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The Insolvency Effect on Attorney-Client Privilege

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The Insolvency Effect on Attorney-Client Privilege

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Introduction

"The attorney-client privilege is the oldest of the privileges for confidential communications known to the common law."[1] This privilege has been held as sacred and essential to encourage complete and candid communication between attorneys and their clients.[2] In fact, if the attorney's "professional mission" is to be carried out appropriately to the fullest extent, then the attorney must be able to acquire all the information necessary to represent his client.[3] Therefore, the privilege allows unfettered communication, for the benefit of both parties.

By carving more exceptions to the privilege, as bankruptcy courts, and even the Supreme Court, have in recent years, the purpose of the privilege will be undermined. For example, the trustee in chapter 7 proceedings has been accorded unilateral power to waive both a corporate and an individual debtor's attorney-client privilege in order to further its duty to make equitable dispositions.[4] The trustee in a bankruptcy proceeding generally has duties to multiple parties in

[1] Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).
[2] *Id.*
[3] Trammel v. United States, 445 U.S. 40, 51 (1980).
[4] *See, e.g.,* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 343 (1985); *see also In re* Fairbanks, 135 B.R. 717, 734 (Bankr. D.N.H. 1991).

any dispute of the estate.[5] So, in order to dutifully fulfill its fiduciary duties, trustees may need the power to access a debtor's privileged communication with his attorney to investigate the debtor's financial affairs and location of assets.

Similarly, committees, as representatives of a debtor's estate, in chapter 11 proceedings are contesting the right to enjoy the same unilateral power.[6] Because of distinct differences between a chapter 7 trustee and a chapter 11 committee, a committee's ability to invoke such a power is not universally recognized.[7] To date, cases that have recognized a committee's right to hold and waive a debtor's attorney-client privilege have done so where they can prove a debtor is insolvent.[8]

First, this memorandum will discuss the chapter 7 trustee's rights to attorney-client privilege in bankruptcy. Specifically, this memorandum will compare three separate approaches utilized by bankruptcy courts: (1) allowing a trustee to waive the debtor's attorney-client privilege; (2) forbidding the trustee to waive the privilege; and (3) utilizing a balancing test in which the courts weigh the potential harm to the debtor against the trustee's ability to carry out his role and administration of the estate. Second, this memorandum will also discuss a split in decisions concerning the ability of chapter 11 committees to enjoy such unilateral waiving power. The courts that allow committees to waive the privilege place the burden of proof on the committee to demonstrate that the debtor was insolvent at the time of the privileged communication.

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[5] Official Comm. of Unsecured Creditors v. Comvest Group Holdings, LLC, *(In re* HH Liquidation, LLC*)*, 571 B.R. 97, 98 (Bankr. D. Del. 2017) (providing the debtors' assertion that a trustee has duties to "all the constituents of a corporation, administrative claimants, secured creditors, unsecured creditors and equity holders").
[6] *In re* HH Liquidation, LLC, 571 B.R. at 98.
[7] Official Comm. of Asbestos Claimants of G-1 Holding, Inc. v. Heyman ("*Heyman*"), 342 B.R. 416, 423 (S.D.N.Y. 2006) (finding that the creditors' committee owed a duty *only* to the creditors).
[8] *In re* HH Liquidation, LLC, 571 B.R. at 98.

I. Trustees' Rights to Attorney-Client Privilege in Bankruptcy

The attorney-client privilege is uncertain for the debtor in bankruptcy cases involving trustees. As an estate representative, under section 323(a) of the Bankruptcy Code, a trustee owes a fiduciary duty to creditors.[9] In connection with this duty, the trustee controls the property of the estate.[10] Therefore, in order to appropriately manage the property, the trustee may require privity of information, acquired through the waiver of the attorney-client privilege.

The right for a trustee of an insolvent corporation to unilaterally waive the corporation's attorney-client privilege regarding pre-bankruptcy communications has been upheld by the Supreme Court.[11] The Court acknowledged that outside of the realm of bankruptcy, the attorney-client privilege is controlled by a corporation's management.[12] Accordingly, the Court rationalized that in bankruptcy proceedings, the trustee fulfills the same role as does the corporation's management, allowing the trustee to possess the ability to waive the attorney-client privilege for the debtor corporation.[13] Therefore, the question of this waiving power was settled by the Supreme Court in cases involving corporate debtors, finding that corporate debtors do not have sole discretion over their attorney-client privileges.

The same issue, however, involving individual debtors remained unanswered.[14] Correspondingly, lower bankruptcy courts remain split on such decisions; some courts have set

[9] 11 U.S.C. § 323(a) (2012).
[10] 11 U.S.C. § 542(a) (2012).
[11] *Weintraub*, 471 U.S. at 343.
[12] *Id.* at 351–52.
[13] *Id.* at 356.
[14] *Id.* at 356–57 ("An individual, in contrast, can act for himself; there is no 'management' that controls a solvent individual's attorney-client privilege. If control over that privilege passes to a trustee, it must be under some theory different from the one that we embrace in this case.").

forth bright-line rules and others have implemented a balancing test approach in determining whether the trustee has the power to waive an individual debtor's attorney-client privilege.[15]

A. Allowing the Trustee to Control the Individual Debtor's Attorney-Client Privilege

In determining whether a trustee has the power to assert the attorney-client privilege, courts have focused on their statutory duties over the estate.[16] Courts have found that the debtor's attorney-client privilege is akin to property that belongs to the estate. Thus, the trustee can control that privilege similar to how it controls assets that are property of the estate.[17] As such, one fraction of bankruptcy courts follow the reasoning that the trustee can unilaterally waive an individual debtor's attorney-client privilege because of his/her power to control and manage the property of the estate.[18]

B. Forbidding the Trustee to Waive the Individual Debtor's Attorney-Client Privilege

Conversely, other bankruptcy courts throughout the country have upheld the common law view that the debtor's attorney-client privilege is sacred, precluding the trustee to waive the privilege in the debtor's stead.[19] This approach focuses on the potential harm to the debtor from the repercussions of allowing another individual to waive the privilege. So, as was traditionally intended through the implementation of the privilege, these bankruptcy courts allow the debtor, exclusively, to retain the right to waive the privilege.[20]

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[15] *See Fairbanks*, 135 B.R. at 734 (holding that the trustee can invoke the power to waive an individual debtor's attorney-client privilege); *but cf. In re* Hunt, 153 B.R. 445, 455 (Bankr. N.D. Tex. 1992) (refuting the trustee's right to invoke such a power).
[16] *Fairbanks*, 135 B.R. at 717.
[17] *Id.* at 723 (finding the debtor's attorney-client privilege as "property" that is allocated to the trustee).
[18] *In re* Smith, 24 B.R. 3, 5 (Bankr. S.D. Fla. 1982) (declaring that the debtor's attorney-client privilege "passes by operation of law to the bankruptcy trustee").
[19] *See In re* Silvio De Lindegg Ocean Devs. of America Inc., 27 B.R. 28, 28 (Bankr. S.D. Fla. 1982) ("There is every reason, as I see it why the trustee cannot waive an individual debtor's attorney-client privilege.").
[20] *Hunt*, 153 B.R. at 454 (declaring that to allow the trustee to waive the debtor's privilege would "contradict[] the purposes and expectation interests behind the attorney-client privilege").

C. The Balancing Test and Case-by-Case Approach to Waiving an Individual Debtor's Attorney-Client Privilege

Still, other courts refrain from setting forth such bright-line rules in determining whether an individual debtor's attorney-client privilege should be properly waived. Instead, these courts apply a balancing test approach, weighing the interests of the trustee and those of the debtor.[21] The balancing test requires the courts to weigh the potential harm to the debtors from disclosing their privileged information against the trustee's role in representing the interests of the state and fairly distributing assets.[22]

Correspondingly, courts determined that the trustee's ability to perform his duties would be "severely hampered" if the trustee was unable to obtain the necessary information to handle the estate.[23] The Bankruptcy Code even prompts the debtor to "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties."[24] Such duties include handing over to the trustee "any recorded information, including books, documents, records, and papers, relating to the property of the estate."[25] Therefore, the attorney-client privilege may be waived by a trustee in cases where privileged information may be needed to carry out the trustee's duties.[26]

II. Committee's Rights to Waive the Debtor's Attorney-Client Privilege

Just as the right for a trustee to waive the attorney-client privilege has been widely litigated, the right for committees in chapter 11 proceedings is also disputed amongst bankruptcy courts.[27] Courts have distinguished the duties and interests of trustees and committees in order to

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[21] Ralph McCullough, Chris Whelchel, & Sharyn Epley, *Trustees: The Ability to Waive the Debtor's Attorney-Client Privilege*, 106 COM. L.J. 1, 14 (2001).
[22] *Id.*; Moore v. Eason *(In re* Bazemore*)*, 216 B.R. 1020, 1024 (Bankr. S.D. Ga. 1998) (determining that courts utilizing bright-line rules in questions of attorney-client privilege focus on the potential harm to debtors).
[23] French v. Miller *(In re* Miller*)*, 247 B.R. 704, 709–710 (Bankr. N.D. Ohio 2000).
[24] 11 U.S.C. § 521(3) (2012).
[25] 11 U.S.C. § 521(4) (2012).
[26] *In re Miller*, 247 B.R. at 710.
[27] *In re* Big M. Inc., No. 13-10233 DHS, 2013 WL 1681489, *1 (Bankr. D.N.J. Apr. 17, 2013) (finding that the power to waive the attorney-client privilege does not extend to the committee); *but cf. In re* HH Liquidation, LLC,

refrain from extending the power of waiving the privilege. Specifically, courts have held that committees would generally prioritize creditors' interests over those of the estate in the face of any conflict.[28] In fact, a trustee generally represents the interests of the estate, whereas a committee "is encouraged only to be vigilant with respect to the interests of its own constituency – the unsecured creditors."[29] Therefore, the trustee's comprehensive fiduciary duty is the overarching reason for its ability to waive the attorney-client privilege, and the committee's more narrow interests explain its inability to do so.

Now, however, courts are beginning to diverge in the other direction, allowing committees to invoke the right to waive the privilege after all. Although there are undeniable differences between the roles of a trustee and a committee, courts have also recognized similarities between the two roles.[30] Notably, the committee is responsible for managing and distributing the recovered damages in an adverse proceeding to multiple parties.[31] Therefore, because committees are "acting on behalf of the [d]ebtors," they are essentially stepping into the shoes of the debtors, just as trustees do.[32]

The main difference between the ability for a committee to waive a debtor's privilege and the right for a trustee to do the same is the determination of the debtor's insolvency. Specifically, courts have devised that the exception to the attorney-client privilege exists for a committee's

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571 B.R. at 98 (concluding that a committee has the right to waive the debtor's attorney-client privilege, as long as the debtor was insolvent at the time of the privileged communication).

[28] *Big M. Inc.*, 2013 WL 1681489, at *1; *see also Heyman*, 342 B.R. at 423.

[29] Official Comm. of Unsecured Creditors v. Belgravia Paper Co., Inc. *(In re* Great Northern Paper, Inc.*)*, 299 B.R. 1, 6 (D. Me. 2003); *Official, Unsecured Creditors' Comm. v. Stern (In re SPM Manufacturing Corp.)*, 984 F.2d 1305, 1315–16 (1st Cir. 1993) (declaring "the committee is a fiduciary for those whom it represents, not for the debtor or the estate generally").

[30] *In re* HH Liquidation, LLC, 571 B.R. at 102 (noting that the committee is "in proximity" with the position of a chapter 7 trustee).

[31] *Id.* at 101 (providing that a committee must primarily distribute anything it recovers to administrative claimants and secured creditors; then, any leftover assets are distributed to unsecured creditors).

[32] *Id.* at 100.

purposes only if the debtors were insolvent at the time of the privileged communication.[33] The status of the debtor's insolvency at the time of the privileged communications determines to whom a fiduciary duty is owed.[34] In cases where the debtor is insolvent at the time of the privileged communications, a fiduciary duty is owed to the debtor's creditors.[35] However, if the debtor was not insolvent at the time of its communications with attorneys, then no fiduciary duty is owed to the creditors, and the privileged communication should remain privileged.[36]

Conclusion

Until the Supreme Court conclusively rules on the issue of allowing a creditors' committee to waive a debtor's attorney-client privilege in order to access privileged information, bankruptcy courts across the country will likely continue to be split in their decisions, just as courts are split on the issue of allowing a trustee to waive the privilege. The contingency certain courts have determined in allowing a committee to waive the privilege is a minimal one; so long as committees demonstrate a debtor's insolvency, they have the power to waive the privilege.

[33] *Id.* at 104.
[34] Teleglobe v. BCE *(In re* Teleglobe Commc'ns Corp.*)*, 493 F.3d 345, 384 (3d Cir. 2007); Garner v. Wolfinbarger, 430 F.2d 1093, 1103–04 (5th Cir. 1970) (allowing the shareholders of a corporation to waive a corporation's attorney-client privilege to prove fiduciary breaches by corporate management).
[35] *In re* Teleglobe Commc'ns Corp., 493 F.3d at 384.
[36] *Id.*