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By Scott J. Bogucki

Good-Faith Affirmative Defenses and the "At Issue Doctrine"

Scott Bogucki is a partner with Gleichenhaus, Marchese & Weishaar, PC in Buffalo, N.Y., where he represents clients in complex restructurings, bankruptcy litigation and commercial transactions. He also serves as a coordinating editor for the ABI Journal.

Generally speaking, virtually all communications between attorneys and their clients and any information obtained by attorneys during the attorney/client relationship are deemed confidential. Therefore, attorneys have an ethical obligation not to disclose their contents.[1] Under certain circumstances, this information may be further afforded evidentiary protection by attorney/client privilege, one of the oldest common law privileges for confidential information.[2]

The *Restatement (Third) of the Law Governing Lawyers* states that the privilege "may be invoked ... with respect to: (1) a communication (2) made between privileged persons (3) in confidence (4) for the purpose of obtaining or providing legal assistance for the client."[3] For purposes of the attorney/client privilege, "privileged persons" include clients, prospective clients and attorneys, as well as each of their agents who facilitate communications among them, and agents of the attorney who assist in the client's representation.[4] The right to assert the privilege rests solely with the client; however, it might be invoked by agents of the client, including their attorney.[5]

Neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure address the attorney/client privilege.[6] According to the Federal Rules of Evidence, state law governs the attorney/client privilege in civil cases.[7] This privilege is not absolute; rather, it is narrowly construed, burdened with exceptions, and susceptible to various ways in which it might be expressly or impliedly waived. The "at issue doctrine" describes how the privilege might be lost through asserting a claim or defense that compels an adversary to seek discovery of privileged communications to deny allegations or defend against a claim. Courts typically employ one of three fact-intensive tests to determine whether the at-issue doctrine results in a waiver of the attorney/client privilege.[8]

The *Hearn* Test

Decided in 1975, *Hearn v. Rhay* stated the broadest "at issue" exception to the attorney/client privilege.[9] In *Hearn*, the plaintiff alleged civil rights violations, and the defendants asserted six affirmative defenses, including that they acted in good faith and were therefore immune from suit.[10] In response, the plaintiff sought discovery of communications that the defendants received from the Washington Attorney General.[11]

The *Hearn* court analyzed the cases relied upon by the plaintiff to argue that the communications were not privileged, noting that in each, "the party asserting the privilege placed information protected by it in issue through some affirmative act for his own benefit, and to allow the privilege to protect against disclosure of such information would have been manifestly unfair to the opposing party."[12] The court granted the plaintiff's motions to compel discovery, holding that an implied waiver of the privilege exists when (1) an affirmative act such as filing suit results in the assertion of privilege, (2) through which the asserting party places protected infor-

1 *See* Model Code of Prof'l Conduct r. 1.6.
2 *Upjohn Co. v. United States*, 449 U.S. 383, 390 (1981).
3 *Restatement (Third) of the Law Governing Lawyers* § 68 (2003).
4 *Id.* at § 70.
5 *Id.* at § 86.
6 *See, e.g., In re O.P.M. Leasing Servs. Inc.*, 13 B.R. 54, 58 (Bankr. S.D.N.Y.), *aff'd*, 13 B.R. 64 (S.D.N.Y. 1981) (courts have flexibility to develop ever-evolving rules of privilege on case-by-case basis); *cf.*, Fed. R. Civ. P. 26 (governing discovery of nonprivileged information); Fed. R. Bankr. P. 7026 (Rule 26 is applicable to adversary proceedings).
7 *See* Fed. R. Evid. 501.
8 *See generally* Douglas R. Richmond, "The Frightening At-Issue Exception to the Attorney/Client Privilege," 121 *Penn St. L. Rev.* 1, 16 (2016).
9 68 F.R.D. 574 (E.D. Wash. 1975).
10 *Id.* at 577.
11 *Id.* at 577-78.
12 *Id.* at 581.

mation at issue by making it relevant to the litigation, and (3) upholding that the privilege would deny the opposing party information vital to their defense.[13]

The *Rhone-Poulenc* Test

The Third Circuit created the most conservative "at-issue doctrine" test.[14] In *Rhone-Poulenc*, more than 200 plaintiffs sued a pharmaceutical company for claims arising from HIV infections, which led to the defendant filing a declaratory judgment against one of its insurers to allege that the insurer owed it coverage for the suits, thereby triggering that insurer to commence its own declaratory judgment action against another insurer by way of a third-party complaint.[15]

The two insurers contended that when procuring its insurance, the defendant knew of the HIV transmissions, concealed its knowledge and further knew that its actions posed an unreasonable risk of harm to the people using its product.[16] The insurers argued that the defendant placed its lawyers' advice at issue by filing the declaratory-judgment action, thereby waiving any attorney/client privilege.[17]

The Third Circuit found that the attorney/client privilege deserves "maximum legal protection" because it serves the interests of justice.[18] The court held that advice of counsel is placed in issue and not protected by privilege only when "the client asserts a claim or defense, and attempts to prove that claim or defense by disclosing or describing an attorney/client communication."[19]

Criticizing the *Hearn* decision, the court eschewed the notion that relevance of the privileged communications should be considered, regardless of the information sought being vital or highly probative, or whether the subject of the communications might have affected the client's state of mind in a relevant manner.[20] The Third Circuit valued predictability in creating its test, further stressing that the holder of the privilege — namely, the client — is the sole party in control of the privilege and the only one able to waive it.[21] The court held that whether the client placed their state of mind in issue is irrelevant to the court's analysis.[22] The court issued a *writ of mandamus*, quashed the subpoenas authorized and upheld by the lower courts, and remanded for further proceedings.[23]

The *Erie* Test

The test developed by the Second Circuit lies between those announced in *Hearn* and *Rouse-Poulenc*.[24] In *County of Erie*, the court was called upon to settle various discovery disputes arising from litigation involving allegations of civil rights violations.[25] The communications at issue were emails between the Erie County Attorney and the Erie County Sheriff's Office, in which the attorney's office reviewed the law, assessed the county's current policies, recommended alternative policies and monitored the implementation of those policies.[26]

Relying on the *Hearn* test, the district court found an implied waiver of the attorney/client privilege based on the defendants' asserting a qualified-immunity defense.[27] Recognizing that the *Hearn* test was the subject of both judicial and academic reproach as compelling too broad of discovery, the Second Circuit further criticized the use of the test because it "presume[d] that the information is relevant and should be disclosed" and lacked "the essential element of reliance on privileged advice in the assertion of the claim or defense in order to effect a waiver."[28]

The court held that a party must rely on privileged communications to put them at issue. In *Erie*, the asserted defense was based on whether the defendants were in compliance with the law at the time of the alleged defense, an objective standard not relying on advice of counsel.[29] The court clarified that the defendants did not assert "a good-faith or state-of-mind defense," and that protecting the communications would not prejudice the plaintiffs.[30] Upon granting the petition for *mandamus*, the court advised that the plaintiffs could reargue the privilege issue if the defendants later attempted to assert the advice of counsel or their good faith as defenses at trial.[31]

Good Faith in Bankruptcy and the At-Issue Doctrine

The Bankruptcy Code does not define "good faith," but the phrase is codified in numerous sections.[32] Courts have also interpreted certain sections to implicitly contain a good-faith requirement.[33] In fraudulent- transfer litigation, § 548(c) provides transferees with an affirmative defense if they can prove that they received the transfer for value and in good faith.[34] Given the lack of any reliable definition of "good faith," courts analyze suspect transfers by an objective standard and "look to what the transferee 'knew or should have known' in questions of good faith, rather than examining what the transferee actually knew from a subjective standpoint."[35]

As a potential bankruptcy litigation pitfall, once the good-faith affirmative defense has been raised, information once assumed to be protected by the attorney/client privilege might be susceptible to discovery. Unfortunately, there is sparse case law indicating how bankruptcy courts may handle discovery issues involving the issue of good faith and privileged information in this context. In *Welch v. Regions Bank (In re Mongelluzzi)*, the U.S. Bankruptcy Court for the

13 *See id.*
14 *Rhone-Poulenc Rorer v. Home Indem. Co.*, 32 F.3d 851 (3d Cir. 1994).
15 *Id.* at 855.
16 *Id.* at 855-56.
17 *Id.* at 857.
18 *Id.* at 862 (citing *Haines v. Liggett Grp. Inc.*, 975 F.2d 81, 90 (3d Cir. 1992)).
19 *Id.* at 863.
20 *See id.* at 864.
21 *Id.* at 863.
22 *See id.* at 864.
23 *Id.* at 866.
24 *Pritchard v. Cnty. of Erie (In re Cnty. of Erie)*, 546 F.3d 222 (2d Cir. 2008).
25 *Id.* at 224-25.
26 *Id.* at 225 (quoting *In re Cnty. of Erie*, 473 F.3d 413, 416 (2d Cir. 2007)).
27 *Id.* at 226.
28 *Id.* at 227-30.
29 *Id.* at 229.
30 *Id.*
31 *Id.* at 230.
32 *See, e.g.*, 11 U.S.C. §§ 1129(a)(3); 1225(a)(3); 1325(a)(3) (requirement for plan confirmation); 11 U.S.C. § 1113(b)(2) (requirement for rejection of collective-bargaining agreement); 11 U.S.C. § 363(m); 11 U.S.C. § 364(e) (mootness doctrine); *cf.*, 11 U.S.C. § 303(i)(2) (penalties for commencing involuntary case in bad faith).
33 *See* 11 U.S.C. § 1108 (authority to operate business); *see also In re Curlew Valley Assocs.*, 14 B.R. 506, 513-14 (Bankr. D. Utah 1981) (court will not object to conduct involving business judgment made in good faith).
34 *See* 11 U.S.C. § 548(c); *see also Bayou Superfund LLC v. WAM Long/Short Fund II LP (In re Bayou Grp. LLC)*, 362 B.R. 624, 631 (Bankr. S.D.N.Y. 2007) ("The good-faith/value defense provided in section 548(c) is an affirmative defense, and the burden is on the defendant-transferee to plead and establish facts to prove the defense.").
35 *Hayes v. Palm Seedlings Partners-A (In re Agric. Research & Tech. Grp. Inc.)*, 916 F.2d 528, 535-36 (9th Cir. 1990).

Middle District of Florida recently ordered production of various documents held to be privileged after the court held that the defendant "injected the issue of good faith into these proceedings by asserting good faith as its affirmative defense under § 548(c)."[36] At a prior hearing, the court ruled that the defense "placed [the defendant's] state of mind at issue" and directed that various emails be produced for *in camera* inspection.[37] The trustee filed a supplemental memorandum of law, arguing that the court's bench decision should end the inquiry and allow discovery of all the subject emails.[38]

In its written opinion, the court stated that it had wide discretion to determine discovery issues and that federal courts look to state law to determine the extent of attorney/client privilege.[39] The court took guidance from *In re Gibco Inc.*, an opinion decided by the U.S. District Court for the District of Colorado when faced with similar claims and defenses.[40] In granting the trustee's motion to compel in part, the *Gibco* court interpreted *Rhone-Poulenc* for the general proposition that a waiver may occur when a claim or affirmative defense puts the privileged matter directly at issue.[41] However, the court noted that a waiver is most likely found when the party affirmatively relies on privileged matters in their claim or defense.[42]

In examining the nature of the affirmative defense, the court turned to *Jobin v. McKay*, an opinion from the Fourth Circuit.[43] The *Gibco* court interpreted *Jobin* as indicating that "good faith includes both objective and subjective components."[44] The court further explained that "*Jobin* upheld the consideration of objective circumstances when a claimed lack of subjective knowledge and intent may have been achieved through neglect or lack of diligence."[45]

The *Mongelluzzi* court addressed the trustee's supplemental briefing, which considered *Hearn* to be the "seminal case on the 'at issue' exception."[46] The court found that *Hearn* created only a narrow exception to the attorney/client privilege and recognized that documents might be protected from production "where the plaintiff does not have a particularly compelling case."[47] The court held that for the at-issue waiver to apply, (1) the subject evidence must be "the 'most probative, if not the only'" evidence of the defendant's knowledge at the relevant time period; (2) the party seeking discovery would be prejudiced if they were unable to use that documentary evidence to corroborate or contradict the asserted claim or defense; and (3) the privilege had been waived to the extent that the information is relevant to the issues.[48] Contrary to the trustee's arguments, the court noted that this test did not provide a "blanket waiver of the attorney/client or work-product privilege such that every document for which a privilege had been asserted was required to be produced."[49]

Conclusion

Several aspects of the at-issue doctrine remain certain. First, filing suit alone does not put attorney/client communications at issue, even if they provide the basis for the complaint or petition.[50] Second, a defendant's denial of allegations alone is not sufficient to place privileged communications at issue.[51] Finally, neither party may put an opponent's privileged communications at issue by their own affirmative action.[52]

Matters of privilege become murky as soon as they are alleged to be put at issue. The *Gibco* court arguably misread the narrow application of the *Rhone-Poulenc* test, neglecting the requirement that the party must also attempt to prove their claim or defense by disclosing or describing privileged communications and not merely relying on them. Taken together with the *Gibco* court's focus on the subjective component of the affirmative defense, it would appear that it was applying a hybrid of both the *Rhone-Poulenc* and *Hearn* tests. After following the *Gibco* court's reasoning, the *Mongelluzzi* court reached its decision only after conducting an in-camera review of the subject documents and communications.

As the unsettled law surrounding the at-issue doctrine illustrates, bankruptcy professionals must remain aware of the issues involving attorney/client privilege, its exceptions and various waivers, and the nuances they produce, from the moment they begin consulting prospective clients, and always be wary of the pitfalls they might cause in litigation. abi

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36 568 B.R. 702, 713 (Bankr. M.D. Fla. 2017).
37 *Id.* at 707-08.
38 *Id.* at 708.
39 *Id.* at 709-10 (citing Fed. R. Civ. P. 26(b); *Arthur v. Comm'r, Ala. Dept. of Corrections*, 840 F.3d 1268, 1304 (11th Cir. 2016)).
40 *Id.* at 712 (citing *In re Gibco Inc.*, 185 F.R.D. 296 (D. Colo. 1997)).
41 *Gibco*, 185 F.R.D. at 300 (citing *Rhone-Poulenc*, 32 F.3d at 862-64)).
42 *Gibco*, 185 F.R.D. at 300 (citing *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156 (9th Cir. 1992)).
43 84 F.3d 1330 (10th Cir. 1996).
44 *Gibco*, 185 F.R.D. at 300-01 (citing *Jobin*, 84 F.3d at 1335).
45 *Gibco*, 185 F.R.D. at 301.
46 *Mongelluzzi*, 568 B.R. at 712.
47 *Id.* at 712-13 (citing *Hearn*, 68 F.R.D. at 581-82)).
48 *See id.* at 712 (citing *Gibco*, 185 F.R.D. at 301).
49 *Mongelluzzi*, 568 B.R. at 712.
50 *See, e.g., Navajo Nation v. Peabody Holding Co.*, 255 F.R.D. 37, 50 (D.D.C. 2009) (advice of counsel not at issue even though relevant to claims for fraudulent concealment and affirmative reliance).
51 *See, e.g., Lorenz v. Valley Forge Ins. Co.*, 815 F.2d 1095, 1098 (7th Cir. 1987) ("To waive the attorney/client privilege by voluntarily injecting an issue in the case, a defendant must do more than merely deny a plaintiff's allegations.").
52 *See, e.g., Gardner v. Major Auto. Cos. Inc.*, No. 11 Civ. 1664(FB)(VMS), 2014 WL 1330961, at *7 (E.D.N.Y. March 31, 2014) (rejecting plaintiff's claim that allegations in complaint forced defendants to put privileged communications at issue).