed mediator filed a term sheet with the court containing all of the material terms of the settlement notwithstanding the fact that the parties continued to negotiate for months about specific provisions of the settlement and the plan of reorganization. The parties opposed to the settlement, citing Gerber's decision in *Lyondell*, argued that the common interest period could begin no earlier than the date that the final plan of reorganization was filed with the court since the parties remained adverse to one another unless and until the settlement was approved, and no formal, written settlement agreement had been signed and negotiations were still underway over various provisions.

Carey sided with the plan co-proponents, concluding that the mediator's term sheets evidenced agreement on the "material terms of [the] settlement" even though negotiations continued and certain terms changed.[20] He stated that after the material terms had been agreed, "it is reasonable to conclude that the parties might share privileged information in furtherance of their common interest of obtaining approval of the settlement through confirmation of the plan."[21]

This decision makes good sense. Before the settlement's material terms are agreed upon, the parties are truly and completely adverse. Each seeks to take as large a piece of the pie as possible in negotiations and this adversity overwhelms any potentially common cause between the parties. Once the material terms are agreed, however, the parties have an overarching common interest in having their settlement approved and a reorganization plan embodying it confirmed. Although they may disagree on particular matters, the nature and magnitude of those disagreements pales in comparison to the overwhelming common endeavor of securing plan confirmation. In *Tribune*, the parties' central difference was about the point at which that occurred.

Implications

Whether communications among formerly adverse plan co-proponents are protected by the common interest privilege can have significant implications in the context of complex Chapter 11 reorganization cases. Without the protections of the common interest privilege, communications among plan co-proponents that have settled their differences—and who are trying to work together to achieve approval of the settlement and confirmation of a plan—would be available for discovery by those opposing the settlement or the plan. These communications could include sensitive materials such as drafts of the settlement agreement or plan, communications among clients and counsel related to the confirmation process itself, emails about confirmation hearing strategy and even early drafts of briefs of confirmation-related pleadings. Indeed, Gerber himself agreed that communications of this type were discoverable absent a common interest privilege.[22] If opponents to a settlement or plan are permitted to obtain such materials, the process of coordinating the defense of a settlement and jointly advocating for a plan of reorganization would become much more difficult.

On balance, the *Tribune* decision can be viewed as more consonant with the policy goal of fostering consensual resolutions in bankruptcy.[23] Given that bankruptcy cases today are larger than ever before, involve a greater number of stakeholders and have become increasingly litigious, the need to allow former adversaries as much flexibility as possible to settle and coordinate with one another is particularly acute.

Given the uncertain state of the law, parties seeking to use the common interest privilege to protect communications among formerly-adverse plan co-proponents from discovery should take care to establish a record of when agreement on the material terms of any settlement occurs. The *Tribune* decision counsels in favor of reducing any agreement to a term sheet in the first instance. It may also be helpful for the parties to enter into a formal common interest agreement with one another. It is less clear whether a court will find meaningful the procedural distinction of seeking approval of the settlement in the context of a settlement agreement pursuant to Rule 9019 of the Bankruptcy Code, or in a settlement that is woven into a plan of reorganization itself.

Until there is more clarity on this issue from the courts, settling adversaries would do well to proceed with caution and be mindful that their communications may not be protected from discovery unless and until a court approves their settlement.

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1. Transcript of Jan. 7, 2010 Tel. Conf., *In re Lyondell Chemical*, No. 09-10023 (REG) (S.D.N.Y.) [*Lyondell,* Jan. 7, 2010 Transcript].
2. *In re Tribune*, No. 08-13141 (KJC), 2011 Bankr. LEXIS 299 (Bankr. D. Del. Feb. 3, 2011).
3. *Lyondell,* Jan. 7, 2010 Transcript at 15.
4. *Tribune*, 2011 Bankr. LEXIS 299 at *16.
5. Id. at *17-18.
6. 2 Edna Selan Epstein, *The Attorney-Client Privilege and the Work-Product Doctrine* 1030 (5th ed. 2007).
7. Paul R. Rice, *Attorney-Client Privilege in the United States* §4:35 (2012 ed.).
8. *Tribune*, 2011 Bankr. LEXIS 299, at *14 (quoting *In re Mortg. & Realty Trust*, 212 B.R. 649, 653 (Bankr. C.D. Cal. 1997)).
9. Paul R. Rice, *Attorney-Client Privilege in the United States* §4:35 (2012 ed.).
10. Id.
11. Id.
12. *Upjohn v. United States*, 449 U.S. 383, 389 (1981).
13. *Lyondell,* Jan. 7, 2010 Transcript at 15.
14. Id.
15. Id.
16. Id. at 78.
17. *Tribune*, 2011 Bankr. LEXIS 299, at *17-18.
18. See *In re Teleglobe Commc'n*, 493 F.2d 345, 364 (3d Cir. 2007); *La. Mun. Police Emp. Ret. Sys. v. Sealed Air.*, 253 F.R.D. 300, 310 (D.N.J. 2008).
19. *Tribune*, 2011 Bankr. LEXIS 299, at *15.
20. Id. at *18.
21. Id. at *17-18.
22. *Lyondell,* Jan. 7, 2010 Transcript at 77 ("I am not of a mind to require copying the Creditors' Committee on any communication that goes back and forth between the debtors and the financing party defendants, but I do not believe that there is anything inherently privileged…that would protect any such communication").
23. See *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*, 390 U.S. 414, 424 (1968).