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Privilege and Conflicts Post-Petition

Nettlesome issues arise on attorney-corporate client relationship.

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BY ITS NATURE, a corporate client can experience a myriad of changes that affect its legal rights and relationships. The succession of a corporation's rights in the context of mergers, stock and asset sales is a frequent subject of litigation. Similarly common is the litigation over the succession of legal rights when a corporation files a bankruptcy petition under Title 11 of the U.S. Code. For attorneys who represent the debtor corporation pre-petition, two particularly nettlesome issues can arise: (1) whether the attorney-client privilege can be asserted (or waived) by the debtor-in-possession or trustee insofar as it applies to pre-petition privileged communications; and (2) whether or not the post-petition entity falls into the category of "former client" for conflicts purposes.

The following will discuss the reported decisions in these areas and how they have led to somewhat conflicting results.

Privilege

What happens to the privilege when a corporation files for bankruptcy protection? At first blush, the question appears to have been answered by the U.S. Supreme Court in *Commodity Futures Trading Commission v. Weintraub*.[1] In *Weintraub*, the Commodity Futures Trading Commission brought a complaint against a brokerage house for violations of the Commodity Exchange Act (7 U.S.C. §1 et seq.). The brokerage house filed a Chapter 7 bankruptcy petition. The commission deposed the brokerage house's in-house counsel and posed questions eliciting privileged communications that occurred pre-petition. The attorney refused to answer those questions asserting the attorney-client privilege.

The Chapter 7 trustee took the position that it had the power to waive the privilege on behalf of the brokerage house. The brokerage house's former officer and director countered that the trustee lacked such authority. The Supreme Court held that the trustee of a corporation in bankruptcy has the power to waive the privilege with respect to pre-petition communications.

The *Weintraub* Court presented a series of rationales supporting the holding that the trustee of a Chapter 7 corporate entity controls the privilege—the thrust of which being that the trustee most closely resembles "management" of the corporate entity and like other corporate successors (e.g. following mergers or stock sales), the succeeding management obtains the right to assert or waive the privilege. In dicta, the Court stated that the rationale would also apply in the instance where the debtor remains in possession. The *Weintraub* Court limited this rule to the corporate context and indicated that it would not be applicable to individuals

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filing for bankruptcy. It then stated:

> When the corporation is solvent, the agent that controls the corporate attorney-client privilege is the corporation's management. Under our holding today, this power passes to the trustee because the trustee's functions are more closely analogous to those of management outside of bankruptcy than are the functions of the debtor's directors.[2]

While *Weintraub* does establish the rule that a trustee controls the attorney-client privilege, it does not directly address whether the post-petition corporation is in fact the same "client" which had the requisite relationship with the attorney giving rise to the privilege. Nevertheless, *Weintraub* and its reasoning have been cited by lower courts with differing results to determine "whether a corporation remains a 'client' after the bankruptcy estate is closed."[3]

Following the *Weintraub* decision, two distinct lines of cases emerged. One approach is seen in *FDIC v. Amundson*,[4] a case decided in the federal district court for the District of Minnesota, and *Bagdan v. Beck*,[5] a case decided by the federal district court for the District of New Jersey. These cases support the proposition that the trustee of the corporation in Chapter 7 bankruptcy is a mere liquidator of assets and is not a former client for conflicts purposes. The rationale was then applied by a U.S. District Court in Tennessee in *Lewis v. United States*, which determined that the Chapter 7 trustee was a liquidator, the corporation was dead and, therefore, the attorney-client privilege no longer applied.

Another line of cases, including a 2005 decision in the Southern District of New York, adopts a different approach. These cases support the proposition that the attorney-client privilege may survive a defunct corporation and that the Chapter 7 trustee should be considered a former client for purposes of the conflict rules.

Conflict of Interest

In *Amundson*, the FDIC purchased the assets of a bank which had been determined insolvent. The FDIC moved to disqualify an attorney from representing the bank's former director because of the attorney's prior representation of the bank. The district court in Minnesota denied the motion. In doing so, the court distinguished the insolvent bank from the corporation in *Weintraub* on grounds that, "[t]here is no thought or effort to reconstitute the [bank] or to run it at all."[6] The court asserted that the FDIC as a liquidator was entirely distinct from a receiver in a bankruptcy action. According to the *Amundson* court, no conflict of interest could exist between the FDIC and the attorney because only the bank, which no longer existed, could claim to have an adverse interest.

A similar line of reasoning was adopted in *Bagdan*. In *Bagdan* the trustee of a corporation in bankruptcy moved to disqualify a law firm from representing the corporation's former directors. The trustee argued that the law firm was barred from representing the former directors because the law firm had previously represented the corporation, thereby creating a conflict of interest pursuant to New Jersey's Rule of Professional Conduct 1.9.

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Relying on *Amundson*, the *Bagdan* court, in the District of New Jersey, held that the law firm should not be disqualified. The *Bagdan* court contrasted the condition of the corporation in its case with the corporation in *Weintraub*: "It must [be] emphasized that *Weintraub* did not address the viability of the attorney-client privilege of a corporation which is in [this corporation's] current condition." The court reasoned that the bankrupt corporation "is, for all intent and purposes, 'dead.' The shell…continues to exist for the sole purpose of marshalling and distributing assets…the corporation…is not a party here."[7] The court concluded that the trustee was not the law firm's former client, and therefore, the trustee's motion should be denied.

In 2004, another district court followed *Amundson* and *Beck*. In *Lewis v. United States*, a non-party law firm moved to quash a subpoena served by the Internal Revenue Service for production of documents related to tax advice the firm provided to a corporate client. Subsequent to the law firm's services for the corporation, the corporation entered Chapter 7 bankruptcy. Relying on *Bagdan*, the *Lewis* court denied the motion to quash on grounds that the attorney-client privilege was inapplicable to a defunct corporation. The court explained that like the corporation in *Bagdan*, the corporation in *Lewis* was "dead" and "should not be considered an applicable 'party' to any such legal matter."[8]

Interpreting 'Weintraub'

Other courts contend that the *Amundson* and *Bagdan* decisions are based upon a misreading of the *Weintraub* case. In *In re Peck*,[9] after a corporation entered into Chapter 7 bankruptcy, the law firm that previously represented the corporation sought to represent a defendant in the same litigation. The corporation's Chapter 7 trustee declined to waive any conflict of interest on behalf of the corporation. The defendant argued that under *Bagdan* and *Amundson*, no conflict existed. The court ruled in favor of the trustee and found that the law firm was barred from representing the defendant because of the law firm's prior representation of the corporation.

The federal bankruptcy court for the Eastern District of Wisconsin reasoned that *Weintraub* was controlling and on point. Just like in *Weintraub*, the law firm in *Peck* owed a duty to the Chapter 7 trustee which stood in the shoes of the firm's former client. The court emphasized that "[t]he underlying principal in *Weintraub* reflects a continuity of the attorney-client relationship from the prepetition entity through the entity or entities in bankruptcy."[10]

The *Peck* court vigorously criticized the *Bagdan* opinion for failing to adequately explain its grounds for distinguishing *Weintraub*. The *Bagdan* decision apparently turned on the premise that unlike the corporation in *Weintraub*, the corporation in *Bagdan* was defunct. The *Peck* court stressed that the *Bagdan* court overlooked that the corporation in *Weintraub* was also defunct because it too had entered into a Chapter 7 bankruptcy.

A California bankruptcy court decision

arrived at a similar result as *Peck*, but without analyzing *Bagdan's* interpretation of *Weintraub*. In *In re Jaeger*,[11] the federal bankruptcy court for the Central District of California granted a Chapter 7 trustee's motion to disqualify a law firm. The court explained that "a trustee appointed in the corporation's Chapter 7 case stands in the shoes of the corporation as a former client of the law firm for the purposes of bringing a motion to disqualify the law firm on the grounds of a conflict of interest."[12] The court determined that the law firm's representation of non-debtors in substantially related litigation violated the firm's duty of loyalty to its former client.

New York Decision

In a March 2005 decision, the federal bankruptcy court for the Southern District of New York weighed in on this issue and explicitly rejected the analyses of *Amundson* and *Bagdan*. In *In re I Successor Corp.*,[13] the plaintiff, consisting of a committee of post-petition nonsecured creditors, alleged a pattern of misappropriation of the defunct corporation's assets by its former officers and directors. The defendants allegedly misappropriated the funds through improper transfers of cash and multiple transactions with other entities controlled by the defendant officers and directors.

Prior to commencement of the lawsuit, the corporation had filed for relief under Chapter 11, and substantially all of its assets were sold to a purchaser. The corporation's name was changed, and it was not an ongoing concern.

The plaintiff argued that the defendants' law firm should be disqualified because the same law firm had represented the defunct corporation in a number of the transactions that were the subject of the lawsuit. In response, the defendants argued that pursuant to *Bagdan* and *Amundson*, a liquidating corporation did not share the attorney-client privilege held by the pre-liquidating entity; therefore, the defunct corporation cannot be deemed to be the attorney's client.

The court concluded that the renamed corporation was a former client of the law firm and granted the motion to dismiss. The claims asserted derivatively on behalf of the corporation were not sold to any of the purchasers; therefore, the court held, the claims remained with the corporation. For that reason, the lawyers' obligations of loyalty and confidentiality remained with the corporation. The court stated that with regard to a former client in the process of liquidation a lawyer's duty of loyalty and confidentiality "are just as important as if the company were an ongoing business entity."[14]

The *Successor* court joined the *Peck* court in criticizing *Bagdan* and *Amundson* because their holdings conflicted with the Supreme Court's decision in *Weintraub*. The Supreme Court's decision in *Weintraub* was apparently predicated on the principal that the privilege passed to the trustee when the corporation entered into a Chapter 7 bankruptcy. Both the *Amundson* and the *Bagdan* courts seemed to ignore that the Supreme Court had found that the attorney-client privilege remained viable even as a defunct corporation was liquidating.

The *Successor* court took its analysis one step further. The court concluded that *Amundson* arrived at a correct decision notwithstanding its mistaken analysis of *Weintraub*. According to the *Successor* court, the error in *Amundson* was concluding that the attorney-client privilege ceased to exist simply because the bank was insolvent. Under the *Successor* court's analysis, the test that should have been applied in *Amundson* was whether the purchaser of the bank (the FDIC) intended to continue the bank's pre-existing operations. Because the FDIC had no such intention, the attorney-client privilege did not transfer to the FDIC, and the FDIC, therefore, did not have standing to assert the attorney-client privilege.

The analysis in *Successor* relied on New York law as set forth in *Tekni-Plex Inc. v. Meyner and Landis*.[15] In *Tekni-Plex*, the New York State Court of Appeals found that when ownership of a corporation changes hands, courts should look at the "practical consequences" of the transfer to determine whether the attorney-client relationship continues. On the one hand, a transfer of assets by itself does not demand that the attorney-client relationship continue. On the other hand, if the transferee continues the operations of the previous corporation, then the attorney-client shield passes to the new managers of the corporation.

The *Successor* court did not indicate whether the *Lewis* case arrived at a correct decision notwithstanding a possibly incorrect reading of *Weintraub*. It is most likely that the *Successor* court would conclude that the Tennessee federal court correctly denied the law firm's motion to quash the subpoena because no remnant of the corporation remained and no entity sought to continue the corporation's operations.

Until an appellate decision is reached, there is likely to be some confusion about the standing of trustees to assert a conflict of interest to disqualify counsel. If the *Successor* court's analysis is deemed to be the correct analysis, the law is that whenever a corporation in a Chapter 11 or Chapter 7 bankruptcy is present as a litigant, either in its own name or in its trustee's name, the corporation or trustee is a "former client" for purposes of the conflict rules.

Conclusion

Attorneys, who often over time develop ties to management or the board of their corporate clients, might be surprised to learn that privileged communications with those persons may not remain privileged post-petition. Indeed, the determination of whether to waive the privilege may rest in the hands of a total stranger like a Chapter 7 trustee. Further, even though that post-petition entity is in liquidation or controlled by a trustee, it may also be deemed to be a "former client" thus preventing an attorney from taking on matters adverse to the post-petition entity on behalf of the former management or board. While some courts might disagree, that seems to be the present rule in the Southern District of New York.

1. 471 U.S. 343 (1985).
2. Id. at 356.
3. *Lewis v. United States*, 2004 WL 3203121, *4 (W.D. Tenn. 2004).
4. 682 F.Supp. 981 (D. Minn. 1981).
5. 140 F.R.D. 660 (D.N.J. 1991).
6. 682 F.Supp. at 987.
7. 140 F.R.D. at 667.
8. 2004 WL 3203121 at * 4.
9. 196 B.R. 434 (E.D. Wis. 1996).
10. 196 B.R. at 438.
11. 213 B.R. 578 (C.D. Cal. 1997).
12. 213 B.R. at 594.
13. 321 B.R. 640 (S.D.N.Y. 2005).
14. 321 B.R. at 654.
15. 89 N.Y.2d 123 (1996).

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