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American Bankruptcy Institute
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Understanding the Common Interest Doctrine

By: David M. Hillman, Stephanie Blattmachr, and Frank Olander[1]

Introduction

The attorney-client privilege protects communications between attorneys and their clients, and the work product doctrine protects documents prepared by attorneys in anticipation of litigation. Generally, a party that shares otherwise privileged communications with a third-party is deemed to have waived the privilege, and is precluded from claiming that the communications were intended to be confidential. The common interest doctrine protects the disclosure of otherwise privileged communications and documents where the parties share a common a legal interest.

What is a "Common Legal Interest"?

As an initial matter, it is important to remember that the common interest doctrine is not a free-standing privilege. Rather, it is an exception to the general rule that disclosure of privileged communications to a third-party constitutes a waiver of privilege. *Shamis v. Ambassador Factors, Corp.*, 34 F. Supp. 2d 879, 893 (S.D.N.Y. 1999) ("The 'common interest' rule is a limited exception to the general rule that the attorney-client privilege is waived when a protected communication is disclosed to a third party outside the attorney-client relationship."). As such,

[1] David M. Hillman is a partner in the Business Reorganization group at Schulte Roth & Zabel LLP. Stephanie Blattmachr is an associate in that group. Frank Olander is an associate in the Litigation group at Schulte Roth & Zabel LLP.

invocation of the common interest doctrine necessarily relies upon an underlying attorney-client or work product privilege. *See Sokol v. Wyeth*, No. 07 Civ. 8442 (SHS)(KNF), 2008 WL 3166662, at *5 (S.D.N.Y. Aug. 4, 2008) ("If a communication is not protected by the attorney-client privilege or the attorney work product doctrine, the common interest privilege does not apply.").

The common interest doctrine protects, at minimum, communications made *between attorneys* when the clients share "a common legal interest." *In re Teleglobe Corp.*, 493 F.3d 345, 364 (3d Cir. 2007). The logic underlying the common interest doctrine suggests that the doctrine should apply with equal force to communications among clients in the absence of an attorney, and courts have generally embraced this reasoning. *See Gucci Am., Inc. v. Gucci*, No. 07 Civ. 6820 (RMB)(JCF) (S.D.N.Y. Dec. 15, 2008) (noting that where "information that is otherwise privileged is shared between parties that have a common legal interest, the privilege is not forfeited even though no attorney either creates or receives that communication"); *In re Tribune Co.*, No 08-13141 (KJC), 2011 WL 386827, at *5-6 (Bankr. D. Del. Feb. 3, 2011) (noting that limitation of common interest to attorney-prepared communications is "too restrictive" and holding that proper inquiry is "whether the subject matter of the communication at issue would be protected by the attorney-client or work product privilege but for its disclosure to a party with the common interest")[2]; *Reginald Martin Agency, Inc. v. Conseco Med. Ins. Co.*, 460 F.Supp.2d 915, 919 (S.D. Ind. 2006) (common-interest doctrine may prevent waiver of otherwise attorney-client privileged communications among plaintiffs even when counsel was not present).

The existence of a "common legal interest" is highly fact-specific and there are no bright-line rules. In fact, one court has described the state of the law on this issue as "unsettled." *Leader Tech., Inc. v. Facebook, Inc.*, No. 08-862-JJF, 2010 WL 2545960, at *2 (D.Del. June 24, 2010). The common legal interest shared by the parties need not be identical, but it must be "substantially similar." *In re Teleglobe*, 493 F.3d at 365; *see also Andritz Sprout-Bauer v. Beazer East, Inc.*, 174 F.R.D. 609, 634 (M.D. Pa. 1997) ("The interests of the parties need not be identical, and may even be adverse in some respects.").

<u>Is Actual and Threatened Litigation Required</u>?

A common legal interest does not require pending or anticipated litigation, although that is the most common scenario in which the common interest privilege has been found to exist because the anticipation of litigation against a common adversary makes it relatively easy to demonstrate a common legal interest. *See U.S.*

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[2] The *Tribune* decision also rejected a common misreading of *dicta* in *In re Teleglobe Commc'ns Corp*, 493 F.3d 345 (3d Cir. 2007), which suggested that the common interest doctrine applied only to communications between attorneys. As *Tribune* noted, the Third Circuit's formulation of the common interest doctrine came in the context of its interpretation of Delaware Rule of Evidence 502(b)(3) and was not intended to be a general statement of law. *See Tribune*, 2011 WL 386827, at *6 n.15. Indeed, the Third Circuit's interpretation of Delaware Rule of Evidence 502(b)(3) has been rejected by subsequent Delaware decisions. *See, e.g.*, *Rembrandt Techs., L.P. v. Harris Corp.*, C.A. No. 07C-09-059-JRS, 2009 WL 402332, at *8 (Del. Super. Ct. Feb. 12, 2009).

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v. Schwimmer, 892 F.2d 237, 244 (2d Cir. 1989) (it is "unnecessary that there be actual litigation in progress for the common interest rule of the attorney-client privilege to apply."); *see also Russo v. Cabot Corp.*, No. Civ. A. 01-2613, 2001 WL 34371702, at *2 (E.D.Pa. Oct. 26, 2001); *Ambac Assurance Corp., et al. v Countrywide Home Loans, Inc.*, et al., 998 N.Y.S. 2d 329 (1st Dep't 2014).

Can Common Interest Privilege Apply in a Transactional Context?

Because the common interest privilege applies to a common legal interest among the clients rather than a common business interest, parties on opposite sides of a business deal can still enjoy the benefits of the common interest privilege. But, communications between parties that share a predominately business, as opposed to legal, interest are not protected by the common interest doctrine. *See Bank Brussels Lambert v. Credit Lyonnais (Suisse) S.A.*, 160 F.R.D. 437, 447-48 (S.D.N.Y. 1995) ("The common-interest doctrine does not encompass a joint business strategy which happens to include as one of its elements a concern about litigation."); *see also Corning Inc. v. SRU Biosystems, LLC*, 223 F.R.D. 189, 190 (D. Del. 2004) (holding that communications made during negotiations between two corporations were not privileged because they were made for the purpose of persuading one corporation to invest in the other); *TIFD III-E Inc. v. U.S.*, 223 F.R.D. 47, 50 (D. Conn. 2004) (holding that communications shared between parties entering into a transaction to form partnership were not covered by common interest privilege because they were exchanged to work toward a business goal, not a legal goal); *In re FTC*, No. M18-304, 2001 WL 396522, at *5 (S.D.N.Y. Apr. 19, 2001) (holding that disclosure of pharmaceutical company's counsel's legal opinion regarding compliance of a proposed advertisement with applicable regulations in context of negotiations with advertising firm was not protected by common interest privilege because the legal interest the parties shared was ancillary to the business relationship); *Katz v. AT&T Corp.*, 191 F.R.D. 433, 438 (E.D. Pa. 2000) (affirming order compelling patent licensing company to disclose documents relating to negotiations of sublicensing agreement); *SCM Corp. v. Xerox Corp.*, 70 F.R.D. 508, (D. Conn. 1976) (holding that disclosure of legal advice regarding antitrust liability during negotiations between parties to joint venture was not protected by common interest doctrine); *but see Schaeffler v. U.S.*, 806 F.3d 34 (2d Cir. 2015) (holding that common interest doctrine protected tax treatment analyses prepared for a client company and shared with a consortium of lenders in the context of a corporate refinancing and restructuring transaction because the lenders shared a common legal interest in the tax treatment of the transaction and certain documents had been prepared in anticipation of litigation); *Hewlett-Packard Co. v. Bausch & Lomb Inc.*, 115 F.R.D. 308, 309 (N.D. Cal. 1987) (holding disclosure of legal opinion letter regarding the validity and possible infringement of a patent was covered by the common interest privilege, even where one reason for sharing was to persuade the prospective buyer, where buyer and seller faced likelihood of joint litigation over the patent).

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The best way to understand these cases is to recall that, in the context of a single attorney-client relationship, business discussions are not protected whereas legal discussions are. This same distinction applies in the context of the common interest doctrine. If the parties' common interest is business related, then the common interest doctrine does not protect communications among the parties and their attorneys. Conversely, if the common interest is legal, then the common interest doctrine will protect communications among the clients. Thus, where the parties' common interest is to accomplish a transaction for business purposes, even where there are ancillary legal issues, the common interest doctrine does not protect communications among the parties.

<u>Can Common Interest Privilege Apply in Plan Confirmation Context?</u>

The common interest privilege may apply to communications among proponents of a plan of reorganization under Chapter 11 of the Bankruptcy Code. Such plan proponents could include parties – secured lenders and/or the committee of unsecured creditors seeking to negotiate and settle certain claims with the debtors pursuant to a plan – who otherwise may be adversaries if such claims were litigated.

Courts are split on the issue of whether the common interest doctrine protects communications among the plan proponents, but the weight of authority suggests that such communications are protected. *See, e.g.*, *In re Quigley Co.*, No. 04-15739 (SMB), 2009 WL 9034027, at *4 (Bankr. S.D.N.Y. Apr. 14, 2009) (holding that

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common interest doctrine protected communications between debtor and non-debtor parent corporation because "they share a common interest and overall strategy geared toward the confirmation of [debtor's] plan"); *Nat'l Union Firs Ins. Co. of Pittsburgh, Pa. v. Porter Hayden Co.*, No. CCB-03-3408, 2012 WL 4378160, at *2 (D. Md. Sept. 24, 2012) (holding that communications among debtor, committee and future claimants' representative regarding plan of reorganization related to matters of common legal interest, including "win[ning] court approval of the resulting plan"); *In re Tribune*, 2011 WL 386827 (Bankr. D. Del. Feb. 3, 2011) (holding that communications among the debtors, creditors committee and lenders sought by certain creditors were protected because the parties shared a common legal interest in seeking approval of settlement in a plan); *see also Longview Power, LLC et al. v. First American Title Ins. Co.*, No. 14-50369 (BLS) at *4 (Bankr. D. Del. Dec. 10, 2014 Letter Ruling) (finding that communications among debtors, agents, certain back-stop parties and their attorneys sought by title insurance company were protected by the common interest doctrine because the parties shared a common legal strategy with respect to the plan, assignment agreement and title policy and were "working towards a common end goal of developing and confirming a plan of reorganization."); *but see In re Lyondell Chemical*, No. 09-10023 (REG) (S.D.N.Y. Jan. 7, 2010 Transcript) (holding that communications among debtors and settling fraudulent transfer parties sought by the creditors' committee were not protected by the common interest privilege because court had not yet approved the settlement and settlement was outside the plan confirmation context).

<u>When Does the Common Interest Privilege Take Effect?</u>

Where adversaries have become allies, a common interest privilege may apply to their communications at such time a court determines that the parties shared a common legal interest. *See Lyondell*, Jan. 7, 2010 Transcript at 15 (holding that debtors and financing party defendants did not share a common legal interest because they were adverse until such time as the court approved the settlement); *Tribune*, 2011 WL 386827, at *18 (finding common interest privilege attached to communications after court filing of term sheet setting forth material terms of agreement among parties); *see also In re Leslie Controls*, 437 B.R. 493 (Bankr. D. Del. 2010) (holding common interest privilege attached to communications among debtor, committee and future claimants' representative because they shared common legal interest in maximizing the size of the asset pool, including any of the debtor's insurance proceeds, against the insurers, their "common enemy," that sought to compel discovery); *In re Almatis B.V.*, No. 10-12308, 2010 Bankr. LEXIS 6377 at *5 (Bankr. S.D.N.Y. June 21, 2010) (holding that common interest privilege arose among debtors, lenders and committee upon execution of plan support agreement).

Must There be a Written Agreement?

There is no requirement that the parties have a final, formal agreement to advance a particular legal interest, but such an agreement or similar markers aid in proof. *See Hunton & Williams v. U.S. Dep't of Justice*, 590 F.3d 272, 282 (4th Cir. 2010) (agreement explained parties' shared interest in limiting scope of any injunction in pending litigation, and clearly manifested agreement to work together toward that end); *Katz v. AT&T Corp.*, 191 F.R.D. 433, 437-38 (E.D.Pa. 2000); *Tribune*, 2011 WL 386827, at *18 (term sheet sufficient evidence that parties were no longer adverse); *Longview Power, LLC et al. v. First American Title Ins. Co.*, No. 14-50369 (BLS) at *4 (Bankr. D. Del. Dec. 10, 2014 Letter Ruling) (finding "common interest" markers on communications when sent indicative of parties' intent at the time communication were made and supported argument that the parties were developing a common legal strategy).

Who Has the Burden of Proof?

The party asserting the common interest privilege has the burden of establishing the underlying privilege. *See U.S. v. Schwimmer*, 892 F.2d 237, 244 (2d Cir. 1989).

Conclusion

While there are no bright line rules, parties who intend to assert the protection of the common interest doctrine should keep in mind the following:

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- An underlying privilege must be established, i.e., attorney-client privilege and/or work product doctrine, and not waived
- Parties must share a common legal, not just business, interest
- Written evidence, i.e., marking communications and documents or written agreement, may support a finding of common interest privilege

A form common interest agreement is attached for reference.

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COMMON INTEREST AGREEMENT

This Common Interest Agreement (the "Agreement") between and among the undersigned (i) counsel acting for, on behalf of, and with the authority of the Official Committee of Unsecured Creditors (the "Committee") of XXX (the "Debtors"), in Chapter 11 Case No. XXX, pending in the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Case") and (ii) counsel acting for and on behalf of XXX (the "Petitioning Creditors") (with the foregoing referred to herein individually as a "Party" and collectively as the "Parties") is made as of XXX (the "Effective Date").

R E C I T A L S

A. The Parties are each parties-in-interest in the Bankruptcy Case.

B. The undersigned counsel and their clients as identified above share common legal interests with respect to and in connection with, among other matters, the pursuit and defense of the Parties' legal rights in connection with the actions captioned XXX (the "Adversary Proceedings" and, together with the Bankruptcy Case, the "Common Legal Interest") and have concluded independently that it is in the mutual, common and best interest of the Parties to cooperate with one another and share information in confidence to the extent permitted by law to preserve, protect and advance that mutuality of interest.

C. Notwithstanding Paragraph B above, nothing herein shall and nothing herein shall be interpreted to define or limit the Committee in its role as a fiduciary for the interests of unsecured creditors of the estate.

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D. There are, and it is likely that there will continue to be, legal and factual issues concerning the Adversary Proceedings that are of common interest to each client in the evaluation, preparation, pursuit and maintenance of their respective claims, defenses or potential common claims and defenses relating to the Adversary Proceedings.

E. The Parties and their respective Counsel and/or Representatives have shared and exchanged, and wish to ensure that they are free to continue sharing and exchanging, information on a confidential basis that may be useful to each of the Parties in the preparation of their claims or potential claims, and any common claims or potential claims, without waiving the protections of the attorney-client privilege, work product doctrine, joint defense privilege, or any other applicable privilege or protection from discovery or disclosure.

F. The Parties desire to engage in certain ongoing allied and joint efforts in connection with the Common Legal Interest and related matters in an efficient and comprehensive manner consistent with applicable law.

G. To facilitate cooperation among the Parties, the Parties may determine, in their respective sole discretion and in furtherance of their individual and common interests, to share documents, information, factual materials, mental impressions, memoranda, interviews, research, correspondence, and communications, whether oral, written, electronic, or otherwise, concerning the Common Legal Interest and related matters (the "Common Interest Materials").

H. The Parties believe that it is in their mutual best interests to disclose (as is deemed appropriate by the Parties) Common Interest Materials to each other (including their outside legal, financial, and other professionals) to enable the Parties to pursue and defend positions in the Bankruptcy Case and Adversary Proceedings without losing any privilege or protection attaching to any Common Interest Materials on account of the disclosure thereof pursuant to this Agreement. Without limiting the generality of the foregoing, the Parties wish to pursue their common interests, including the sharing among the Parties of Common Interest Materials, without the Parties or their counsel waiving any protection, immunity, or privilege, including, but not limited to, the attorney-client privilege, the common interest privilege, and the work product immunity.

I. Without waiver of the existing confidentiality and privileges attendant thereto, the Parties enter into this Agreement to formalize and memorialize the privileged and confidential nature of their shared communications. The Parties intend that this Agreement protect from disclosure the Common Interest Materials, which include, without limitation, communications, documents, and other information shared among the Parties, their counsel, members, or employees of their counsel's respective law firms, and financial and other professionals, to the greatest extent permitted by law. The Parties further intend that any such information, whether written, oral, or in any other form, shared between or among them or their respective representatives with respect to the Common Legal Interest remain protected from disclosure to the maximum extent allowed by law.

J. Based upon the foregoing, and subject to the provisions of this Agreement, the Parties intend that any and all sharing of information pursuant to and prior to entry into this Agreement will be protected pursuant to the "common interest" doctrine to the fullest extent such protection is available under applicable law. For the avoidance of doubt, references herein to any of the Parties shall be deemed to include the applicable Party's or Parties' clients, experts, advisors, agents, and professionals unless the context requires otherwise.

WHEREFORE, the Parties agree as follows:

A G R E E M E N T

1. The preceding recitals are true and correct and are incorporated into this Agreement by this reference.

2. Common Interest Materials may be exchanged between the Parties to this Agreement directly or between counsel (including employees of their respective law firms) executing this Agreement on the Parties' behalf. Counsel receiving Common Interest Materials may share such information with their clients, pursuant to the terms hereof.

3. Common Interest Materials shall be used solely to facilitate the common pursuit of the Parties' interests in connection with the Common Legal Interest and any related matters. Common Interest Materials shall not be used for other business purposes or in any manner adverse to the interest of any Party hereto.

4. All written Common Interest Materials shall, where practical, be transmitted from counsel to counsel and may, where practical, be clearly marked with one or more of the following legends: "Privileged and Confidential," "Common Interest Materials," "Joint Interest Materials," or any other legend sufficient to identify the intent to have such information treated as confidential Common Interest Materials. Failure to follow any of the procedures of this paragraph, however, shall not constitute a waiver of any applicable privilege or protection as against any third parties, including, without limitation, the common interest privilege.

5. Any Party producing materials or information under this Agreement may, in its sole discretion, place additional restrictions on the use or dissemination of its own Common Interest

Materials. For example, if a Client wishes to limit disclosure of Common Interest Materials solely to outside Counsel, may do so by designating such materials "Outside Counsel Only." If materials are provided in writing, then such designation must be made by affixing the words "Outside Counsel Only" on the writing or on the transmission including such materials. The use of such designations shall be done in a manner so as to minimize the opportunity for inadvertent disclosure, and shall not in any way affect the validity of this Agreement, the application of its terms, or the rights and obligations of the Parties and Counsel set forth herein.

6. It is the express intent of the Parties that, by exchanging confidential Common Interest Materials, none of them waive (or be deemed to have waived) any attorney-client privilege, work product protection, protections afforded under the common interest and/or joint defense or joint prosecution doctrines, or any other relevant privilege, immunity, or protection (including under any existing non-disclosure agreements) that might be applicable to such materials. The Parties believe that such exchanges of information are within the ambit of, and enter into this Agreement pursuant to, any and all applicable attorney-client privilege doctrines, common interest privilege, joint defense privilege, or similar protections (whether arising under Federal and/or applicable state law and procedure). No Party will be estopped from arguing that the attorney-client privilege, work product protection, protections afforded under the common interest and/or joint defense or joint prosecution doctrines, or any other relevant privilege, immunity, or protection does not apply to the materials so exchanged, provided, however, that each party shall treat Common Interest Materials provided by each other Party as subject to such privilege, immunity and protection unless and until a court of competent jurisdiction determines otherwise, and no challenge shall be made to such privilege, immunity or protection, unless and until the materials are called for pursuant to applicable procedural rules and are withheld on the

grounds of a privilege, immunity and/or protection.

7. Each Party may communicate and share Common Interest Materials with the other Party hereto to the extent such Party determines to do so in its respective sole discretion, and no Party shall be obligated to share any Common Interest Materials with the other Party. Except as provided herein, each Party agrees that Common Interest Materials received from the other Party pursuant to terms of this Agreement shall be held in strict confidence. The sharing or disclosure of Common Interest Materials between the Parties hereunder will not diminish in any way the confidentiality of such materials and will not constitute a waiver of any available privilege, immunity, or protection. Each of the Parties agrees that it will not assert that the other Party's disclosure of Common Interest Materials pursuant to this Agreement constitutes a waiver of any such privilege, immunity, or protection.

8. The Parties agree that all Common Interest Materials provided by a Party to the other Party prior to the execution of this Agreement or the Effective Date were provided in furtherance of the Parties' common interests and that the Common Interest Materials so provided are subject to this Agreement.

9. Either Party may withdraw from this Agreement at any time by giving written notice to the other Party as provided herein. Such withdrawal shall take effect upon receipt of such notice by the other Party. The obligations of the Parties not to disclose Common Interest Materials, except in accordance with this Agreement, shall remain in effect as to any Common Interest Materials received and shall not be affected by a Party's withdrawal from this Agreement or by the termination of this Agreement.

10. No Party receiving Common Interest Materials hereunder shall disclose such

materials to any person or entity without the consent of the Party that furnished such materials; provided, however, that nothing herein shall prohibit disclosure by any Party to: (i) its counsel, or by counsel to an employee of counsel's law firm or to experts and consultants whose receipt of such materials is necessary or beneficial to further the representation of the Party receiving the information; and (ii) a regulatory or law enforcement authority to the extent disclosure is required by law or requested by the applicable regulatory authority pursuant to binding and valid process; provided, however, that nothing in such disclosure shall be deemed or construed to constitute a waiver of any applicable protection or privilege with respect to such Common Interest Materials.

11. The restrictions on the use or disclosure of Common Interest Materials shall not apply to information from a Party: (i) that is independently developed by the other Party or lawfully received or known by the other Party from another source without breach of this Agreement or without restriction under, or violation of, another confidentiality agreement; or (ii) that is or becomes generally available to the public without breach of this Agreement by any Party; or (iii) that, at the time of disclosure, was known to the recipient Party as shown by the recipient Party's pre-existing written records.

12. Any counsel, expert, consultant, or other person who is furnished Common Interest Materials shall be subject to the terms of this Agreement. The Party furnishing such Common Interest Materials to counsel, an expert, a consultant, or other person shall be obligated to advise such recipient of the terms of this Agreement and to secure such recipient's acknowledgement of his, her, or its obligations hereunder.

13. Nothing in this Agreement shall be construed to affect the separate and independent representation of each Party by its respective counsel or fiduciary. Nothing in this Agreement

shall create or be deemed to have created an attorney-client or fiduciary relationship between a Party's counsel and another Party or between the Parties. Entry into this Agreement and the sharing of Common Interest Materials or any other materials or information hereunder shall not be a basis for disqualification of any Party's counsel, agent, consultant, or other professional.

14. Except as otherwise may be provided by applicable law or ethical standards, in the event that either or any of the Parties hereto become a witness who may be called upon to provide evidence concerning the other Party hereto, or in any way undertakes any act or position that may be construed to be adverse to such other Party (including, but not limited to, appearance as a witness adverse to the other Party hereto), nothing in this Agreement shall be deemed to create a conflict of interest so as to require the disqualifications of any counsel. Except as otherwise may be provided by applicable law or ethical standards, no counsel for either of the Parties hereto shall be disqualified from examining or cross-examining any Party hereto who testifies in any proceeding because of such counsel's participation in this Agreement or access to Common Interest Materials, provided, however, that counsel may not use Common Interest Material against the other Party.

15. Nothing in this Agreement limits, modifies, or otherwise diminishes the rights of the Parties under applicable law to seek, pursuant to applicable procedural rules, any information or documents from the other Party that such other Party does not voluntarily produce. By entering into the Agreement, no party undertakes any responsibility or legal obligation to exchange Common Interest Materials.

16. Any unintentional or inadvertent waiver of any privilege or immunity applicable to any Common Interest Materials by any Party (or personnel employed by such Party) shall not constitute a waiver of such privilege, protection, or immunity by any other Party, each of which

reserves the right to object to the discovery and/or admissibility of any Common Interest Materials protected by any applicable privilege, protection, or immunity. Upon the discovery of the inadvertent or unintentional production of Common Interest Materials, the Parties shall cooperate to restore the confidentiality, privilege, or immunity to that disclosed material, including, without limitation, and to the extent practicable, retrieval of all copies of such inadvertently or unintentionally disclosed Common Interest Materials.

17. This Agreement is not intended to and shall not be construed to require, prevent or otherwise affect the ability of any Client to settle or decline to settle any claim or defense. However, the Clients agree not to enter into any settlement or other agreement that would require or permit the disclosure of protected Common Interest Materials received from another Client or such other Client's Counsel under this Agreement without first obtaining the written consent of such other Client.

18. The Clients and their Counsel shall maintain the confidentiality of this Agreement to the same extent as Common Interest Materials, and no Client or its Counsel shall disclose the existence or any terms of this Agreement without the prior consent of the other Clients or their Counsel, except to the extent that there is a legal obligation to do so, to the extent necessary to object to a demand by a third party for Common Interest Materials, or to the extent necessary to enforce its terms or to protect the disclosure and confidentiality of the Common Interest Materials.

19. The Parties agree from time to time to do and perform such other and further acts and to execute and deliver any and all such other instruments as may be required by law or reasonably requested by the other Party to establish, maintain, and protect the rights and remedies of the Parties under this Agreement, and to carry out and effect the intent and purpose

of this Agreement.

20. This Agreement may be amended from time to time for any reason. No supplement, modification, amendment, or waiver of any provision of this Agreement shall be binding unless executed in writing by the Parties or the Counsel hereto. No waiver of any provision of this Agreement shall be deemed or shall constitute a waiver of any other provision hereof (whether or not similar), nor shall any waiver constitute a continuing waiver.

21. This Agreement: (i) constitutes the entire agreement and supersedes all other prior and contemporaneous agreements and undertakings, both written and oral, between the Parties hereto with regard to the subject matter hereof; (ii) is not intended to confer upon any person who is not a Party any rights or remedies hereunder or with respect to the subject matter hereof except as specifically provided for in this Agreement; and (iii) shall not be assigned by operation of law or otherwise.

22. Any Party adversely affected by any breach of this Agreement shall be entitled to equitable relief, including injunction and specific performance, in addition to all other remedies available at law or in equity. It is further understood and agreed that no failure or delay by any Party with respect to rights and obligations set forth herein will operate as a waiver thereof, nor will any single or partial exercise thereof preclude any other or future exercise thereof or the exercise of any right, power or privilege hereunder. Provided, however, nothing in this Agreement shall or shall be construed to confer any rights upon any entity or person that is not a signatory to this Agreement.

23. This Agreement shall be deemed to have been drafted jointly by the Parties, and shall be neutrally construed without regard to whether any particular provision shall have in fact

been drafted by one of the Parties.

24. Any attorney signing this Agreement represents that he or she has the authority to act as agent for, and to bind, his or her client to the terms of the Agreement

25. In the event that any provision(s) of this Agreement shall be held by any court of competent jurisdiction to be illegal, void, or unenforceable generally or in any particular jurisdiction, such provision(s) shall be reformed if possible in a manner so as to accomplish the objectives of the Parties as stated in this Agreement, or if such reformation is not possible, such provision(s) shall have no force or effect, but the illegality or unenforceability of such provision(s) shall neither affect nor impair the enforceability of any other provision of this Agreement. The reformation and severance of such provision in one jurisdiction shall not affect the terms of this Agreement in any other jurisdiction.

26. This Agreement may be executed in counterparts with the same force and effect as if executed by the Parties in one complete document. Facsimile signatures shall be deemed original signatures for the purpose of the execution of this Agreement.

27. This Agreement shall be binding not only on the Parties and their employees, agents, consultants, and experts as receive Common Interest Materials, but also on their successors and assigns, affiliates, members, and constituencies.

28. Any notices required under this Agreement shall be sent by (i) facsimile, overnight courier, or personal delivery, and (ii) email, and shall be deemed effective upon receipt of such notice (as attested to by an appropriate actual or electronically generated receipt), and shall be addressed to the following:

If to the Committee:

XXX

If to the Petitioning Creditors:

XXX

29. This Agreement shall be construed in accordance with and governed by New York law, as applicable to agreements wholly performed within said state, and without regard to choice of law principles.

30. This Agreement memorializes the understandings and relationship of the Parties hereto with respect to the disclosure of Common Interest Materials as herein set forth. Accordingly, the Parties Agree that this Agreement covers any oral or written communications that they may have had prior to the execution of this Agreement which otherwise constitute Common Interest Materials.

WHEREFORE, the Parties, through their undersigned counsel, do execute this Agreement as of the Effective Date.

DERIVATIVE STANDING TO PROSECUTE ESTATE CLAIMS IN CHAPTER 11 CASES

By Philip Bentley and Hon. Melanie L. Cyganowski (Ret.)[1]

I. Derivative Actions Brought by a Creditors' Committee

The Bankruptcy Code is silent as to whether a creditors' committee may bring a derivative action on behalf of the debtor's estate. 11 U.S.C. § 1103(c)(5) permits a creditors' committee to "perform such other services as are in the interest of those represented," and 11 U.S.C. §1109(b) provides: "A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."

Three decisions of the Court of Appeals for the Second Circuit collectively form the "*STN Trilogy,*" and establish "the foundation for committees to acquire derivative standing to press claims on behalf of debtors' estates …." *Official Comm. of Equity Sec. Holders v. Adelphia Communs. Corp. (In re Adelphia Communs. Corp.)*, 371 B.R. 660, 666 (S.D.N.Y. 2007), *affirmed* 544 F.3d 420 (2d Cir. 2008). These three cases are:

- *Unsecured Creditors Comm. v. Noyes (In re STN Enters.)*, 779 F.2d 901 (2d Cir. 1985), remanded, 73 B.R. 470 (Bankr. D. Vt. 1987);
- *Commodore Int'l v. Gould (In re Commodore Int'l Ltd.)*, 262 F.3d 96 (2d Cir. 2001); and
- *Glinka v. Federal Plastics Mfg. (In re Housecraft Indus. USA, Inc.)*, 310 F.3d 64 (2d Cir. 2002).

[1] Philip Bentley is a partner in the New York office of Kramer Levin Naftalis & Frankel LLP. Former Chief U.S. Bankruptcy Judge Cyganowski served a full 14-year term in the Eastern District of New York, returning to private practice at Otterbourg P.C. in 2008 where she is currently Chair of the firm's Bankruptcy Practice.

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A. *Permitting Derivative Actions to Be Brought Without Debtor's Consent*

In *In re STN Enters.*, the Second Circuit ruled that under 11 U.S.C. §§ 1103(c)(5) and 1109(b), creditors' committees may seek court approval to initiate proceedings "where the trustee or debtor in possession unjustifiably failed to bring suit or abused its discretion in not suing to avoid a preferential transfer." According to the Court of Appeals, the criteria to be considered by the Bankruptcy Court in granting such relief include:

(a) presentation of a "colorable claim or claims for relief that on appropriate proof would support a recovery";

(b) evidence that such claim "is likely to benefit the reorganization estate";

(c) a "determination of probabilities of legal success and financial recovery in event of success"; and

(d) a "determination as to whether it would be preferable to appoint a trustee in lieu of the creditors' committee to bring suit."

A married couple in the *STN* case owned and operated the eventual debtor, STN, and served as its sole directors. The husband subsequently died after the company was formed, and his wife administered his estate, which succeeded to his ownership interest in the company. Shortly thereafter, STN filed for Chapter 11. The STN unsecured creditors' committee then unsuccessfully sought permission from the District Court to commence an action against the surviving spouse, both individually and in her capacity as the administrator of her late husband's estate.

On appeal, the Second Circuit upheld the District Court's determination regarding the estate of the late husband on the ground that litigation would not be cost-effective. With regard to the surviving spouse individually, the Court of Appeals held that Sections 1103 and 1109 allowed the committee to seek permission from the courts to commence an action.

B. <u>Permitting Derivative Actions to Be Brought With the Debtor's Consent</u>

"In *Commodore,* the court extended the doctrine of derivative standing to apply in cases where the debtor-in-possession consents to a committee's maintenance of the claim." *In re Adelphia Communs. Corp.*, 371 B.R. at 666. Significantly, in *Commodore*, the Second Circuit affirmed the dismissal of an action brought by a creditors' committee, notwithstanding the debtor's consent, on the grounds that prior actions were already pending in the Bahamas, and thus the action brought by the creditors' committee was "neither necessary nor beneficial." *In re Commodore Intl* ., 262 F.3d at 100.

Still, in its affirmance, the Second Circuit made clear that no *per se* bar operated against such law suits, and that the emerging rule was that such derivative actions could be brought where the debtor had consented, and the lawsuit was "necessary and beneficial to the resolution of the bankruptcy proceedings." 262 F.3d at 100. In the absence of such a showing in *Commodore*, the court did not permit the committee's lawsuit to move forward.

C. <u>Permitting Creditors' Committee to Be a Co-Plaintiff</u>

In *Housecraft,* "the court held that bankruptcy courts may grant standing to a committee to sue as a co-plaintiff with the debtor-in-possession on behalf of the estate." *In re Adelphia Communs. Corp.*, 371 B.R. at 666. The *Housecraft* plaintiffs, including a trustee and a creditor who were parties to a joint prosecution agreement, brought fraudulent transfer claims in the District Court against the defendants. The District Court denied the defendant-company's motion to dismiss, entered judgment against the defendant, and denied its request to set off a claim against the judgment. On appeal, the Second Circuit affirmed the decision below and rejected defendants' contention that the committee lacked standing to be a plaintiff.

After recapitulating its prior holdings in *STN* and *Commodore*, the Second Circuit observed:

> The case for recognition of creditor standing here is more compelling than in *Commodore* because the Trustee is also a named plaintiff, and Federal Plastics [defendant] has not challenged his standing …. The Trustee's participation as a party is also significant because, unlike the plaintiffs in *Commodore*, BNP [co-plaintiff] is not replacing the Trustee as a claimant; it is simply assisting him with the litigation.

In re Housecraft, 310 F.3d at 71-72.

II. <u>Can a Creditors' Committee Without *STN* Authority Settle Estate Claims?</u>

The *STN Trilogy* empowered creditors' committees within the Second Circuit to commence derivative actions on behalf of the estates of Chapter 11 debtors in appropriate circumstances. A potential corollary might be that a creditors' committee can be empowered to settle a claim of the debtor's estate even though the committee had not previously been authorized to prosecute that claim.

Whatever the logical appeal of this argument, it is potentially constrained by the text of Bankruptcy Rules 9019 and 9001. Rule 9019(a) expressly authorizes a Chapter 11 trustee to settle claims: "On motion by the trustee and after notice and a hearing, the court may approve a compromise or a settlement." Rule 9001(11) states that "'Trustee' includes a debtor in possession in a chapter 11 case." Because Rule 9019(a) authorizes only trustees and debtors in possession to seek judicial approval of settlements, it could be argued that the power to settle estate claims is limited to those parties and does not generally extend to creditors' committees.

Prior to the full development of the *STN Trilogy,* the Ninth Circuit's Bankruptcy Appellate Panel in *Wells Fargo N.A. v. Guy F. Atkinson Co. of California (In re Guy F. Atkinson Co. of California)*, 242 B.R. 497 (9th Cir. B.A.P. 1999), grappled with the question of whether "pursuant to Fed. R. Bankr. P. 9019, the court may authorize an entity other than the trustee to negotiate and propose compromise and settlements of claims affecting property of the debtors' estates," *id*. at 500, and held that the language of Rule 9019 did not completely foreclose an entity other the Chapter 11 trustee or the debtor-in-possession from seeking approval of a settlement.

In *Guy F. Atkinson*, banks had loaned money to two related debtors who were engaged in post-bankruptcy construction projects. Pursuant to the terms of the underlying bonds, the bonding companies took control over the projects. After the projects were completed, the bonding companies successfully moved the Bankruptcy Court for permission to settle certain disputes.

On appeal, the Ninth Circuit's Bankruptcy Appellate Panel held that the language of Rule 9019 did not preclude settlements negotiated by parties-in-interest other than the debtor or trustee, but remanded the settlement for review by the Bankruptcy Court for application of the appropriate standards:

> [I]nterpreting Rule 9019 as restricting negotiation of compromises and settlements to the trustee and debtor in possession is contrary to the reading the Ninth Circuit and other panels of this BAP have given to similar language in other parts of the Bankruptcy Code. Under those precedents, the court may, under appropriate circumstances discussed below, authorize an entity other than the trustee or debtor in possession to pursue settlement of claims of the estate.

In re Guy F. Atkinson Co. o f California, 242 B.R. at 502.

The court then examined what circumstances and facts legally justified an entity other than the trustee to seek approval of a settlement. In its view, entities other than a trustee or a debtor-in-possession may propose a settlement for court approval where two conditions have been met: (1) sufficient reason must exist, and (2) "the entity's interests and incentives in settling the case must be consistent with maximizing the estate for all creditors." Sufficient reason had previously been deemed by the Court to exist where:

(a) the creditor was pursuing interests common to all creditors;

(b) the third party had been appointed to enforce a plan of reorganization;

(c) the trustee had no economic incentive to pursue a claim; or

(d) the trustee or the debtor-in-possession had otherwise failed to fulfill their obligation to prosecute actions on behalf of the estate.

The Second Circuit subsequently addressed the same issue, in *Smart World Techs, LLC v. Juno Online Svcs. Inc.*, 423 F.3d 166 (2d Cir. 2005), and came to a somewhat different conclusion. In a unanimous ruling that made no mention of *Guy F. Atkinson*, the Court of Appeals vacated the decisions of the Bankruptcy and District Courts, and held that in the absence of exceptional circumstances, Rule 9019's settlement mechanism is limited to a Chapter 11 trustee and a debtor-in-possession. In other words, derivative standing to settle a stand-alone claim in a Chapter 11 case is far narrower than standing to commence an action in a Chapter 11.

In *Smart World*, the Bankruptcy Court had approved a Section 363 sale, which the parties ultimately failed to consummate. Thereafter, a dispute arose as to whether the failure of the would-be buyer (Juno) to close was the result of bad faith. The debtor-in-possession sought a hearing on that issue, and Juno, in turn, commenced an adversary proceeding against the debtor-in-possession, in which it sought declaratory relief. Juno subsequently reached a settlement with the secured creditors – but without the debtor's consent.

The creditors moved for court approval of the settlement, which the Bankruptcy Court granted despite the debtor's opposition. The Bankruptcy Court approved the settlement on the grounds that the debtor's estate was insolvent, continued litigation posed a risk to the debtor, and the settlement was in the best interests of the constituencies. After the District Court affirmed the Bankruptcy Court's determination, the Second Circuit vacated the District Court's determination on the ground that the creditors lacked standing to move for the approval of a settlement. In the Court of Appeals' view, Rule 9019(a) granted "the debtor-in-possession the sole authority to bring a motion to settle or compromise …." 423 F.3d at 183. The Second Circuit also opined that in "rare circumstances," a creditor may be afforded derivative standing to move to approve a settlement over the debtor's objection, but rejected the settling creditors' contention that derivative standing should be granted. Without going into specifics, the Court indicated that satisfying that test would be difficult.

III. What Powers do the Debtor and the Court Retain After Entry of an *STN* Order?

When a third party obtains derivative standing to pursue claims on behalf of the estate, issues arise if the debtor subsequently seeks either (i) to transfer prosecution of the claims to another entity, such as a litigation trust, or (ii) to settle the claims. The Second Circuit has addressed the first issue in the *Adelphia* bankruptcy. While there is a dearth of case law addressing the second issue, the standards set forth in *Adelphia* are instructive on this issue as well.

A. Power to Transfer Claims to a Different Party

In *Official Comm. of Equity Sec. Holders v. Adelphia Communs. Corp. (In re Adelphia Communs. Corp.)*, 544 F.3d 420 (2d Cir. 2008), the Second Circuit held that derivative authority conferred on a committee by a Bankruptcy Court can subsequently be transferred to a different party in appropriate circumstances. In the Second Circuit's view, "It would be contrary to the reasoning of this Circuit's precedent to hold that the bankruptcy court's grant of derivative standing vested the Equity Committee with a veto over both the court and the debtor-in-possession." *In re Adelphia Communs. Corp.*, 544 F.3d at 425.

In *Adelphia*, the Bankruptcy Court had initially granted an equity committee *STN* authority to pursue claims against the debtors' lenders and investment bankers, after the debtors had neither supported nor opposed the committee's motion. In granting the committee's motion, the Bankruptcy Court expressed little confidence in the committee's prospective claims, but found them to be colorable, and hence saw them as being in the best interest of the estate.

Subsequently, the debtors' proposed a plan of reorganization that provided for a newly-created litigation trust to pursue the same claims that the committee had been authorized to pursue, thereby effectively withdrawing those claims from the committee's control. Rejecting the committee's objections, the Bankruptcy Court observed that, "for 'value to pour down all the way to equity, the [litigation trust] would have to recover at least $6.5 billion, an ambitious goal, which seemingly is so ambitious that it could fairly be said that equity is hopelessly out of the money.'" The bankruptcy court approved the proposed claims transfer, and the district court and the Second Circuit affirmed.

The crux of the equity committee's argument was that the bankruptcy court's grant of derivative standing to the equity committee transferred ownership of the claims to the equity committee, and therefore the claims could not be transferred to the litigation trust absent the equity committee's consent. *Id.* at 424. The Second Circuit, in an opinion by then Judge Sonia Sotomayor, rejected the equity committee's argument, holding that a court "may withdraw a committee's derivative standing and transfer the management of its claims, even in the absence of that committee's consent, if the court concludes that such a transfer is in the best interests of the bankruptcy estate." *Id*. at 423. The court explained that the grant of derivative standing "does not undermine either the debtor's central role in handling the estate's legal affairs or the court's responsibility to monitor for abuses by the parties." *Id.* at 424. To the contrary, it remained the debtor's duty "to wisely manage the estate's legal affairs" and the court's role "to oversee the litigation and to check any potential for abuse by the parties." *Id.* at 424 (internal quotations omitted). To hold otherwise would provide "the equity committee with a veto over both the court and the debtor-in-possession." *Id.* at 425.

B. <u>Power to Settle</u>

When a third party obtains derivative standing to pursue claims on behalf of the estate, an important issue is whether the debtor retains settlement authority with respect to these claims – i.e., whether the debtor has the power to settle the claims "out from under" the *STN* plaintiff. While there do not appear to be any reported cases addressing this issue, the principles adopted by the Second Circuit in *Adelphia* provide guidance as to the standards that are likely to be applied when this issue is litigated.

The Second Circuit in *Adelphia* emphasized that, even after a grant of *STN* standing, the debtor and the court retain discretion to handle the case in a manner that is in the best interests of the estate. It would appear to follow that, if the debtor were able to negotiate a settlement that served the best interests of the estate and otherwise satisfied the standards for approval under Rule 9019, the court should approve the settlement.[2]

One question left unresolved by *Adelphia* is whether consideration of a debtor's proposed settlement of claims that a third party had been prosecuting pursuant to an *STN* order necessitates a one-step or a two-step inquiry. Specifically, in considering such a settlement, should the court employ the simple one-step inquiry of determining whether the settlement is in the estate's best interests and otherwise satisfies Rule 9019? Or should the court conduct a two-step inquiry, under which the debtor is first required to demonstrate that grounds exist to strip the *STN* party of previously-conferred derivative standing, and the settlement's merits may only be evaluated if the debtor is able to clear this threshold?

If the court conducts a two-step inquiry of this sort, a further question that may arise is how high the initial threshold should be. For example, would the debtor be required to show changed circumstances sufficient to warrant reconsideration of the original *STN* order under Fed. R. Civ. P. 60 and Fed. R. Bankr. P. 9024?

Additional questions relate to whether, in evaluating the merits of a settlement of claims being prosecuted pursuant to an *STN* order, the court should modify the usual Rule 9019

[2] A court may approve a settlement under Rule 9019 if it is fair and equitable and in the best interests of the estate, with the burden on the settlement proponent to satisfy this standard. *HSBC Bank USA, Nat'l Ass'n v. Fane (In re MF Global Inc.)*, 466 B.R. 244, 247-48 (Bankr. S.D.N.Y. 2012). In considering whether the settlement falls within the range of reasonableness, courts in the Second Circuit apply the following factors: (1) the balance between the litigation's possibility of success and the settlement's future benefits; (2) the likelihood of complex and protracted litigation, with its attendant expense, inconvenience, and delay; (3) the paramount interests of creditors; (4) whether other parties in interest support the settlement; (5) the nature and breadth of releases to be obtained by officers and directors; (6) the competency and experience of counsel supporting, and the experience and knowledge of the bankruptcy court judge reviewing, the settlement; and (7) the extent to which the settlement is the product of arm's-length bargaining. *Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452, 462 (2d Cir. 2007).

standards in any way. A strong argument can be made that these standards should not be modified. Rather, in keeping with the *Adelphia* decision, the settlement should be approved if it is in the best interests of the estate – and the Rule 9019 standards are the tried-and-true method for determining whether the settlement is in fact in the estate's best interests.

Yet, at the same time, the court should take into account the circumstances that led to the initial grant of *STN* relief. For example, if *STN* authorization stemmed from a conflict of interest, the debtor should be required to demonstrate that the conflict no longer exists, and does not otherwise taint the proposed settlement. If the debtor cannot do so, the settlement should be evaluated using the heightened scrutiny applicable to settlements tainted by a conflict of interest. At the other end of the spectrum, if derivative standing was granted because the debtor waived the right to bring claims as part of a DIP financing order, there should be no thumb on the scale weighing against the debtor settling the claims.

CONCLUSION

At this juncture, it is well-established that the Bankruptcy Court may authorize a committee to bring derivative claims on behalf of the debtor's estate. The rationale and holdings of the *STN Trilogy* have taken root, and the prosecution of estate claims by committees and litigation trusts has become a common feature of the reorganization landscape. While multiple issues remain unresolved, the Second Circuit's decisions in *Smart World* and *Adelphia* offer valuable guidance.

American Bankruptcy Institute—18th Annual New York City Conference

Discovery in Bankruptcy

Dion Hayes[1] and Karin Jenson

I. Proportionality

The recent amendments to the Federal Rules of Civil Procedure, which went into effect on December 1, 2015 and apply to bankruptcy proceedings through incorporation by the Federal Rules of Bankruptcy Procedure, have given the discovery community a new buzzword: proportionality. Specifically, among other changes, the amendments reworked Rule 26. Under the Rule's prior iteration, parties to an action could obtain discovery on matters relevant to any party's claim or defense—subject to a balancing of the burdens, expenses, and benefits of the discovery sought. *See Robertson v. People Magazine*, No. 14–cv–6759 (PAC), 2016 WL 9077111, at *2 (S.D.N.Y. Dec. 16, 2015) (describing the prior version of Rule 26). But now, Rule 26 provides that,

> [u]nless otherwise limited by court order, the scope of discovery is as follows: [p]arties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense *and proportional to the needs of the case*, considering the importance of the issues at stake in the action, the amount in controversy, the parties' relative access to relevant information, the parties' resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the proposed discovery in resolving the issues, and whether the burden or expense of the proposed discovery outweighs its likely benefit.

[1] Mr. Hayes would like to thank Kyle Hosmer, associate at McGuireWoods LLP, for his assistance in preparing these materials.

Fed. R. Civ. P. 26(b)(1) (emphasis added). Further, language that allowed parties to obtain discovery of information "reasonably calculated to lead to the discovery of admissible evidence" is gone. Instead, the new Rule 26 simply provides that "[i]nformation . . . need not be admissible to be discoverable." *Id.*

Thus, some contend, the once far-reaching scope of discovery has been narrowed by the 2015 amendments to the Federal Rules of Civil Procedure. (Others disagree—the amendments have sparked a serious debate. On this point, the latter change identified above attempts to clarify the scope of discovery rather than alter it: the Advisory Committee believed that the phrase "reasonably calculated to lead to the discovery of admissible evidence" was being "improperly invoked to narrow the scope of discovery." Nicholas J. Brannick, *Key Considerations for Bankruptcy Practitioners Regarding Amended Federal Rules of Civil Procedure*, Bankruptcy & Restructuring Law Monitor (Jan. 20, 2016) *available at* http://www.jdsupra.com/legalnews/key-considerations-for-bankruptcy-32362/ (last accessed Mar. 18, 2016) [hereinafter "*Key Considerations*"] (citing Fed. R. Civ. P. 26, Comm. Notes on Rules—2015 Amend.).)

The scope of discovery under amended Rule 26 is "intended to encourage judges to be more aggressive in identifying and discouraging discovery overuse by emphasizing the need to analyze proportionality before ordering production of relevant information." *Henry v. Morgan's Hotel Grp., Inc.*, No. 15–cv–1789 (ER) (JLC), 2016 WL 313114, at *3 (S.D.N.Y. 2016). But it is not the courts' obligation alone to ensure that discovery is tailored to the facts and circumstances of the case:

"lawyers—through representing adverse parties—have an affirmative duty to work together, and with the court, to achieve prompt and efficient resolutions of disputes." Chief Justice John Roberts, *2015 Year-End Report on the Judiciary*, at 6, Dec. 31, 2015, *available at* http://www.supremecourt.gov/publicinfo/year-end/2015year-endreport.pdf (last accessed March 17, 2016) [hereinafter "*Report on the Judiciary*"] (discussing the impact of the 2015 amendments, with particular attention to Federal Rule of Civil Procedure 1). Accordingly, attorneys "must size and shape their discovery requests to the requisites of a case." *Id.* at 7.

In truth, proportionality has always been a factor in discovery. The 1993 amendments to the Federal Rules, though, inadvertently subordinated that consideration when they subdivided Rule 26(b)(1). *See* Fed. R. Civ. P. 26, Comm. Notes on Rules—2015 Amend. The 2015 amendments, then, merely restored proportionality to the position it held in the discovery hierarchy as of 1992. *Id.* Indeed, the 2015 amendments merely "reinforce[] the Rule 26(g) obligation of the parties to consider" (1) the cost and burden imposed by discovery; (2) the needs of the case; (3) any prior discovery; (4) the amount in controversy; and (5) the importance of the issues at stake in the action when making a discovery request. *Id.*; *see e.g.*, Fed. R. Civ. P. 26(g)(1)(B)(iii).

Parties will have to take these proportionality factors into account when making discovery requests. "The key" to a proper discovery request under the new Rule 26 "is [a] careful and realistic assessment of actual need." *Report on the Judiciary* at 7. This "assessment may, as a practical matter, require the active involvement of a neutral arbiter—the federal judge—to guide decisions respecting the scope of discovery." *Id.* Thus, the new scope of discovery imposed by the 2015 amendments to the Federal Rules will likely be felt in two ways.

First, in more planning on the front end. Attorneys must meet and confer with each other, appear before the presiding judge, and develop a case management plan earlier than they were required to do under the prior version of the Federal Rules. Proportionality will no doubt play a key role in these conferences. *See, e.g.*, *Ganek v. Leibowitz*, No. 15–cv–1446, —F. Supp. 3d—, 2016 WL 929227, at *15 (S.D.N.Y. Mar. 10, 2016) ("The parties should [form] an equitable and proportional discovery plan consistent with the recent revisions to the Federal Rules of Civil Procedure."). And second, in motions practice. The new Rule 26 "does not [explicitly] impose on the party seeking discovery the burden of addressing all proportionality factors, and it does not allow the party from whom discovery is sought to make a boilerplate objection that the discovery request is not proportional." *See* 10 COLLIER ON BANKRUPTCY ¶ 7026.03 (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.) (discussing Advisory Committee comments to the 2015 amendments to the Federal Rules of Civil Procedure). Indeed, boilerplate objections are entirely excluded by virtue of changes to Rule 34, which now requires a party to specify what it has withheld in connection with an objection or describe the search it is willing to conduct. Thus, the proportionality battle will be waged in motions to compel and quash discovery. As described by Nicholas Brannick,

> [t]he party ***resisting*** discovery has always had, and will continue to have, the burden of establishing that the

> discovery sought is disproportionate. However, the party seeking to ***compel*** discovery has the initial burden of establishing that the discovery sought satisfies the scope of permitted discovery under Rule 26(b)(1). When establishing that discovery was within the permitted scope simply requires a party to satisfy a broad notion of relevance, the burden on the party seeking to compel discovery was light. However, if the party seeking to compel must now also satisfy the requirements of proportionality, the movant likely carries a heavier burden. Additionally, the considerations for governing proportionality under Rule 26(b)(1) have been incorporated into the standard for limiting discovery under Rule 26(b)(2)(C)(iii).

Key Considerations (emphases in original) (internal citations omitted). This reality is already apparent. In a recent non-bankruptcy case, the Eighth Circuit affirmed the denial of a motion to compel because the record contained information similar enough to that sought by the requested discovery. *Haukereid v. Nat'l R.R. Passenger Corp.*, No. 14–3752, —F.3d—, 2016 WL 877955, at *4 (8th Cir. Mar. 8, 2016). Put another way, proportionality is more an emphasis under the new Rule 26 rather than a rebalancing of burdens.

Further on this point, the revised Federal Rule of Civil Procedure 1 requires "the court and the parties" to employ the Federal Rules "to secure the just, speedy, and inexpensive determination of every action and every proceeding." Fed. R. Civ. P. 1. And the spirit of the amendments, generally, is one of collaboration by the federal judiciary and the parties to ensure that justice is administered in an efficient, non-burdensome, and cost-effective manner. *See Report on the Judiciary* at 9 (stating that the goal of Rule 1 will only be achieved "if the entire legal community, including the bench, bar, and legal academy, step up to the challenge of making real change.") and Fed. R. Civ. P. 26, Comm. Notes on Rules—2015 Amend. ("The parties and the court have a collective responsibility to consider the proportionality of all discovery and consider it in resolving discovery disputes.").

Accordingly, proportionality under the amended Federal Rules is a fact-based and fluid calculation. It acknowledges that what appears to be an important discovery request to one party may represent an undue burden to another. The comments to the new Rule spell this out. They state that "[t]he parties may begin discovery without a full appreciation of the factors that bear on proportionality. A party requesting discovery, for example, may have little information about the burden or expense of responding. A party requested to provide discovery may have little information about the importance of the discovery in resolving the issues as understood by the requesting party." *See* Fed. R. Civ. P. 26, Comm. Notes on Rules—2015 Amend.

The cost of responding to discovery is only one factor to be balanced against a number of others, though. "Consideration of the parties' resources does not foreclose discovery requests addressed to an impecunious party, nor justify unlimited discovery requests addressed to a wealthy party." *Id.* Similarly, the amount in controversy in a lawsuit is no indication of the importance of the discovery sought—public policy cases frequently allege small quantifiable damages yet raise significant societal concerns. *Id.* In short, "[t]he burden or expense of discovery should be determined in a realistic way" by the parties to the action. *Id.*

To this end, Judge Elizabeth Laporte and Jonathan Redgrave have helpfully identified ten "best practices" that attorneys should follow to comply with Federal Rules' new emphasis on proportionality:

1. Focus on the specific discovery at issue (micro-level analysis) and avoid arguments about discovery in general (macro-level analysis).

2. Recognize that proportionality and relevance are conjoined considerations for civil discovery.

3. Understand that proportionality is a consideration that can support a multi-faceted approach to discovery.

4. Respect that non-parties have greater protections from discovery and that burdens on non-parties will impact the proportionality analysis.

5. Raise discovery scope and proportionality issues early in the litigation and continue to address and revisit them as needed.

6. Do not consider the 'amount in controversy' factor to be determinative with respect to the proportionality of discovery requests or responses.

7. Do not approach discovery disputes with the notion that discovery is perfect or that it will result in the production of 'any and all' relevant documents or information.

8. Do not address proportionality arguments by citing superseded case law, rotely reciting the rules, or making unsupported assertions of burden.

9. Do not get caught up in an academic dispute regarding the 'burden of proving' proportionality as courts will expect that each side of the dispute will have something to contribute, although not necessarily equally, and the most reasonable position will likely prevail.

10. Do not forget that proportionality considerations also apply to preservation decisions and disputes.

Hon. Elizabeth D. Laporte & Jonathan M. Redgrave, *A Practical Guide to Achieving Proportionality Under New Federal Rule of Civil Procedure* 26, 9 Fed. Cts. L. Rev. 19, 51 (2015).

Because Federal Rule of Civil Procedure 26 applies to bankruptcy proceedings through incorporation by the Federal Rules of Bankruptcy Procedure, bankruptcy practitioners will have to follow the foregoing tips to ensure that their discovery requests comply with the new focus on proportionality. Fed. R. Bankr. P. 7026, 9014. Where practitioners engage in ordinary discovery, it is clear that they will have to abide by the new scope as defined by the amended Federal Rules of Civil Procedure. *See, e.g.*, *In re Fustolo*, No. 13–12692–JNF, 2015 WL 9595421, at *4–5 (Bankr. D. Mass. Dec. 31, 2015) (applying amended Rule 26 to discovery requests in a chapter 7 case); *see also Henry*, 2016 WL 303114 at *3–4 (applying the new Rule 26); *Del. Display Grp. LLC v. Lenovo Grp. Ltd.*, No. 13–2108–RGA, 2016 WL 720977, at *2–6 (D. Del. Feb. 23, 2016) (the same); *Sibley v. Choice Hotels Int'l*, No. CV 14–634 (JS)(AYS), 2015 WL 9413101, at *2–8 (E.D.N.Y. Dec. 22, 2015) (the same).

However, whether courts will apply the Rules' new emphasis on proportionality to Rule 2004 examinations is another matter. Federal Rule of Bankruptcy Procedure 2004 authorizes courts to "order the examination of any entity." Fed. R. Bankr. P. 2004(a). A Rule 2004 examination inquires into matters that relate to "the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge." Fed. R. Bankr. P. 2004(b). It enables the examining entity to compel both a party's attendance for examination and also the production of documents. Fed. R. Bankr. P. 2004(c).

"Rule 2004 examinations have been characterized as 'fishing expeditions' because of the broad scope of inquiry the rule permits." *In re Hope 7 Monroe St. Ltd. P'Ship*, 743 F.3d 867, 874 (D.C. Cir. 2014) (citing *In re Buckner*, No. EO–00–073, 2001 WL 992063, at *4 (B.A.P. 10th Cir. Aug. 30, 2001)); *see also In re W&S Invs., Inc.*, 985 F.2d 577, at *2 (9th Cir. 1993) (unpublished) (citing *In re Wilcher*, 56 B.R. 428, 433 (Bankr.. N.D. Ill. 1985)). While an investigatory tool similar to discovery, Rule 2004 examinations serve different purposes and are subject to different protections than are normal discovery procedures, such as depositions. *Simon v. FIA Card Servs., N.A.*, 732 F.3d 259, 268 (3d Cir. 2013). For example, Rule 2004 "'is meant to give the inquiring party broad power to investigate the estate, [and therefore] does not provide the procedural safeguards offered by [Bankruptcy Rule] 7026." *Id.* at 268 n.6 (quoting *In re Bennett Funding Grp.*, 128 B.R. 509, 516 (Bankr. E.D.N.Y. 1991)) (initial alteration added, second alteration in original). Accordingly, "'under a [Rule] 2004 examination, a witness has no general right to representation by counsel, and the right to object to immaterial or improper questions is limited.'" *Id.* (quoting *Bennett Funding Grp.*, 128 B.R. at 516) (alteration in original). Further, "[a]t least one court has found that the Bankruptcy Rules do not 'require [Rule 2004] examinations to be transcribed or transcripts to be filed.'" *Id.* (quoting *In re Thow*, 392 B.R. 860, 867 (Bankr. W.D. Wash. 2007)) (alteration in original).

The breadth of Rule 2004 discovery is wide by design. The "purpose of the administration of the debtor's estate is to discover, recover[,] and distribute assets to the creditors." Lawrence R. Ahern, III & Nancy Fraas MacLean, *Scope of Discovery*, Bankr. Proc. Manual § 7026:3 (Jan. 2016) (citing *In re Analytical Sys., Inc.*, 71 B.R. 408 (Bankd. N.D. Ga. 1987)). Whether it will be constrained by the new emphasis on proportionality imposed by the 2015 amendment to Rule 26 remains to be seen. If courts and parties take their duties under the new Rule 1 and the spirit of the 2015 amendments to the Federal Rules seriously, then it is likely that Rule 2004 examinations will be similarly restricted.

II. E-DISCOVERY

Under the Model Rules of Professional Responsibility, being competent in technology is part of our duty of competency to our clients. The prevailing view is that if a matter presents issues in electronic evidence, an attorney must either be competent to handle the matter, associate with someone who is, or decline the representation.

One helpful tool in getting up to speed is The Sedona Conference's Jumpstart Outline, which describes how to approach issues in electronic discovery. Jumpstart's authors recently updated the Outline to reflect changes in technology and the law and to incorporate certain provisions from December 1, 2015 changes to the Federal Rules of Civil Procedure. Jumpstart is available on The Sedona Conference's website under Publications.

An excellent resource specific to bankruptcy is the American Bar Association's Best Practices Report on Electronic Discovery ("ESI") Issues in Bankruptcy Cases, which covers guidelines for large, middle market and small chapter 11 cases, chapter 7 cases, chapter 13 cases, and in connection with proofs of claim and contested matters.

Here are some additional tips to consider in helping to manage electronic evidence in bankruptcies:

A. Preservation

Preservation of evidence can be tricky in bankruptcy. Employees who are knowledgeable about the data may no longer be available. There may be competing interests—for example, a need to sell off assets before the full scope of the issues to be litigated is known. Questions of who has possession, custody, or control of data may be muddy. For all of these reasons, consider whether to make a First Day Motion to sort out the preservation process. Being transparent about your process and seeking input from interested parties may reduce expenses and help avoid a discovery side show later in the matter.

B. Privilege

It seems far more common in bankruptcy than in typical civil litigation to be called upon to produce a large volume of documents under incredible time pressures. For this reason, it is important to take steps to protect the privilege, if necessary.

First, consider whether to seek an order under Federal Rule of Evidence 502(d) early in the matter. That rule protects a party from waiver in the event that a privileged document is produced. Unlike under FRE 502(b), under (d) there is no requirement to establish that you took measures to protect the privilege and the document was produced inadvertently, but the protections are only afforded through a court order, not a party agreement. FRE 502(d) orders are incredibly helpful to ensure that you can claw back documents and keep any dispute focused on whether the documents are indeed privileged, rather than the circumstances of the production. Magistrate Judge Andrew Peck of the Southern District of New York has a sample FRE502(d) order on his home page.

Second, before producing ESI, ask your technologist to prepare a domain name analysis of any emails. This is a list of all the domains (e.g, gmail.com, espn.com) at which emails were sent or received. Examine this list for domain names of law firms. If you are unable to develop a list of attorneys who represented your client over the years, this is a simple way to identify them. Your technologist can then exclude emails to or from the law firm domains, if warranted. You can always review the domains that were withheld from the production and produce non-privileged communications later.

Finally, you may have identified your client's in-house attorneys and withheld their mail from a production, but don't forget to search the emails you are producing for that person's name, to ensure that you are excluding potentially privileged emails in other employees' mailfiles.

C. Technology-Assisted Review/Predictive Coding

Technology-Assisted Review ("TAR") can be a powerful tool to move through large volumes of electronically stored information at a faster pace. In basic terms, TAR operates to replace the first-level review of ESI. It works in a similar way to how Netflix makes suggestions for movies you might like, based on what you've watched previously, or how Amazon makes recommendations of things you might buy based on your previous purchases or searches.

Again, in basic terms, you feed the computer information about key documents and then the computer finds similar ones. In a recent bankruptcy matter, predictive coding was used to identify relevant documents on a backup tape containing more than 500,000 documents and resulted in the team having to review less than 15,000 documents. The process of getting to that 15,000 documents for review took just a few days and, obviously, dramatically reduced attorneys' fees compared to a traditional review. Just be sure that your technologist has substantial experience in using TAR—if not used appropriately, TAR can have the opposite effect, resulting in higher costs and delays. In addition, you should be aware that there are varying views on how much you disclose about the use of TAR to your adversary. Finally, be sure to test the defensibility of the results of TAR by examining or running key search terms over the excluded documents.

D. Metadata

Civil litigators went through a phase of fearing or refusing to produce metadata. That phase is largely over and metadata is typically included in productions. Metadata is the data about the documents—it is information imbedded in ESI about who created the document and when, whether it was modified, who it was sent to and when, and other details. Metadata facilitates the searching and organization of ESI, and it can help maximize efficiencies in bankruptcy. For example, you can use metadata to quickly identify and isolate all communications within the 90-day preference period, or to identify differences in financial statements over time.

If you are a requesting party, ask for either TIFFS (which are images of documents) with a load file if you have the technology, such as Relativity, to review documents in that format. If you don't, ask for a native file production. Producing in native is often the cheapest way to produce, because you avoid the cost of converting the documents to images, but there is no easy way to brand natives with Bates labels or confidentiality designations.

E. Data Rooms

The use of electronic data rooms is becoming increasingly common in bankruptcy. A data room can provide all the various constituencies in a matter with direct, searchable access to a wide variety of the debtor's documents. It can be organized in many different ways, including, for example, having all financial statements in one folder, emails in another, and so on. It can be constructed, if necessary, to limit a user's access to only certain categories of documents, to preclude or allow printing or downloading, and to allow a party to code documents but without other parties having access to that coding. A well-organized, user-friendly data room can dramatically reduce the cost of discovery in bankruptcies.

III. MODEL PROTOCOL

Entering into a stipulated protocol for the preservation, collection, and production of ESI can provide more predictability and consistency in a contested matter. Federal Rule of Civil Procedure Rule 26(f) requires parties to discuss these issues regardless, and folding them into written parameters can be helpful so that there is no confusion about expectations. The protocol can be filed with your Rule 26(f) report or on a date set in the case management plan. Here's a list of ten issues parties should consider including in an ESI protocol:

1. A description of the data that is being preserved. This can help reduce disputes about preservation or loss of data later.

2. A description of what is viewed as "inaccessible" ESI that will not be searched, such as old backup tapes without indices.

3. Search parameters by source. For email, for example, will search terms be run across the entire email server, or just certain people's mailfiles? Will the terms be run over an entire department's fileshare, or just documents that were created by certain people? Search parameters should always include the date range of the relevant time periods during which documents will be searched and produced.

4. The discovery workflow and sequencing. Will certain places be searched first? Will the search parameters be negotiated and agreed to after a

Rule 34 request for production of documents, and how much participation will other parties have in that process? Some negotiated protocols do away with written requests for documents entirely, and instead lay out a discovery plan that is based on using agreed-upon search terms with date and custodian limitations. Are there other ways to stage or triage discovery to reduce the costs and burdens? This workflow should also include provisions for rejecting or modifying search terms that result in an unworkable volume of documents or a high rate of false positives.

5. The use of technology. Will predictive coding be used? A data room?

6. Deduplication, particularly with respect to emails. The typical approach is that the producing party will produce only one instance of an email, but include a metadata field with the other custodians who also had a copy of that email.

7. The format of production. This may be different for emails, electronic documents and paper documents. A typical ESI protocol contains a list of the metadata that will be included in a production, as well as a list of the required fielded data, which is the data applied to a document during processing such as Bates numbers and confidentiality branding.

8. Provisions on structured data, like financial data. If the debtor is a large company that used a proprietary accounting platform, how will you extract and produce that data?

9. Provisions on cost shifting.

10. Provisions relating to third-party productions, including who is responsible for producing incoming third-party productions to the other parties, and whether the production protocol applies to the third parties.

You can also consider whether to include provisions on privilege logging, redactions, a Federal Rules of Evidence 502(d) agreement (but then the stipulation must be filed), and confidentiality designations if they are not already laid out in a separate protective order. You should also review the local and chambers' rules for your court to see if there any other provisions that should be part of the protocol—and if your court has a model protocol. Publicly-available model ESI protocols are all over the internet. However, model protocols should be a conversation starter between parties—some models will have terms that do not apply, and will be missing necessary provisions. Here are some samples:

U.S. District Court for the Southern District of New York: http://www.nysd.uscourts.gov/rules/Complex_Civil_Rules_Pilot_14.11.14.pdf

Seventh Circuit Electronic Discovery Pilot Program: http://www.discoverypilot.com/content/model-discovery-plan-and-privilege-order

U.S. District Court for the Northern District of California: http://www.cand.uscourts.gov/eDiscoveryGuidelines

IV. LIMITS ON E-DISCOVERY—THE *RESCAP* DECISION

Moore's Law holds that computing power doubles roughly every two years. This exponential growth has caused a commensurate expansion of digitization and cloud computing by businesses, which have generally become leaner, more mobile, and more efficient as a result. But these developments have not been without expense. One area, in particular, that imposes costs on businesses is the preservation and production of electronic documents in the event of litigation—as has been described above. This is an especially pointed concern in bankruptcy, where funds are scarce and creditors plentiful. The Residential Capital, LLC bankruptcy, No. 12–12020 (MG) (Bankr. S.D.N.Y.) [hereinafter "*ResCap*"], shows how these concerns interact, and also how courts manage that relationship.

ResCap has been described as a "wildly unpredictable bankruptcy that . . . presented the most complicated legal issues and resolutions in recent memory." Maria Chutchian, *ResCap Attorneys Look Back on a Rollercoaster Bankruptcy*, Law 360 (Dec. 19, 2013), available at http://www.law360.com/articles/497351/rescap-attys-look-back-on-a-rollercoaster-bankruptcy (last accessed Mar. 18, 2016). In relevant part, *ResCap* concerned a discovery dispute that stemmed from "allegedly false and misleading statements and omissions made in registration statements, prospectuses[,] and other offering materials relating to $6 billion of residential mortgage-backed securities [] purchased . . . between September 23, 2005 and May 30, 2007." *In re Residential Capital, LLC*, 480 B.R. 529, 532 (Bankr. S.D.N.Y. 2012). Specifically, a handful of parties asked the bankruptcy court to require the debtors to produce over 45,000 "Loan Files." *Id.* They later supplemented their request by requesting that the debtors also produce "Loan Tapes" and "Originator Files." *Id.* at 534.

The discovery dispute started in a third-party action in district court but quickly found its way before the bankruptcy court. *See id.* at 533–34. There, the dispute centered on whether the automatic stay, 11 U.S.C. § 362(a), protected the debtors from what they believed would be an "extremely costly and burdensome" production of documents. *Id.* at 535. To wit, the debtors claimed that compiling and transmitting the loan tapes and files and origination information sought would "distract [their] employees from key tasks related to the restructuring and preservation of their business, and [that] the costs associated with producing [the requested] files would adversely affect the value of [their] estate and prejudice their creditors." 480 B.R. at 535. The parties that requested discovery, on the other hand, argued that the automatic stay did not protect the debtors from discovery "because the discovery [was] not being requested in a proceeding against the [d]ebtors." *Id.*

The bankruptcy court agreed with the debtors. The Bankruptcy Code "marshal[s] and protect[s] the assets and the property of the estate throughout the administration" of a case. *Id.* at 537 (citing 11 U.S.C. § 541 and 5 COLLIER ON BANKRUPTCY ¶ 541.01 (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.)). For that reason, the court concluded that use of the broad equitable powers granted to it by 11 U.S.C. § 105 and extend the automatic stay to protect the debtors from third-party discovery requests was appropriate. *Id.*

In reaching this conclusion, the court considered six factors: (1) the scope of requested discovery; (2) the context in which the request arises; (3) the need for the discovery; (4) the timing of the discovery; (5) the burden on the debtors from the requested discovery; and (6) the expense of discovery and who should bear the cost. *Id.* at 539–40. No single factor is determinative; rather, whether a court should stay discovery hinges upon whether the requests "will 'threaten to thwart or frustrate the debtor's reorganization efforts.'" 480 B.R. at 540, 541 (quoting *In re the 1031 Tax Grp. LLC*, 397 B.R. 670, 684 (Bankr. S.D.N.Y. 2008)).

Applying these factors, the *ResCap* court found that the broad discovery sought—in connection with independent, expedited requests by the Committee of Unsecured Creditors—numerous other cases pending or threatened against the debtors, ability to obtain the requested information from other sources, compressed schedule, incredible burden of production, and expense of production all weighed in favor of extending the automatic stay to preclude discovery requests on the debtors absent further court order. *Id.* at 545–50.

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