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HEADNOTE: IN THE COURTS

Steven A. Meyerowitz 193

**TREATMENT OF "MAKE-WHOLE" AND "NO-CALL" PROVISIONS BY
BANKRUPTCY COURTS**

David M. Hillman and Lawrence S. Goldberg 195

**DELAWARE COURT OF CHANCERY REJECTS ATTEMPT BY
CREDITORS OF INSOLVENT LLC TO BRING DERIVATIVE CLAIMS**

Robert S. Reder and Nehal M. Siddiqui 201

**DOES THE RECENT STRING OF EXAMINER APPOINTMENTS IN
DELAWARE REPRESENT A SEA CHANGE IN APPROACH OR MERELY
A PERFECT STORM OF CASES?**

Ryan M. Murphy 207

***IN RE LESLIE CONTROLS, INC.*: THE DELAWARE BANKRUPTCY
COURT WEIGHS IN ON THE COMMON-INTEREST DOCTRINE**

Brad B. Erens and Timothy W. Hoffmann 226

***IN RE QUIGLEY COMPANY, INC.*: NEW YORK BANKRUPTCY COURT
DENIES CONFIRMATION OF PROPOSED CHAPTER 11 ASBESTOS
PLAN**

Brad B. Erens 232

GERMAN BANK RESTRUCTURING ACT TAKES EFFECT

Thomas Schürle and Klaudius Heda 237

THE YEAR IN BANKRUPTCY: PART I

Charles M. Oellermann and Mark G. Douglas 244

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In re Leslie Controls, Inc.:
The Delaware Bankruptcy Court Weighs In
on the Common-Interest Doctrine

BRAD B. ERENS AND TIMOTHY W. HOFFMANN

The authors of this article explain a recent Delaware bankruptcy court decision which provides parties participating in plan negotiations some reassurance that sharing documents during the course of such negotiations will not make the materials subject to discovery in later litigation.

The “common interest” doctrine allows attorneys representing different clients with aligned legal interests to share information and documents without waiving the work-product doctrine or attorney-client privilege. Issues involving the common-interest doctrine often arise during the course of a business restructuring, because restructurings tend to involve various constituencies, including the company, the official committee of unsecured creditors, secured debt holders, other creditors, and equity holders, whose legal interests may be aligned at any one time. As a result, restructuring scenarios often produce strange bed-fellows, as what would otherwise appear to be competing factions work together to build a consensus on how to proceed with a restructuring.

*In re Leslie Controls, Inc.*¹ is the latest decision from the Delaware

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bankruptcy court addressing the common-interest doctrine. In *Leslie*, the court determined that the common-interest doctrine protected certain prepetition communications and documents relating to insurance coverage for potential asbestos liabilities that counsel to Chapter 11 debtor Leslie Controls, Inc., shared with counsel to an ad hoc committee of asbestos plaintiffs and counsel to a proposed future-claims representative during the course of restructuring negotiations. The negotiations eventually culminated in a bankruptcy filing and the submission of a consensual plan of reorganization.

THE COMMON-INTEREST DOCTRINE

The common-interest doctrine applies only to documents or communications that are otherwise protected from discovery under the attorney-client privilege or work-product doctrine. As such, rather than establishing an independent basis to prevent discovery of communications or documents, the common-interest doctrine expands the attorney-client privilege and work-product doctrine to allow parties represented by separate attorneys to share communications and documents without losing the protections afforded by the attorney-client privilege or work-product doctrine. To demonstrate successfully that the common-interest doctrine applies to a communication or document, three elements must be satisfied:

- the communication was made by separate parties in the course of a matter of common interest;
- the communication was designed to further that effort; and
- the privilege has not otherwise been waived.

As noted by a California bankruptcy court in its 1997 ruling in *In re Mortgage & Realty Trust*,² with respect to the first element, the parties must show that “at least a substantially similar legal interest” exists, but complete agreement or accord among the parties is unnecessary. “The privilege applies where the interests of the parties are not identical, and it applies even where the parties’ interests are adverse in sub-

stantial respects.” In fact, the common-interest doctrine may apply between codefendants even if a lawsuit appears likely between them sometime in the future. When the parties’ interests diverge, however, the common-interest doctrine will not apply to communications involving those matters as to which the parties fail to possess a common interest.

To satisfy the second element, the parties must demonstrate that the purpose of the communication at issue was to further the common interest shared among the parties. Stated otherwise, the existence of a theoretical common interest is not sufficient; parties must affirmatively demonstrate a collective cooperation in the development of a shared legal strategy.

Finally, the third element requires the parties not to have otherwise waived the attorney-client privilege or protections afforded under the work-product doctrine.

LESLIE CONTROLS

Leslie Controls involved a discovery dispute between certain insurance companies and the debtor, a manufacturer of industrial water heaters, control systems, and regulators based in Tampa, Florida. The insurance companies provided insurance coverage for various asbestos liabilities of the debtor. Those asbestos liabilities ultimately led the debtor to file for Chapter 11 protection in Delaware in July 2010.

Prior to filing for bankruptcy, the debtor engaged in negotiations with an ad hoc committee of asbestos plaintiffs and a proposed future claimants’ representative regarding a potential plan of reorganization. During the course of these negotiations, the debtor shared various documents with the ad hoc committee and the proposed future-claims representative, including a memorandum prepared by the debtor’s insurance coverage lawyers. The memorandum addressed how various legal positions taken by the insurance companies would impact creditor recoveries under a plan of reorganization. The sharing of the memorandum, other documents, and communications occurred, in part, prior to the time that the debtor, the ad hoc committee, and the proposed future-claims representative reached an agreement on the terms of a Chapter 11 plan.

The debtor asserted that the memorandum and other documents and

communications among itself, the ad hoc committee, and the proposed future-claims representative were protected from discovery under the common-interest doctrine. The bankruptcy court agreed with the debtor.

Before issuing its opinion, the court conducted an *in camera* review of the memorandum, related documents, and other communications and concluded that the items were all subject to either the attorney-client privilege or the work-product doctrine. Accordingly, the sole remaining issue involved whether the debtor's sharing of the documents and other communications caused a waiver of the privilege or whether the documents and communications remained protected from discovery under the common-interest doctrine.

In its analysis of the common-interest doctrine, the court first determined that the debtor, the ad hoc committee, and the proposed future-claims representative all shared a common *legal* interest, disagreeing with the insurance companies' argument that the parties shared, at most, a common commercial interest, which may be insufficient to assert a privilege under the common-interest doctrine. In making this determination, the court noted that a party asserting the common-interest doctrine must provide evidence that a legal interest is implicated. The debtor, the ad hoc committee, and the proposed future-claims representative, the court observed, shared an interest in "preserving and maximizing the insurance proceeds available to pay asbestos claims." According to the court, this was an inherently legal interest, because it involved an analysis of the insurance policies and related documents, in addition to insurance, contract, and bankruptcy law.

The bankruptcy court next turned to the question of whether the debtor, the ad hoc committee, and the proposed future-claims representative shared a common interest. The insurance companies asserted that the parties could not have shared a common interest prior to reaching an agreement on a Chapter 11 plan structure. The insurance companies buttressed this argument by stating that during the course of negotiations, the sole interest of the ad hoc committee and the proposed future-claims representative was to maximize recoveries for their respective creditor constituencies, and therefore their interests were diametrically opposed.

The bankruptcy court noted that the insurance companies' position

on this point would essentially create a per se rule that parties engaged in negotiations could never share a common interest. Although the court acknowledged that some case law exists to support this position, it explained that other case law, including the Third Circuit's 2007 ruling in *In re Teleglobe Comm. Corp.*,³ which involved the negotiation of a merger agreement, supports a contrary conclusion.

After concluding that a case-by-case approach is appropriate for assessing the issue, the *Leslie* court determined that the debtor, the ad hoc committee, and the proposed future-claims representative shared the requisite common interest. In reaching this conclusion, the court cited to a New Jersey district court's 2008 ruling in *Louisiana Municipal Police Employees Retirement System v. Sealed Air Corp.*,⁴ a case that addressed whether parties shared a common interest in the context of a class-action lawsuit for alleged violations of securities laws. The focus of the litigation in *Sealed Air* was the solvency of chemical conglomerate W.R. Grace & Co. at the time it engaged in a major corporate transaction with Sealed Air Corporation ("SAC"). The plaintiff sought the production of documents relating to potential asbestos liabilities that the companies shared between themselves while negotiating the transaction. SAC asserted that the documents were privileged and subject to the common-interest doctrine. The district court agreed with this position, stating that "the fact that the parties were on adverse sides of a business deal...does not compel the conclusion that the parties did not share a common legal interest."

Following the court's analysis in *Sealed Air*, the *Leslie* court concluded that although the debtor, the ad hoc committee, and the proposed future-claims representative had conflicting interests in attempting to maximize their respective constituencies' recoveries, they shared with the debtor a common interest in maximizing the collective pool of assets, including any insurance proceeds. As such, the court concluded, the necessary common interest existed among the parties.

CONCLUSION

Debtors and their respective creditor constituencies often engage in negotiations prior to and during a Chapter 11 case in an attempt to achieve a

consensual restructuring. Equally common is litigation over the confirmation of a Chapter 11 plan. Therefore, the ability of debtors and their various creditor constituencies to share information during plan negotiations without losing the protections afforded by the attorney-client privilege or work-product doctrine in subsequent litigation is an important issue. In this regard, *Leslie Controls* provides parties participating in plan negotiations some reassurance that sharing documents during the course of such negotiations will not make the materials subject to discovery in later litigation.

NOTES

¹ *In re Leslie Controls, Inc.*, 437 B.R. 493 (Bankr. D. Del. 2010).

² *In re Mortgage & Realty Trust*, 212 B.R. 649 (Bankr. C.D. Cal. 1997).

³ *In re Teleglobe Comm. Corp.*, 493 F.3d 345 (3d. Cir. 2007).

⁴ *Louisiana Municipal Police Employees Retirement System v. Sealed Air Corp.*, 253 F.R.D. 300 (D.N.J. 2008).