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From the Bankruptcy Courts: Creditors' Committee Composition-Avoiding Attorney-Client Privilege Conflict

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CREDITORS' COMMITTEE COMPOSITION—AVOIDING ATTORNEY-CLIENT PRIVILEGE CONFLICT

A committee in a chapter 11 case often includes so-called ex officio nonvoting members. The question arises whether the nonvoting members may be privy to all privileged discussions between the committee's counsel and the voting members. This problem arose in the *Baldwin-United* case[1] on a motion by the Baldwin-United Official Unsecured Creditors' Committee (BUCC) to amend the order appointing the committee to eliminate the ex officio nonvoting members from the committee and to reclassify them as invitees.

Waiver of Privilege?

As originally constituted, the BUCC Committee consisted of eight voting members, two nonvoting members, and two nonvoting invitees. The BUCC Committee's position was opposed by both of the nonvoting members, First National Bank of Chicago (FNBC) and the Federal Deposit Insurance Corporation (FDIC). The voting members asserted that nonvoting members were not necessary to the workings of the committee because their nonvoting status deprived them of a major incident of committee membership, and their presence during meetings with the committee's counsel might be deemed a waiver of the committee's attorney/client privilege. Moreover, the FDIC could not serve as a committee member under any circumstances because it was not a "person" as defined in Section 101 of the Bankruptcy Code and therefore, not eligible for appointment as a member of the committee under Section 1102(b)(1).

Should Attorney-Client Privilege Be Ignored?

FNBC countered, arguing that the attorney/client privilege was not available to a creditors' committee and even if it were, FNBC's presence did not endanger the privilege. The FDIC

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[1] *In re* Baldwin-United Corp., 38 Bankr. 802 (S.D. Ohio 1984) (Newsome, J.).

joined in the bank's argument and asserted that nothing in Section 1102(b)(1) prevented it from serving as a nonvoting member on the committee. Moreover, counsel for another official committee, the D.H. Baldwin Official Unsecured Creditors Committee (DHBCC) filed an amicus brief requesting the court to ignore the privilege issue and hold that all members of the committee are entitled to the same rights, regardless of whether or not they vote.

The position of DHBCC appealed to the court because the "concerns for protecting allegedly privileged communication is more imaginary than real, since no concrete dispute regarding disclosure of information has been presented. A determination of whether the privilege attaches to a particular communication is primarily a question of fact, which cannot be decided in the abstract."[2]

Parameters of the Privilege

Additionally, the court indicated that the attorney-client privilege did not attach to all communications between the two parties but only to those communications that fell within well-established parameters. The privilege applied only if:

1. The holder of the privilege is or sought to become a client;
2. Communication must be made to a member of the bar acting as lawyer in connection with the communication or to the lawyer's subordinate;
3. The communication relates to a fact of which the attorney was informed by the client, without the presence of strangers, for the purposes of securing primarily either an opinion on the law, legal services, or assistance in some legal proceeding but not for the purpose of committing a crime or tort; and
4. The privilege has been claimed and not waived by the client.[3]

Narrow Construction of the Privilege

The court observed that the privilege was to be narrowly construed "since it stands as an exception to the policy favoring full disclosure and discovery of all facts in the pursuit of truth."[4] Although one may have considerable concern in undertaking an analysis of the privilege, under the circumstances presented, the nature of the dispute made an analysis unavoidable. However, the first question to be determined was whether communications between counsel and a creditors' committee, which met all the above criteria, were protected from disclosure by the attorney/

[2] 38 Bankr. at 804.

[3] Criteria summarized from United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 358–359 (D. Mass. 1950).

[4] 38 Bankr. at 804.

client privilege. Counsel for the objectors argued that the privilege was inimical to the very purposes of a creditors' committee, which was established not merely to represent creditors in the negotiation of a plan, but to provide them with ready access to information regarding a debtor's affairs.

Relationship of Privilege to Fiduciary Responsibilities of Committee

The court's response to the objections took cognizance of the fiduciary responsibilities that a creditors' committee owed to those it represents, but the court was unconvinced that the attorney/client privilege was inherently antagonistic to those responsibilities.

> The purposes underlying the privilege have no less applicability to a creditor's committee than they do to any other entity, at least when disclosure or privileged communications is sought by those who are not represented by the committee, or who stand in an adversarial relationship with it. If the committee cannot engage in 'full and frank communications' with its attorneys without fear of disclosure to such outsiders, then its work may be seriously hampered, to the detriment of those it represents.[5]

[5] *Id.* at 804–805.

Balancing of Privilege

However, the court noted that although the privilege may be absolute as to those who are not represented by the creditors' committee, a narrower construction was needed as to those represented: "A fiduciary owes the obligation to his beneficiaries to go about his duties without obscuring his reasons from the legitimate inquiries of the beneficiaries."[6] This relationship required a "balancing" of the injury resulting from disclosure with the interest of those whom the committee represented in obtaining information. Analogies that the court drew were the relationship between a corporation and its shareholders and of controlling shareholders to minority shareholders.

Analogy to Shareholder Derivative Suits

Analyzing cases in which shareholders have sought disclosure of privileged information from a corporation in shareholder derivative suits, the bankruptcy court, citing the *Garner* case,[7] stated that "many courts have held that the privilege is available

[6] *Id.* at 805 (quoting from Valente v. Pepsico, Inc., 68 F.R.D. 361, 370 (D. Del. 1975)).

[7] Garner v. Wolfinbarger, 430 F.2d 1093, 1103–1104 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971).

to the corporation subject to the right of the stockholders to show cause why it should not be invoked in the particular instance. . . . This same rule has been applied in cases involving other types of fiduciary relationships. . . . (defendant bank acting as fiduciary for plaintiff in a land purchase) . . . (rule applied to pension fund trustees). . . ."[8]

Burden of Nondisclosure Is on Committee

The court thought that the doctrine in the *Garner* case struck an appropriate balance between the creditor's right to information and the committee's need for confidentiality, "and accordingly, we find it applicable to requests by creditors for privileged information from the committee that represents them."[9] However, the court concluded that the committee should bear the burden of establishing good cause for not disclosing privileged information to its constituent creditors. Nonetheless, the court indicated that there might be sound policy reasons for nondisclosure that did not involve the attorney/client relationship and that such situations should be dealt with on a case-by-case basis in order to adequately protect the interests of both fiduciaries and beneficiaries.

Control Group Test Rejected

Having found that the BUCC Official Committee was entitled to the protection afforded the attorney/client privilege, the court found that nonvoting members "are no less 'necessary' to the workings of the committee than are voting members, and accordingly that their presence in no way threatens the privileged nature of communications with counsel."[10] The court rejected the argument of the BUCC Official Committee's counsel seeking to apply the "control group" test, which was specifically rejected in *Upjohn*.[11] That test provided that only voting members control the committee's decision-making process. The court pointed out that FNBC was an indenture trustee for some $180 million in debentures issued by the debtor and that FNBC desired the status of a nonvoting member in order to avoid a conflict of interest between its fiduciary duties to the debenture holders and its fiduciary duties as a committee member. Considering the substantial interests of FNBC, "it can hardly be asserted that their nonvoting status makes their input as a committee member unnecessary to the committee's counsel in rendering legal advice, or that it should be considered a 'stranger' to the committee. Cer-

[8] 38 Bankr. at 805.
[9] *Id.*
[10] *Id.* at 806.
[11] Upjohn v. United States, 449 U.S. 383, 397 (1981).

tainly *Upjohn* requires a contrary result."[12]

Governmental Units Ineligible for Committee Membership

As to the eligibility of the FDIC's membership, the court focused on Section 1102(b) of the Bankruptcy Code: " 'A committee of creditors appointed under subsection (a) of this section shall ordinarily consist of the *persons* willing to serve, that hold the seven largest claims against the debtor. . . .' A 'person' as defined in Section 101(30) 'includes individual, partnership, and corporation, *but does not include governmental unit.*' "[13] Nor was the court impressed with the FDIC's argument that it only precludes a governmental unit acting as a voting member of a committee. Accordingly, the motion of the BUCC Official Creditors' Committee to amend the court's order appointing the committee was granted to the extent of removing the FDIC from the committee and reclassifying it as an invitee and denied insofar as it sought to remove the FNBC and reclassify it as an invitee.

Observation

The case clarifies the two capacities in which creditors may become members of the committee as well as attain the status of invitees. Voting on committee resolutions is performed only by fullfledged members. However, nonvoting or ex officio members are entitled to participate in all discussions and resolutions. Confidential information between the committee's attorney and the committee can be revealed to the nonvoting members without the privilege being waived. Invitees have none of the rights that are accorded to nonvoting members and in essence are merely auditors.

Any creditor who requests confidential information from the committee puts the burden on the committee to establish good cause as to why the information should not be given. Each situation will be disposed of on a case-by-case basis. Moreover, in such situations, the statement made to a creditor in confidence as authorized by the court should be protected by the attorney/client privilege to the same extent as if it had been made to a member of the committee.

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[12] 38 Bankr. at 806.

[13] *Id.* (emphasis added). At the time of this decision, "person" was defined in § 101(30). Pursuant to subsequent amendments, the definition of "person" is now contained in § 101(35).