Protecting the Attorney-Client Privilege in Corporate Families

January/February 2008

Kelly M. Mayerfeld

The importance and practical benefits resulting from the use of the same in-house counsel for an entire corporate family are numerous. For example, the in-house attorneys are particularly familiar with the corporate family's structure, can assist with joint public filings, and can expertly oversee the corporate family's compliance with regulatory regimes. If a subsidiary in the corporate family becomes financially distressed, however, the creditors of the financially distressed entity may look to the parent corporation for recourse. In seeking to advance their litigation, creditors of the subsidiary may claim that various information distributed by or to in-house counsel is discoverable by such creditors because the same in-house attorneys represented the entire corporate family. In essence, the creditors may argue that although the information is protected against disclosure to third parties by the attorney-client privilege, the privilege cannot be invoked to preclude joint clients from accessing such information. In such a context, may the parent corporation successfully assert the privilege against its former family member? Given the widespread practice of utilizing the same in-house counsel for a corporate family, the need for clear guidelines with respect to protecting the attorney-client privilege is important.

The Third Circuit recently provided guidance on this issue in *Teleglobe USA, Inc. v. BCE, Inc. (In re Teleglobe Communications, Inc.),* where it held, among other things, that a debtor subsidiary could not breach the attorney-client privilege solely because the corporate family used the same in-house counsel. If the in-house counsel, however, jointly represented the debtor subsidiary and the parent on a matter central to the litigation between the debtor subsidiary and the parent, *Teleglobe* stands for the proposition that the parent could not successfully assert the attorney-client privilege, and the parent would be forced to produce the documents related to that representation to the debtor subsidiary and its creditors. Thus, corporate families that utilize the same in-house attorneys should carefully analyze the *Teleglobe* decision to ensure that the attorney-client privilege is not unintentionally waived as a result of the activities of its in-house attorneys.

Background

In *Teleglobe*, the chapter 11 debtors (the “Debtors”) were wholly owned subsidiaries of Teleglobe, Inc. (“Teleglobe”). The Debtors commenced an action in their bankruptcy proceeding against Bell Canada Enterprises, Inc. (“BCE”), Teleglobe’s parent. The Debtors alleged in their complaint that BCE’s actions led to Teleglobe’s financial distress. According to the Debtors, in late 2000, BCE directed Teleglobe to accelerate the development of a fiber optic network called GlobeSystem and pledged its financial support. Further, the Debtors alleged that BCE caused Teleglobe and its subsidiaries to borrow $2.4 billion from banks and bondholders to fund the costly endeavor. After those funds were exhausted, BCE approved an $850 million equity infusion for Teleglobe and announced its intention to continue funding Teleglobe. About this time, BCE began to reassess Teleglobe’s future, based upon, among other things, BCE’s declining confidence in the profitability of GlobeSystem. In April 2001, BCE opted to discontinue Teleglobe’s funding. Within weeks, Teleglobe and the Debtors filed for restructuring relief in Canada, and the Debtors also filed for chapter 11 relief in the U.S. Bankruptcy Court for the District of Delaware.

Based upon BCE's participation in funding and subsequent abandonment of Teleglobe, the Debtors sued BCE under numerous theories, including breach of fiduciary duties, misrepresentation, and estoppel. The district court withdrew its automatic reference to the bankruptcy court with respect to the Debtors' suit. During the course of the litigation, the parties became embroiled in numerous discovery disputes. The district court referred the discovery issues to a special master. In response to the Debtors' motion to compel production of documents, BCE indicated that it had produced all nonprivileged documents related to Teleglobe other than those reflecting legal advice to BCE solely. The Debtors argued, among other things, that as a result of broad joint representation between BCE and Teleglobe by the in-house attorneys, the documents were not protected by the attorney-client privilege. Upon an *in camera* review of certain documents that BCE claimed as privileged, the special master ultimately determined that the in-house attorneys jointly represented BCE and Teleglobe on issues relating to Teleglobe's abandonment. The special master then reviewed all 800 documents on the privilege log *in camera* and stated that the documents revealed a broad, joint representation of BCE and Teleglobe by the in-house attorneys and that all documents, even those prepared by outside counsel solely for BCE, were discoverable. The district court affirmed.

The Co-Client Doctrine

Upon appeal, the Third Circuit noted the importance of in-house counsel and the need for clarity with respect to the application of the attorney-client-privilege principles in relation to in-house counsel. To that end, the court took the opportunity to expound upon the relevant privilege doctrines. The court explained that the joint-client or co-client privilege, which applies when two or more clients hire the same attorney to represent them on a matter of common interest, closely aligns to the issues presented by modern in-house counsel. Under the co-client doctrine, communications between co-clients and their attorneys are protected by the privilege against parties outside the joint representation but are available among the co-clients in adverse litigation. Further, a co-client may assert the privilege regarding communications between itself and the joint attorney for matters outside the joint representation, even if interests between the co-clients had diverged to a point that the joint attorney had an ethical duty to end the dual representation.

Viewing each entity in the corporate family as a separate client of the in-house attorneys, the court noted that it was permissible for the members of the corporate family and the in-house attorneys "to limit the scope of a joint representation in a sophisticated manner; nothing requires construing the scope of a joint representation more broadly than the parties to it intend." Further, the court observed that it is inevitable that parent and subsidiary companies may find that their interests have diverged, particularly in situations involving spinoffs, financial distress, and sale. In those situations, the court noted, the parent should secure separate representation for the subsidiary, as maintaining joint representation could risk the forced production of documents to its former subsidiary in adverse litigation. Nonetheless, in-house counsel can still jointly represent the subsidiary on matters apart from those relating to the spinoff, financial distress, or sale. Thus, in-house counsel could take steps to protect a parent company's privilege by carefully entering into joint representations only when necessary, limiting the scope of such representations, and separating counsel on matters in which subsidiaries' interests are adverse to the parent.

Turning to the case at hand, the court held that although BCE and Teleglobe may have been parties to a joint representation, the lower court should not have ordered the production of all documents without a finding that BCE and the Debtors were parties to a joint representation. Further, the court held that Teleglobe could not effectively waive the privilege in favor of the Debtors, because a co-client cannot waive the privilege in favor of a third party without the consent of the other co-client. Moreover, the court held that the fact that documents prepared by outside counsel to BCE were funneled through in-house counsel had no significance to the privilege issue. What mattered was the scope of any joint representation—documents within the scope of a joint representation are discoverable, while those outside the scope are not. Thus, on remand, the court ordered the district court to determine whether BCE and the Debtors were party to a joint representation on a matter of common interest.

The Fiduciary Exception to the Attorney-Client Privilege

The Debtors also argued that they should be allowed to access the privileged documents by application of the fiduciary exception to the attorney-client privilege set forth in *Garner v. Wolfinbarger*. In *Garner,* the court held that:

> where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance.

Under *Garner*, upon a showing of good cause, shareholders of a corporation may invade the attorney-client privilege to prove fiduciary breaches by those in control of the corporation.

The Debtors argued that the *Garner* exception applied in equal force to their situation: BCE controlled the Debtors, the Debtors were insolvent, BCE had fiduciary duties to the Debtors, and the creditors of the Debtors were the primary beneficiaries of such duties.

The Third Circuit opined that Delaware courts might extend the *Garner* exception to such a situation. The court, however, lacked sufficient information to rule on the Debtors' arguments. The court noted that, on remand, critical issues to consider would be whether the Debtors were insolvent at the time of the privileged communications and whether the Debtors had a colorable claim of breach of fiduciary duty to show "good cause" to invade the privilege.

Conclusion

The Third Circuit's decision in *Teleglobe* provides helpful guidance with respect to protecting the attorney-client privilege among corporate entities that use the same in-house counsel. Among other things, *Teleglobe* offers parameters for the use of in-house counsel, including entering into joint representations only when necessary; carefully limiting the scope of such representations; and separating counsel on matters where the corporate entities are likely to be adverse, such as spinoffs, sales, and insolvency. Further, *Teleglobe* acknowledged the possibility of a viable fiduciary-exception response by creditors of a financially distressed corporation to a corporate parent's assertion of the attorney-client privilege. Thus, as a result of the numerous privilege issues deliberated upon, the important *Teleglobe* decision should be carefully considered by those addressing attorney-client privilege matters within corporate families.

Teleglobe USA, Inc. v. BCE, Inc. (In re Teleglobe Communications, Inc.), 493 F.3d 345 (3d Cir. 2007).

Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970).