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A CRITICAL ANALYSIS OF SEVENTH CIRCUIT BANKRUPTCY DECISIONS

KEITH J. SHAPIRO*

I. INTRODUCTION

With each passing year since the enactment of the Bankruptcy Reform Act of 1978 ("Bankruptcy Code"),1 the United States Court of Appeals for the Seventh Circuit has become increasingly involved in substantive issues of bankruptcy law. The cases discussed in this article are some of the most interesting and controversial decisions of the Seventh Circuit for the period from June 1, 1983 to May 31, 1984.

II. WHEN IS A GARNISHMENT A PREFERENCE?

Section 547(b) of the Bankruptcy Code sets out five conditions which must be met before the trustee will be authorized to avoid a transfer as a preference.2 One of these conditions concerns the timing of the transfer. If a transfer is deemed to have occurred on or within the 90-day period described in Section 547(b)(4)(A), and the other requirements of Section 547(b) are met, the transfer may be avoided by the trustee as a

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2. 11 U.S.C. § 547(b) provides:
   (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor—
      (1) to or for the benefit of a creditor;
      (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
      (3) made while the debtor was insolvent;
      (4) made—
         (A) on or within 90 days before the date of the filing of the petition; or
         (B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer—
            (i) was an insider; and
            (ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; and
      (5) that enables such creditor to receive more than such creditor would receive if—
         (A) the case were a case under chapter 7 of this title;
         (B) the transfer had not been made; and
         (C) such creditor received payment of such debt to the extent provided by the provisions of this title.
Determining if and when such a transfer has occurred has proven difficult where wages are garnished within 90 days of the filing of a bankruptcy petition pursuant to a garnishment order issued prior to the 90-day period.

The Seventh Circuit addressed this issue in *In re Coppie,* where the wages of two separate debtors were garnished pursuant to an order of an Indiana court. As the Seventh Circuit pointed out, much of the controversy surrounding the time of transfer results from variances among state garnishment statutes. Additional confusion results from the provision in Section 547(e)(3) that a transfer for purposes of determining whether an avoidable preference has occurred "is not made until the debtor has acquired rights in the property transferred." The garnishment orders in *Coppie* provided for a continuing lien on the debtors' future income to the extent of ten percent of the debtors' salaries. In asserting the estates' right to wages earned and garnished within 90 days of the bankruptcy filing, the trustees argued that the debtors had no rights in those wages until they are earned; therefore, the debtors could not have transferred those rights prior to commencement of the preference period.

The Seventh Circuit affirmed the Bankruptcy Court, holding that the relevant transfers occurred when the continuing garnishment orders were entered, outside of the preference periods. The court found that under Indiana law, the issuance of a garnishment order makes an employer directly liable to a garnishing creditor for payment of the wages subject to that order. It compared the effect of the garnishment order to "a novation of 10% of the debtor's salary." Thus, "the debtors no 3. 11 U.S.C. § 547(b)(4)(A).
5. 728 F.2d 951. (7th Cir. 1984).
6. Id. at 952.
7. Id. "For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred." 11 U.S.C. § 547(e)(3).
8. 728 F.2d at 953.
9. Id.
10. Id.
11. Id. at 952.
longer had a property interest in 10% of their future salaries.”

The Seventh Circuit distinguished Coppie from its decision in Grain Merchants of Indiana, Inc. v. Union Bank and Savings which was expressly overruled by Congress when it enacted Section 547(e)(3) of the Code. Grain Merchants dealt not with garnishment order, but with the issue of whether a security interest in after-acquired accounts receivable perfected prior to the preference period sufficiently transferred the debtor's rights in those receivables at that time so as to prevent avoidance by the trustee. The Seventh Circuit held that no preference had occurred.

Acknowledging Congress' repudiation of the Grain Merchants decision, the Seventh Circuit in Coppie held that unlike the effect of a continuing garnishment in Indiana, the perfection of a security interest in after-acquired accounts receivable does not prevent a debtor from acquiring "some rights in the future accounts receivable when the accounts receivable come into existence" and does "not transfer ownership of the debtor's future accounts receivable." Thus, despite the fact that Section 547(e)(3) overruled the Seventh Circuit's position as to security interests in after-acquired property, the court held that

Section 547(e)(3) does not come into play in this case simply because after a garnishment order providing for a continuing lien is entered in Indiana, a debtor will never acquire rights in the portion of his or her wages to be garnished in the future. Once a garnishment order has been entered by a court, the debtor's rights in 10% of his or her future wages are irrevocably transferred to the garnishment plaintiff.

A particularly perplexing aspect of the Seventh Circuit opinion in Coppie is the court's apparently ambiguous conclusion that a continuing garnishment in Indiana prevents a debtor from ever acquiring rights in the future wages covered by the order and that these rights which the debtor will "never acquire" are "irrevocably transferred" under the continuing garnishment order. The language of Section 547(e)(3) appears to mandate that a purported transfer by a debtor is not deemed to have occurred until the debtor acquires rights in the subject property. It is not clear how an irrevocable transfer of rights could have occurred in Coppie where the court held that the debtors never acquired any such rights nor how Section 547(e)(3) really "does not come into play."

Nevertheless, the Seventh Circuit cited strong support for its posi-

12. Id. at 952, 953.
13. 408 F.2d 209 (7th Cir. 1969).
14. Id.
15. 728 F.2d at 953.
16. Id. (emphasis added).
tion in Coppie. The decision is based in great part on the Second Circuit's parallel decision in Riddervold v. Saratoga Hospital,\(^\text{17}\) which involved a New York garnishment statute substantially similar to the Indiana garnishment statute interpreted in Coppie. Further support is found in Judge Mabey's attempts to distinguish his finding of a preference in Larson v. Olympic Finance Co.\(^\text{18}\) from the Riddervold decision. He stated that:

Because of the effect of New York law, Section 547(e)(3) was inapplicable [in Riddervold]. That section comes into play only if the debtor acquires rights in the property transferred. In Riddervold, the debtor never had rights in the property transferred. Any decision reached here and in other cases may be attributed to differing state law on whether a debtor who earns wages after a garnishment has been served has any interest in wages withheld under the garnishment.\(^\text{19}\)

The popular trend in determining Coppie-type problems is to focus on the debtor's rights to his or her future wages based on applicable state garnishment law. But these problems must also be resolved with an intellectually honest view of Section 547(e)(3) and in contemplation of the Bankruptcy Code's "fresh start" philosophy.\(^\text{20}\)

### III. INTEREST ON UNSECURED TAX CLAIMS IN CHAPTER 11

In In re Burgess Wholesale Mfg. Opticians, Inc.,\(^\text{21}\) the Chapter 11 debtor filed a reorganization plan which proposed payment of a federal tax claim of $14,500.65 in monthly installment over a period of five years. The debtor asserted that Section 1129(a)(9)(C) requires only that an unsecured federal tax claim be paid in full for its face amount over a period of years.\(^\text{22}\) The reorganization plan submitted by the debtor therefore made no provision for the payment of interest on the unsecured tax claim on the Internal Revenue Service.

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17. 647 F.2d 342 (2d Cir. 1981).
19. Id. at 272, 273 n.12.
20. Whether a garnishment order is continuing or for a set term seems irrelevant other than as a determinant of the time frame in which the debtor's wages will be garnished. Larson, for example, was not a continuing garnishment.
21. 721 F.2d 1146 (7th Cir. 1983).
22. 11 U.S.C. § 1129(a)(9)(C) provides:

(a) The Court shall confirm a plan only if all of the following requirements are met:

(9) Except to the extent that a holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—

(C) with respect to a claim of a kind specified in Section 507(a)(6) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.
The I.R.S. objected to the debtor's plan because it failed to take into account the time-value of money. In a well-reasoned analysis, the Seventh Circuit reversed both the District Court and the Bankruptcy Court in holding that the I.R.S. was entitled to interest on its unsecured tax claim.\footnote{23}{721 F.2d at 1146.}

The Seventh Circuit analysis first focused upon the language of Section 1129(a)(9)(C).\footnote{24}{See Supra note 22.} The court held that the debtor's interpretation of this statute was improper because it disregarded the requirement that the claimant should receive the "value, as of the effective date of the plan, equal to the amount of such claim."\footnote{25}{721 F.2d at 1147, (emphasis added), citing 11 U.S.C. § 1129(a)(9)(C).} This means that the payments must be arranged so as to reflect the time-value of money.\footnote{26}{721 F.2d at 1147.}

The court found strong support for its position in the comments of the House Judiciary Committee: "... ‘Value, as of the effective date of the plan’ as used in § 1129(a)(9)’ indicates that the promised payment under the plan must be discounted to present value as of the effective date of the plan. ’"\footnote{27}{Id., citing, H.R. Rep. No. 595, 95th Cong., 2d Sess. 408, U.S. Code Cong. and Admin. News 1978, 5787 (1978).}

It further noted, in essence, that rather than complain about the need to pay interest where a Chapter 11 plan proposes payment of an unsecured tax claim in installments, debtors should instead thank Congress for doing away with the pre-Code requirement that unsecured priority tax claims be paid in full prior to confirmation of a reorganization plan.\footnote{28}{Id., citing, 11 U.S.C. § 599 (1976) (repealed 1978).}

In dicta, the court also noted that the I.R.S. in Burgess was not seeking unmatured interest on its claim and that Section 502(b)(2) would make payment of unmatured interest unavailable in any event.\footnote{29}{721 F.2d at 1147, n.1.} In addition, the Seventh Circuit specifically declined to discuss the issue of what an appropriate discount rate would be in making a present value determination for purposes of Section 1129(a)(9)(C).\footnote{30}{721 F.2d at 1147.}

IV. WAIVER OF THE RIGHT TO PREPAYMENT PREMIUMS BY SEEKING RELIEF FROM THE AUTOMATIC STAY

In a decision critical to real estate lenders, the Seventh Circuit held

\footnote{23}{721 F.2d at 1146.}
\footnote{24}{See Supra note 22.}
\footnote{25}{721 F.2d at 1147, (emphasis added), citing 11 U.S.C. § 1129(a)(9)(C).}
\footnote{26}{721 F.2d at 1147.}
\footnote{29}{721 F.2d at 1147, n.1.}
\footnote{30}{721 F.2d at 1147.
in *In re LHD Realty Corporation*\(^{31}\) that the filing of a request for relief from the automatic stay (Section 362(a))\(^{32}\) by a mortgage holder can be deemed an acceleration and result in a waiver by the mortgage holder of its contractual rights to a prepayment premium.\(^{33}\)

The mortgage agreement in *LHD* provided that early payment of the balance due on the underlying loan was permissible, but would subject the mortgagor to a prepayment premium.\(^ {34}\) After filing its Chapter 11 petition, LHD made several late monthly mortgage payments under the mortgage agreement. The mortgage holder, National Life Insurance Company ("National"), responded by filing a complaint seeking relief from the automatic stay in order to foreclose its lien. LHD countered by seeking court authorization to sell the mortgaged property. After several hearings on each of these requests, the court denied the relief sought by National and approved the sale of the property by LHD.\(^ {35}\) It was at that point that National asserted its right to a prepayment premium pursuant to the terms of the mortgage agreement.

Although the Seventh Circuit acknowledged the enforceability of reasonable prepayment premiums, it cited several limitations on the right to receive them. One limitation is that a lender waives its right to a prepayment premium when it chooses to accelerate the underlying debt.\(^ {36}\) The court explained that: "acceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity."\(^ {37}\)

In addition, the Seventh Circuit found that the intention to accelerate can be inferred from the actions of a lender over a period of time.\(^ {38}\) The court described prepayment premiums as "insurance against a decline in interest rates"\(^ {39}\) and described acceleration as a voluntary choice on the part of a lender to waive the right to this "insurance" in favor of immediate payment of outstanding principal. By filing its request for relief from the automatic stay, the court held that National had chosen to

\(^{31}\) 726 F.2d 327 (7th Cir. 1984).
\(^{32}\) Section 362(a) provides generally for the automatic stay of all proceedings, judicial and administrative against the debtor which either were or could have been brought against the debtor prior to the commencement of bankruptcy proceedings, or which are based on claims against the debtor that arose prior to the bankruptcy proceedings. 11 U.S.C. § 362(a).
\(^{33}\) 726 F.2d at 331.
\(^{34}\) *Id.* at 329.
\(^{35}\) *Id.* at 329, 330.
\(^{37}\) 726 F.2d at 331.
\(^{38}\) *Id.* at 331.
\(^{39}\) *Id.*
accelerate the debt. "National’s actions established that it preferred, sensibly no doubt, accelerated payment over the ‘opportunity’ to earn interest from the LHD loan over a period of years."\textsuperscript{40}

Several aspects of \textit{LHD} are particularly troublesome and several questions remain unanswered. For example, what other actions in the context of a bankruptcy case would equate to an election to accelerate? This uncertainty may cause lenders to hesitate to act for fear of triggering an unwanted acceleration.

In addition, National asserted that a per se rule that prepayment premiums are unenforceable after acceleration would lead to intentional defaults by debtors seeking to avoid paying prepayment premiums. The Seventh Circuit suggested two solutions to this potential problem. First, "the lender [could] sidestep the [debtor’s] ploy by suing only for overdue payment as they mature, together with attorney’s fees."\textsuperscript{41} Second, a lender, even after acceleration, could “regain the right to its premium by revoking its acceleration and reinstating the mortgage prior to detrimental reliance by the borrower on the acceleration.”\textsuperscript{42}

In addition to these suggested lender tactics, the court also opened a potentially wide back-door to the LHD acceleration exception, concluding that “should such intentional defaults become a problem, however, we believe courts could deal with the difficulty by denying the acceleration exception in appropriate cases.”\textsuperscript{43} This language seems to allow for the exercise of discretion by bankruptcy courts in determining when the LHD acceleration exception applies, apparently to prevent debtors from improperly planning around its invocation. This vaguely enunciated exception to the exception should create even more uncertainty. Perhaps it would be best to allow a Chapter 11 debtor to plan around the \textit{LHD} acceleration exception, especially in view of the Seventh Circuit’s acknowledgement that it is the lender, not the borrower, who chooses whether or not to accelerate.\textsuperscript{44}

Another troublesome aspect of \textit{LHD} is the court’s discussion of the lender’s option to revoke its acceleration and reinstate the mortgage absent detrimental reliance by the borrower.\textsuperscript{45} No mention is made by the Seventh Circuit of how revocation and reinstatement are to take place in the context of a bankruptcy case, or when it may occur procedurally.

\textsuperscript{40} Id.
\textsuperscript{41} Id.
\textsuperscript{42} Id. at 331, n.4.
\textsuperscript{43} Id. at 331.
\textsuperscript{44} Id.
\textsuperscript{45} Id. at 331 n.4, 333, n.7.
The court also doesn’t discuss what constitutes reliance on the part of a borrower. Apparently, though, this option could be a key means of avoiding loss of the right to a prepayment premium. Since *LHD* is unclear as to what lender actions trigger an acceleration, borrowers and lenders should be equally surprised to learn what actions the courts will subsequently decide cause acceleration. Thus, it is unlikely that most debtor/borrowers will be able to prove their reliance on a lender’s acceleration.

The Seventh Circuit rejected Nation’s claim that the automatic stay itself prevents lenders from accelerating a loan after a bankruptcy petition is filed. It found that although Section 362(a) precludes foreclosure, “it need not be read to preclude acceleration.”46 Instead, the Seventh Circuit held that

[S]ince section 1124 recognizes the authority to ‘deaccelerate’ a mortgage and since section 1124(2)(A) refers in this context to defaults (and presumably accelerations) occurring after commencement of the case under Chapter 11, the implication is that a lender can accelerate a loan notwithstanding section 362, subject to its action being reversed pursuant to section 1124.47

In concluding that National had accelerated its loan and waived its right to a prepayment premium, the Seventh Circuit indicated in dicta what it believed the practical effect of *LHD* would be. In order to retain its right to a prepayment premium, the lender could simply refrain from exercising its acceleration option and wait for a decision by the trustee or the debtor. If the trustee or debtor then decides to repay the loan, the lender “presumably” could enforce the prepayment premium provision, provided it is valid in other respects.48

Finally, the Seventh Circuit appears to have left a trail to follow in the search for an escape from the *LHD* trap. The court, after describing the various exceptions to the enforceability of reasonable prepayment premium clauses in mortgage agreements, noted that “[t]hese exceptions have been read into contracts by courts and could presumably be modified by the parties through appropriate contractual provisions.”49 Thus, careful drafting of mortgage agreements could be the most direct means of avoiding a waiver of an otherwise enforceable prepayment premium in the wake of *LHD*.

46. *Id.* at 332.
47. *Id.*
48. *Id.*
49. *Id.* at 331 n.5.
V. ADMINISTRATIVE PRIORITY CLAIMS

The Seventh Circuit decision In re Jartran, Inc., is most significant for its analysis of the law regarding administrative priority claims in a Chapter 11 case and for the unique factual circumstances under which it arose. The court held that Jartran’s pre-bankruptcy irrevocable commitment to purchase classified telephone directory advertising from Reuben H. Donnelley Corporation ("Donnelley") did not create an administrative priority claim despite the fact that the ads appeared in the directories after the Chapter 11 case was commenced.

Under section 503, administrative priority claims include “the actual and necessary costs and expenses of preserving the estate, including . . . commissions for services rendered after the commencement of the case.”

Donnelley argued that since the ads were published post-petition and were important in Jartran’s efforts to reorganize, they should be treated as priority administrative expenses and thus be paid before many of Jartran’s pre-petition creditors. In rejecting Donnelley’s argument, the Seventh Circuit followed the test set forth by the Supreme Court in the pre-Code case of In re Mammoth Mart, Inc. Under Mammoth Mart, a claim is treated as a priority administrative expense “if the debt both (1) ‘arise[s] from a transaction with the debtor-in-possession’ and (2) is ‘beneficial to the debtor-in-possession in the operation of the business.’ ” The Seventh Circuit noted that while the ads were certainly beneficial to the reorganization efforts of Jartran, the relevant transaction did not occur with the debtor-in-possession, but with the pre-bankruptcy Jartran.

The court found that the underlying purpose of the administrative expense priority was to enable financially strapped debtors to obtain credit in order to remain in business and facilitate a reorganization effort. It held that reorganization efforts would be of limited effectiveness without provisions like Section 503: debtors would be unlikely to

51. Id. at 587.
52. Section 503(b)(1)(A) in its entirety provides:
   (b) After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under Section 502(f) of this title, including—
   (1)(A) the actual necessary costs and expenses of preserving the estate, including wages, salaries, or commencement of the case; 11 U.S.C. § 503(b)(1)(A) (1982).
53. 732 F.2d at 586.
54. 536 F.2d 950 (1st Cir. 1976).
55. 732 F.2d at 587, citing Mammoth Mart, 536 F.2d at 954.
56. 732 F.2d at 587.
57. Id. at 586.
persuade creditors to advance required goods and services to them if the creditors had no assurances that their claims would be given priority.\textsuperscript{58} Furthermore, the court held that the administrative expense priority was not unfair with regard to pre-petition creditors, since reorganization is attempted for their benefit.\textsuperscript{59}

Because of these policies, the Seventh Circuit found the issue of "inducement" of creditors' performances under their agreements with debtors to be "crucial" to determination of administrative priority claims.\textsuperscript{60} The court upheld the bankruptcy court's determination that the debtor-in-possession in \textit{Jartran} in no way induced performance on the part of Donnelley, and noted that the inducement by the debtor-in-possession was unnecessary "since the liability for the costs of the ads was irrevocably incurred before the petition was filed."\textsuperscript{61} Notably, though, the court specifically declined to address the issue of what conduct would constitute an inducement sufficient to result in a determination that a contract had been affirmed by a debtor-in-possession so as to be entitled to administrative priority status.\textsuperscript{62}

In addition, the Seventh Circuit also rejected Donnelley's assertion that "equity and fairness" required that their claim be accorded administrative priority status.\textsuperscript{63} It concluded that allowing Donnelley's equitable claim and that of other creditors whose extension of credit benefited a Chapter 11 debtor-in-possession would defeat the purpose of the administrative expense priority—to encourage the extention of credit to Chapter 11 debtors.\textsuperscript{64}

The court stated it was not able to conclude that its decision would result in a "major disruption" in Yellow Pages advertising. The court stated that all creditors assume, to some extent, the risk of bankruptcy, and that Donnelley may have assumed it for too long by its arrangement with Jartran. The court mentioned insurance or different methods of payment to "ameliorate the difficulties caused by advertiser bankruptcies." However, the court said significant problems should be left for Congress.\textsuperscript{65}

\textsuperscript{58} \textit{Id.}
\textsuperscript{59} \textit{Id.}
\textsuperscript{60} \textit{Id.} at 587.
\textsuperscript{61} \textit{Id.} at 586, 587.
\textsuperscript{62} \textit{Id.} at 591.
\textsuperscript{63} \textit{Id.} at 590.
\textsuperscript{64} \textit{Id.}
\textsuperscript{65} \textit{Id.} at 590-1.
VI. REOPENING A CASE & TIMELY FILING OF A PROOF OF CLAIM

Section 523(a) of the Bankruptcy Code provides that a discharge under Section 727, 1141, or 1328(b) does not discharge an individual debtor from liability on any debt which is—

(3) neither listed nor scheduled under section 521(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit— (a) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing;\(^7\)

The Seventh Circuit in *In re Stark*, examined the phrase “timely filing of a proof of claim” under Section 523(a)(3)(A) to determine whether debtors who had failed to list or schedule a creditor in a no-asset Chapter 7 case could reopen their case after discharge to add the omitted creditor. The court in Stark also shed light upon the considerations which a court must make in determining whether reopening a closed case would be appropriate.

The Starks had incurred a debt to St. Mary’s Hospital (“St. Mary’s”) for medical services provided just prior to the filing of their bankruptcy petition. Believing that their insurance carrier would pay the hospital bill, the Starks felt it unnecessary to list St. Mary’s in their schedules. The debt ultimately went unpaid and St. Mary’s obtained a judgment in state court against the Starks in the amount of the debt. The Starks, having previously received a discharge in their Chapter 7 case, sought to reopen the case in order to add St. Mary’s to their list of creditors.

St. Mary’s argued that allowing the Starks to reopen their Chapter 7 case would be improper as it would enable the Starks to discharge a debt which would otherwise have been non-dischargeable under Section 523(a)(3)(A). Additionally, St. Mary’s asserted that even if the case were reopened, a timely claim could not be filed due to the fact that the

\(^{66}\) Section 727 governs the discharge of debts in cases of liquidation. 11 U.S.C. § 727 (1982).

\(^{67}\) Section 1141 governs the discharge of debts in reorganization cases. 11 U.S.C. § 1141 (1982).

\(^{68}\) 717 F.2d 322 (7th Cir. 1983).

\(^{69}\) 717 F.2d at 179, 180.

\(^{70}\) 717 F.2d at 179.

\(^{71}\) Id.

\(^{72}\) Id.

\(^{73}\) Id.

\(^{74}\) 717 F.2d at 180.
six month filing period prescribed by Rule 302(e)(4) had passed.\textsuperscript{75}

The Seventh Circuit focused its analysis upon Bankruptcy Rules of Procedure 203(b)\textsuperscript{76} and 302(e)(4).\textsuperscript{77} Based on these procedural rules, the Seventh Circuit affirmed the District Court and held that the case could be reopened to allow for the addition of St. Mary's to the list of creditors.\textsuperscript{78} The court reasoned that since a "Notice of No Dividend" had been filed in the Starks' Chapter 7 case, all of the Starks' creditors, including St. Mary's, would still have the opportunity to file a timely proof of claim in accordance with Rule 302(e)(4) if assets were ultimately located.\textsuperscript{79} It held that St. Mary's was to be treated the same as the Starks' other creditors in this regard, despite the fact that St. Mary's had previously not been listed or scheduled by the Starks.\textsuperscript{80}

The Seventh Circuit stated one clear prerequisite to reopening a case to add a creditor. Where the court finds that the creditor whom the debtor seeks to add was not listed or scheduled by the debtor due to fraud or intentional design, equitable considerations dictate that reopening the case not be allowed.\textsuperscript{81} The Seventh Circuit agreed with the District Court that a bankruptcy court "should exercise its equitable powers with respect to substance and not technical considerations that will pre-

\textsuperscript{75} Id.
\textsuperscript{76} 717 F.2d 322 (7th Cir. 1983). Bankruptcy Rule of Procedure 203(b) provides:
\hspace{1cm} (b) Notice of No Dividend. If it appears from the schedules that there are no assets from which a dividend can be paid, the court may include in the notice of the first meeting a statement to that effect, that it is unnecessary to file claims, and that if sufficient assets become available for the payment of a dividend, the court will give further notice of the opportunity to file claims and the amount allowed therefore.

Bankruptcy Rule of Procedure 203(b), which was applicable in \textit{Stark}, has since been superceded by Rule 2002(e). Rule 2002(e) provides:
\hspace{1cm} (e) Notice of No Dividend. In a chapter 7 liquidation case, if it appears from the schedules that there are no assets from which a dividend can be paid, the notice of the meeting of a creditors may include a statement to that effect; that it is unnecessary to file claims; and that if sufficient assets become available for the payment of a dividend, further notice will be given for the filing of claims.

\textsuperscript{77} Bankruptcy Rule of Procedure 302(e)(4) provides:
\hspace{1cm} (e) Time for Filing. A claim must be filed within 6 months after the first date set for the first meeting of creditors, except as follows:
\hspace{1cm} (4) If notice of no dividend was given to creditors pursuant to Rule 203(b), and subsequently the payment of a dividend appears possible, the court shall notify the creditors of that fact and shall grant them a reasonable, fixed time for filing their claims of not less than 60 days after the mailing of the notice or 6 months after the first date set for the first meeting of creditors, whichever is the later.

Bankruptcy Rule of Procedure 302(e)(4), which was applicable in \textit{Stark}, has since been superceded by Rule 3002(c) which reduces the time for filing in most cases to within 90 days after the first date set for the meeting of creditors called pursuant to Section 341(a).

\textsuperscript{78} 717 F.2d at 324.
\textsuperscript{79} Id.
\textsuperscript{80} Id.
\textsuperscript{81} Id. at 323.
Particularly notable in Stark is the Seventh Circuit's apparent endorsement of the District Court finding that "Section 523(a) should not be mechanically applied to deprive a debtor of a discharge in a no asset case where there is no showing of fraud or genuine harm to the creditors." This statement is important because it appears to set forth an additional prerequisite to the reopening of a closed case. The Seventh Circuit apparently agrees that prior to having its Chapter 7 case reopened in order to add an omitted creditor, a debtor must also show that reopening the case will not cause genuine harm to the creditors. In addition to merely reciting the District Court's finding in this regard, the Seventh Circuit apparently applied the genuine harm standard in Stark by finding that "[i]n this case the creditor has not been harmed in any way, and the debtors have not been required to forfeit any of their benefits under the Bankruptcy Code."

But just what was meant by the "genuine harm" language in Stark? The finding of the District Court regarding the genuine harm standard is couched in terminology relating to an objection to discharge under Section 727, not dischargeability of a debt under Section 523 as would seem appropriate under the facts in Stark. This language was adopted by the District Court from a case arising under the Bankruptcy Act of 1898, In re Callaham, and indicates either an unfortunate drafting error, or conceptual confusion on the part of the Callaham court, as well as the District Court and Seventh Circuit via their apparent adoption of this language. Although possibility of an error is most likely, the flaw is especially ironic in view of the fact that the holding in Stark apparently allows a debtor to reopen a case and add a creditor who is not able due to time limitations to file an objection to a debtor's discharge under Section 727(a). Although the added creditor could seek a revocation of the debtor's discharge under Section 727(d), the grounds giving rise to this relief are narrower than those giving rise to a denial of discharge under Section 727(a).

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82. Id. at 323, noting that District Court cited Kenneally v. Standard Electronics Corp., 364 F.2d 642, 647 (8th Cir. 1966).
84. Id. at 324.
85. Section 727(a) generally provides that "the court shall grant the debtor a discharge," provided that the debtor is acting in good faith, has not been granted a discharge in bankruptcy in the preceeding six years, and is not guilty of any specified acts of bad faith or fraud. 11 U.S.C. § 727(a) (1982).
87. Section 727(d) provides:
(d) On request of the trustee or a creditor, and after notice of a hearing, the court shall revoke a discharge granted under subsection (a) of this section if—
Section 727(a). Aside from appearing to yield an inequitable result, an argument could be made that this result itself displays the existence of "genuine harm" imparted upon the added creditor.

A better approach might be to set a final deadline for the listing or scheduling of creditors, with the subsequent case reopening and creditor additions completely restricted or limited to showings of circumstances more extraordinary than negligence on the part of the debtor.

VII. THE TRUSTEE'S DUTY UNDER THE LABOR LAWS

_Yorke v. National Labor Relations Board_\(^8\) (NLRB) adds another chapter to the growing body of law dealing with the relationship between the bankruptcy laws and the labor laws. The Seventh Circuit, in an opinion written by Senior Judge William H. Timbers of the Second Circuit,\(^9\) held that a bankruptcy trustee, like any other employer, has a duty to observe and comply with workers' rights under the labor laws to the extent that they are not inconsistent with the trustee's duties under the Bankruptcy Code.\(^9\) More particularly, the court found that the Chapter 11 trustee had a duty, pursuant to Sections 8(a)(1) and 8(a)(5) of the National Labor Relations Act,\(^9\) to conduct effects bargaining with the labor union over the effects on union member employees of his decision to terminate the Chapter 11 debtor's operations.\(^9\) As the Seventh Circuit explained, "'effects' bargaining provides the Union with an opportunity to bargain in the employees' interest for such benefits as severance pay, payments into the pension fund, preferential hiring if the employer continues operating at other plants, and reference letters with respect to other jobs."\(^9\)

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\(^1\) such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge;

\(^2\) the debtor acquired property that is property of the estate, or became entitled to acquire property that would be property of the estate, and knowingly and fraudulently failed to report the acquisition of, or entitlement to, such property, or to deliver or surrender such property to the trustee; or

\(^3\) the debtor committed an act specified in subsection (a)(6) of this section.


89. Sitting by designation.

90. 709 F.2d at 1142.

91. Sections 8(a)(1) and 8(a)(5) of the National Labor Relations Act provide:

Sec. 8(a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in Section 7;

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of Section 159(a) of this title.


92. 709 F.2d at 1143.

93. _Id_.
Yorke is significant in that it is a case of first impression and appears to be supported by the Supreme Court’s ruling in *NLRB v. Bildisco and Bildisco*\(^9\) as well as the recently enacted Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"). The Seventh Circuit made its policy position clear in *Yorke*: “The law in question—the duty to bargain over the effects of a decision to terminate operations—strikes us as critical to protect employees from the ravages of economic dislocation.”\(^9\)

In addition, the court found that although the trustee’s discretion in bargaining with the union might be impeded by the need to obtain bankruptcy court authorization, “that limitation can be taken into account in any bargaining.”\(^9\) "We believe that recognizing a duty to bargain would not unduly impede the Trustee’s discharge of his responsibilities.”\(^9\) Moreover, “[w]hile the Trustee may have been required to obtain the bankruptcy courts’ authorization before granting concessions, the Trustee could have bargained subject to that approval.”\(^9\)

Finding that the trustee had failed to engage in good faith “effects” bargaining with the union, the Seventh Circuit upheld a limited backpay order imposed by the NLRB on the debtor-corporation.\(^9\) The court rejected the trustee's argument that there can be no meaningful bargaining with a debtor-corporation due to the inability of such a company to make concessions, noting that at the time the company closed its doors it possessed nearly $6,000,000 worth of unliquidated assets.

In essence, the Seventh Circuit’s analysis of *Yorke* seems to be disproportionately weighed in favor of the labor laws. The policies underlying the Bankruptcy Code in general, and the policies and provisions relating to the powers and duties of trustees specifically are largely ignored. Rather than being a “correct” decision, *Yorke* is arguably the product of an unequal balancing of labor and bankruptcy law policies which yielded a result that subsequently corresponded to a revised Congressional intent as expressed in Subtitle J of BAFJA.\(^10\)

In this regard, dissenting Circuit Judge Coffey vehemently criticized the majority for its failure to properly weigh these important considerations. Judge Coffey was distressed by what he perceived as the majority’s disregard for the fact that this was a matter which arose in the context of

95. 709 F.2d at 1143.
96. Id.
97. Id.
98. Id. at 1145.
99. 709 F.2d at 1144.
100. See infra text accompanying note 106.
a bankruptcy case.\textsuperscript{101} By ignoring this distinction, the majority failed to give adequate consideration to the limitations placed on a trustee’s authority, thereby “encroaching on the Bankruptcy Court’s exclusive jurisdiction over Chapter XI bankruptcy proceedings.”\textsuperscript{102} Furthermore, he stated that the majority opinion undermined the policy goals involved in bankruptcy cases by failing to properly balance the interests of revitalizing business and achieving acceptable labor relations.\textsuperscript{103} Finally, he concluded that

\ldots the majority’s decision foists an unreasonable burden on business enterprises involved in Chapter XI bankruptcy proceedings. It is the height of absurdity for the NLRB to exert a fatal chokehold on Congress’ (sic) specific intent to allow mortally wounded businesses a chance to make a financial comeback at a time when our basic industries are struggling to survive.\textsuperscript{104}

Perhaps not so coincidentally, the day after it denied certiorari in \textit{Yorke}, the Supreme Court decided \textit{Bildisco} and in dictum implied its approval of the \textit{Yorke} result.\textsuperscript{105} After dealing broadly with the enforceability of collective bargaining agreements after a bankruptcy petition is filed but prior to their acceptance or rejection by a debtor-in-possession or trustee, the 5-4 majority concluded that:

our determination that a debtor-in-possession does not commit an unfair labor practice by failing to comply with § 8(d) prior to formal rejection of the collective-bargaining agreement does undermine the policy of the NLRA, for that policy, as we have noted, is to protect the process of labor negotiations, not to impose particular results on the parties. \ldots but while a debtor-in-possession remains obligated to bargain in good faith under NLRA § 8(a)(5) over the terms and conditions of a possible new contract, it is not guilty of an unfair labor practice by unilaterally breaching a collective-bargaining agreement before formal Bankruptcy Court action.\textsuperscript{106}

\textit{Bildisco} and \textit{York} are distinguishable in that \textit{Yorke} deals only with general good faith bargaining duties under § 8(a)(1) and § 8(a)(5), whereas \textit{Bildisco} deals with the duty to bargain as it relates to the acceptance and rejection of collective bargaining agreements. \textit{Bildisco} clearly stops short of shielding trustees and debtors-in-possession from otherwise incurring liability under the NLRA’s good faith bargaining provisions.

In addition, the recent enactment of BAFJA can be construed as giving even greater vitality to \textit{Yorke}. The new provisions found in Subti-
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The significance of these new provisions is that they manifest a distinct Congressional policy change (resulting from the outcry over Bildisco) and extend good faith bargaining requirements into the previously untouchable realm of the collective bargaining agreement in bankruptcy cases. Certainly Congress' extension of these duties in the wake of Bildisco serves as a reinforcement for the findings in Yorke and Bildisco regarding the enforceability of the labor laws as to general good-faith bargaining duties.

Also notable in Yorke is the Seventh Circuit's finding that the imposition of a limited backpay requirement on a corporation, guilty of a labor law violation occurring prior to commencement of the bankruptcy case, is not inappropriate merely because the company is a Chapter 11 debtor. Specifically, the court held that:

[the purpose of the limited backpay requirement in such circumstances is not to punish, but to create an incentive for the Company to bargain in good faith. Ensuring meaningful bargaining comports with the primary objective of the [National Labor Relations] Act.]

VIII. WAIVER OF ATTORNEY-CLIENT PRIVILEGE BY BANKRUPTCY TRUSTEE

The attorney-client privilege is the oldest of the communication privileges, and its importance has long been recognized. Despite the importance of the privilege throughout the common law, however, its status in the context of a bankruptcy case is currently in question. Recent decisions by the Second, Eighth, and Ninth Circuit Courts of Appeal have held that bankruptcy trustees can, under certain circumstances, waive the attorney-client privilege of debtor-corpor-

107. Section 1113(f) of Subtitle J provides:

"No provision of this title shall be construed to permit a trustee to unilaterally terminate or alter any provisions of a collective bargaining agreement prior to compliance with the provisions of this Section."

108. 709 F.2d at 1145. Such an award apparently would be treated as an administrative expense entitled to priority. See 11 U.S.C. §§ 503, 507(a)(1).

109. 8 J. Wigmore, EVIDENCE § 2290 (1961). The attorney-client privilege has been established for over four centuries. The privileges existing between a husband and a wife are also long-established, but their origins are less clear. Other privileges, such as that between physician and patient or priest and penitent, have been established relatively recently, generally by statute. See 8 J. Wigmore, EVIDENCE, § 2286 et seq. (1961).

The Seventh Circuit, on the other hand, recently rejected the position of the Second and Eighth Circuits and refused to uphold the trustee's asserted waiver of the debtor-corporation's attorney-client privilege.

The Seventh Circuit, in *Commodity Futures Trading Commission v. Weintraub,* observed that despite the broad grant of power given to bankruptcy trustees by the Bankruptcy code, "nowhere is the trustee given specific statutory authority either to assert or waive a corporate-debtor's attorney-client privilege." The court held that the trustee of a Chapter 7 debtor-corporation did not have the power to waive the corporation's attorney-client privilege as to communications occurring on or before the commencement of the case. The U.S. Supreme Court recently granted certiorari in the *Weintraub* case to resolve the conflict among the circuits of this important question.

In *Weintraub,* the Commodity Futures Trading Commission (CFTC) had instituted an enforcement proceeding against Chicago Discount Commodity Brokers, Inc. ("CDCB") in the district court. By consent, the court appointed an equity receiver. The equity receiver placed the corporation into bankruptcy, filing a Chapter 7 petition under the Code's special provisions for commodity broker liquidations. The receiver was ultimately named permanent trustee by the bankruptcy court.

In the course of the CFTC investigation relating to the enforcement action against CDCB in district court, the Commission deposed Gary Weintraub, an attorney formerly representing CDCB. Weintraub refused to answer several questions, asserting the attorney-client privilege. The CFTC's motion to compel Weintraub to answer was granted by a federal magistrate who ruled that the trustee for CDCB formally waived the company's attorney-client privilege as to pre-filing communications and information. The district court affirmed and the issue was then presented to the Seventh Circuit.

111. *In re O.P.M. Leasing Service Inc.*, 670 F.2d 383 (2d Cir. 1982); *Citibank, N.A. v. Andros,* 666 F.2d 1192 (8th Cir. 1982); *In re Boileau & Johnson, Inc.,* 736 F.2d 503 (9th cir. 1984) (court-appointed examiner with expanded powers, rather than a trustee).


114. *Id.* at 342, n.8.

115. *Id.* at 343.

116. Certiorari was granted on 10-29-84. *See supra* note 102.


118. 722 F.2d at 339.

119. *Id.*

120. *Id.*

121. 722 F.2d at 339, 340.
The three-member Seventh Circuit panel readily accepted the proposition that the attorney-client privilege extends to corporations, including those which have filed for protection under the bankruptcy laws.\textsuperscript{122} As the Supreme Court recently stated, the purpose of the privilege is to encourage "full and frank communication between attorneys and their clients. . . . The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer being fully informed by the client."\textsuperscript{123} Similarly, in \textit{Fisher v. United States}, the Court noted that the purpose of the privilege is "to encourage clients to make full disclosure to their attorney."\textsuperscript{124}

It is also well settled that the attorney-client privilege may be waived by the client.\textsuperscript{125} However, when the "client" is a corporation, the issue has arisen as to whom is empowered to waive the privilege. Generally, courts have held that the power rests with the board of directors or with authorized corporate agents, because a corporation can only act through its officers.\textsuperscript{126} However, in the bankruptcy context, a majority of courts which have had occasion to rule on the issue have held that the bankruptcy trustee has the authority to waive the corporate attorney-client privilege.\textsuperscript{127}

The Second Circuit, in \textit{In re O.P.M. Leasing Services, Inc.},\textsuperscript{128} recently upheld the trustee's waiver of a corporation's attorney-client privilege over the objection of the company's former president and director. In \textit{O.P.M.}, due to resignations, the corporation had no officers and directors during the trustee's term, unlike the situation in \textit{Weintraub} where one officer and director remained active in the corporation after the trustee's appointment. The Second Circuit noted:

> We hold that in this situation the power to make such a decision as is encompassed by assertion or waiver of the important attorney-client privilege adheres to the trustee by virtue of the nonexistence of any other entity authorized to so act.\textsuperscript{129}

The Seventh Circuit considered the \textit{O.P.M.} decision in the \textit{Weintraub} case, but distinguished it on the basis that unlike \textit{O.P.M.}, CDCB

\textsuperscript{123} Upjohn Co. v. United States 449 U.S. 383 (1981).
\textsuperscript{124} 425 U.S. 391, 403 (1976).
\textsuperscript{125} Glover v. Patten, 165 U.S. 394, 408 (1897); Hunt v. Blackburn, 128 U.S. 464, 470 (1888).
\textsuperscript{126} Velsicol Chemical Corp. v. Parsons, 561 F.2d 671, 674 (7th Cir. 1977), \textit{cert. denied} 935 U.S. 942 (1978).
\textsuperscript{127} \textit{See In re O.P.M. Leasing Services, Inc.}, 670 F.2d 383 (2d Cir. 1982); Citibank, N.A. v. Andros, 666 F.2d 1192 (8th Cir. 1982).
\textsuperscript{128} 670 F.2d 383 (2d cir. 1982).
\textsuperscript{129} \textit{Id.} at 387.
still retained an officer/director capable of deciding whether to assert the company's attorney-client privilege.

In *Citibank, N.A. v. Andros*, the Eighth Circuit upheld the trustee's power to waive a debtor-corporation's attorney-client privilege over the objection of the remaining corporate officers. Acknowledging the factual similarities between *Weintraub* and *Andros*, the Seventh Circuit rejected the Eighth Circuit's conclusion that the power to invoke a debtor-corporation's attorney-client privilege passes with the property of the debtor-corporation to the bankruptcy trustee. The Seventh Circuit noted that the court in *Andros*, like the court in *O.P.M.*, failed to support its conclusion with a discussion of the policies underlying the attorney-client privilege.

The Seventh Circuit found that a corporation is still capable of numerous functions after filing for relief under the Bankruptcy Code, and is not replaced as an entity by the trustee. Nor, the court noted, does the trustee automatically succeed to the officer and director positions of a debtor-corporation. The Seventh Circuit found that "[t]he trustee may hold the power to manage the bankrupt corporation's property and assets, but he does not thereby acquire absolute power over the corporation's legal rights." This conclusion finds support in the Bankruptcy Code. The commencement of a bankruptcy case creates an estate consisting of all of the tangible and intangible property of the debtor. The trustee acquires this estate together with certain additional powers; i.e., to avoid fraudulent transfers, to recover preferential transfers, and to avoid various liens. The trustee also acquires the right to manage the debtor's business. While the extent of the property and powers expressly granted to the trustee under the Bankruptcy Code is extensive, there is no specific grant to the trustee of the power to waive a debtor's legal privileges. No statutory basis has been found suggesting the trustee holds such a power.

130. 666 F.2d 1192 (8th Cir. 1982).
131. The Eighth Circuit in *Citibank* stated that the Bankruptcy Code vested broad management powers in the trustee, and that "[b]ecause the right to decide whether to waive a corporation's attorney-client privilege belongs to management, the right to assert or waive that privilege passes with the property of the corporate debtor to the trustee." 666 F.2d at 1195.
133. *Id.* at 342, citing 15 A.W. FLETCHER, PRIVATE CORPORATIONS, § 7657 (Revised Ed. 1981).
134. *Id.* at 342.
Ownership of the corporate entity does not pass to the trustee; rather, the trustee receives only the assets owned by the corporation itself, along with certain enumerated powers.\textsuperscript{140} The shareholders continue to own the corporate entity and the entity remains in the shareholders' ultimate control.

Despite the apparent support for the Seventh Circuit position found in the Bankruptcy Code generally, distinguishing between the debtor-corporation's legal rights and the trustee's management powers may prove problematic in practice. Specifically, how will a trustee know if a contemplated action is one that his fiduciary duty requires him to take in order to properly manage the assets of the debtor-corporation, or whether it is one that will be deemed an improper exercise of the debtor-corporation's legal rights? The Seventh Circuit offers no guidelines for making such a determination, and the result may be hesitancy and confusion on the part of trustees in certain circumstances.

It has been asserted that if the trustee held the power to waive the attorney-client privilege, some possible benefit to the estate may inure. Generally, however, it would only save the trustee the effort involved in finding facts on his own without the use of privileged information. If he could not obtain otherwise privileged information from the debtor's attorney, he would still be free to obtain the desired information by use of ordinary discovery rules and his own investigation. As the Supreme Court noted, "The privilege only protects disclosure of communication; it does not protect disclosure of the underlying facts by those who communicated with the attorney."\textsuperscript{141} The Supreme Court also stated that a witness cannot refuse to answer a relevant question merely because he had discussed the subject with his attorney.

It is essential for an attorney to have all available information from his client if he is adequately represent his client in any legal proceeding, including a bankruptcy case. The court in \textit{Weintraub} recognized the chilling effect on attorney-client communications which could result if a trustee could waive the privilege and require the debtor's attorney to reveal confidential information. The result could be that the attorney for a debtor is given less than complete information, or possibly false information, because the sophisticated debtor would know that his attorney could be required to reveal the client's communication in the future.

The possibility for abuse extends even beyond the chilling effects suggested by the Seventh Circuit in \textit{Weintraub}. For example, such a

\textsuperscript{140} 722 F.2d at 342.
power would seem to be an open invitation to use the Bankruptcy Code for purposes of discovery. If a creditor is involved in litigation against a debtor, he could, theoretically, file an involuntary petition against the debtor, and (assuming grounds for the petition are proven) have the trustee require the debtor's attorney to reveal all of the contemplated defenses and communications. Furthermore, the bankruptcy trustee himself could use his power to waive the debtor-corporation's attorney-client privilege for discovery purposes, to the detriment of the debtor. As the Seventh Circuit stated, "[S]uch a passing of the privilege could engender the absurd result of the trustee waiving the debtor’s privilege as to information sought by the trustee."\(^1\)

In fact, the "absurd result" envisioned by the Seventh Circuit was actually reached three months after \textit{Weintraub} by the Ninth Circuit in \textit{In re Boileau & Johnson, Inc.}\(^2\) In \textit{Boileau}, a court-appointed examiner was enabled to waive the debtors-corporation's attorney-client privilege so as to compel the debtor-in-possession to produce written pre-petition attorney-client communications. The Ninth Circuit carefully noted that the examiner in \textit{Boileau} had been specifically empowered with many of the rights and duties of a trustee and that the decision therefore was not determinative of the right of an examiner without these expanded powers to waive a debtor-corporation's attorney-client privilege.\(^3\)

Despite its unique factual setting, \textit{Boileau} is still a valuable aid in reviewing the Seventh Circuit's ruling on a trustee's power to waive the debtor's attorney-client privilege. The Ninth Circuit afforded little weight to \textit{Weintraub} in reaching its decision, making clear that the Seventh Circuit approach stood alone as a minority view. The Ninth Circuit made no mention of an asset and property management/legal rights dichotomy of the type utilized in \textit{Weintraub},\(^4\) yet it is readily apparent in \textit{Boileau} that the relative powers and duties of the debtor and the examiner played an essential role in determining who possessed the power to waive the corporation's attorney-client privilege.

In \textit{Boileau}, since a trustee had not actually been appointed, the debtor remained a "debtor-in-possession."\(^5\) But, as the Court noted, the debtor's role as a debtor-in-possession, in view of the expanded powers given to the examiner, was "nominal."\(^6\) He no longer held any

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142. 722 F.2d at 343.
143. 736 F.2d 503 (9th Cir. 1984).
144. \textit{Id.} at 506.
145. \textit{See supra} note 122.
147. 736 F.2d at 506.
“substantial participation in the management of Boileau & Johnson.” The Ninth Circuit concluded that the debtor-in-possession in Boileau retained no authority to assert the corporate attorney-client privilege and ordered that the letters at issue be turned over to the examiner.

It seems logical to infer from Boileau that had the debtor-in-possession retained some significant degree of managerial power over the company, the corporate attorney-client privilege would not have passed to the examiner. If this was the key Ninth Circuit criteria, it can be implied that had a trustee, with its significantly more extensive managerial powers and duties, been in place in Boileau, the Ninth Circuit would have found that the corporate attorney-client privilege had passed to the trustee.

The Ninth Circuit would probably have joined the majority view and held contrary to the Seventh Circuit’s decision in Weintraub. The Seventh Circuit, however, would find the Ninth Circuit, as it did the Second and Eighth Circuits, guilty of failing to consider sufficiently the policies underlying the attorney-client privilege.

The mere economic plight of a client is no basis for extinguishing the attorney-client privilege. In Weintraub, the Seventh Circuit found that allowing a trustee to waive a debtor-corporation’s attorney-client privilege discriminated against debtor-corporations solely on the basis of economic status. The court stated that “[a] solvent . . . corporation, as long as it remains solvent, can freely assert or waive its attorney-client privilege. Once the corporation enters bankruptcy, however, it would lose to the trustee the power to control the privilege.”

This point has more validity when phrased in terms of “debtor companies vs. non-debtor companies” as opposed to “solvent companies vs. insolvent companies.” Since insolvency is not a prerequisite to a corporation’s filing for protection under the Bankruptcy Code, an insolvent corporation would not necessarily have to file a bankruptcy petition to

148. Id.
149. Id.
150. It is unclear in Boileau whether there remained “any other entity” authorized to exercise the corporate attorney-client privilege under the O.P.M standards although it would appear that at least one officer or director of the corporation remained in office. If not, however, it is possible that the Seventh Circuit would distinguish Boileau, as it did O.P.M., based on the lack of any other person with the authority to exercise the corporate attorney-client privilege.
151. Note that Boileau had also filed a Chapter 11 petition individually. He thus asserted that compelling production of the letters would violate his fifth amendment right against self-incrimination. The Ninth Circuit rejected Boileau’s argument, finding that the production of documents required no oral testimony on Boileau’s part and that the letters were addressed to the general counsel and general partners of the corporation, Boileau & Johnson, and not Boileau individually, thus making the fifth amendment privilege inapplicable.
152. Weintraub, 722 F.2d at 343.
lose its right to assert the attorney-client privilege, and a solvent corporation could lose its right to assert the attorney-client privilege should it choose to file a bankruptcy petition.

In any event, the Seventh Circuit's point is clear that "[w]hile the trustee's interest in investigating the affairs of the corporate debtor on behalf of the creditors is certainly legitimate, it does not justify erosion of the corporation's attorney-client privilege simply on the basis of a change in economic circumstances."\(^{153}\) This was certainly the most critical aspect of the Seventh Circuit's decision. Allowing a trustee to waive a debtor-corporation's attorney-client privilege as to pre-filing communications and information will chill attorney-client communications. Corporate clients will be unwilling or hesitant to confide in attorneys for fear of a loss of confidentiality in the event of a subsequent bankruptcy filing. Equally serious is the potential "chilling effect" on a financially troubled corporation's willingness to seek the protection of the Bankruptcy Code. A company that has confided in counsel regarding particularly sensitive information may choose to forego what might otherwise be a successful reorganization in order to preserve it's attorney-client privilege.

Moreover, it is often in times of financial distress that a company most needs and seeks the advice and counsel of its attorneys. This is certainly the most traditional form of argument in defense of the attorney-client privilege and one which has arisen in a multitude of contexts. The Court was unambiguous in describing its overriding concern in Weintraub: "Free interchange between attorney and client is the cornerstone of effective legal representation."\(^{154}\) A strong argument can be made that the importance of preventing the chilling of attorney-client communications outweighs the possible negative effect on the effectiveness of trustees in carrying out their duties.

Although the decision in Weintraub appears to be limited to situations in which there remains an officer or director authorized to assert or waive the corporation's attorney-client privilege, a broader reading could easily be implied. Although the Seventh Circuit distinguished O.P.M based on its lack of officers and directors, the court at no point stated that it agreed with the O.P.M. decision. The chilling effect on pre-filing attorney-client communications would be no less severe if the privilege could be waived by the trustee in a subsequent bankruptcy case merely because the officers and directors have resigned or been dismissed. The economic discrimination concerns described by the court would also not

\(^{153}\) Id.

\(^{154}\) Id.
dissipate. In view of the factors which the Seventh Court found to be most persuasive in *Weintraub*, it would not be unreasonable to expect an extension of its application to facts such as those in *O.P.M.*

The *Weintraub* decision serves as a guide to attorneys on the issue of whether a trustee in the case of an individual debtor can waive the debtor's attorney-client privilege. Clearly, the Seventh Circuit believes that the trustee in an individual case has no such power.155 The court, by way of a footnote, specifically rejected the contrary finding of the bankruptcy court in the Chapter 7 case of *In re Smith*.156 The *Smith* decision, the Seventh Circuit noted, is based essentially upon the corporate-debtor cases of *O.P.M.* and *Andros*.157 The *Smith* court found that: "Any attorney-client privilege which the debtor had passes by operation of law to the bankruptcy trustee."158

The cases are noticeably silent as to the trustee's power to assert or waive a corporate-debtor's attorney-client privilege as to communications and information occurring after the filing of a bankruptcy petition or after the trustee is appointed. The result should be based on the same policies and legislative authorities the court used in reaching its decision in *Weintraub*; the corporation should retain its privilege, waived only by its board of directors or authorized agents.

The importance of the attorney-client privilege is recognized by Federal Rule of Evidence 501.159 It is a policy that has survived challenges for the hundreds of years it has existed at common law. There is no adequate reason suggested by any of the cited cases for its demise in bankruptcy cases. The rule allows clients to speak freely with their counsel, and does not destroy the trustee's ability to discover facts.

**CONCLUSION**

The Seventh Circuit has clearly taken on a more active role in the area of bankruptcy law during the past year. It has aggressively dealt with controversial and previously unaddressed issues and has provided lower courts and practitioners with much-needed interpretive guidance.

The coming year should find the Seventh Circuit faced with a flurry

155. The Seventh Circuit also found that it would be unfairly discriminatory to allow the trustee of a debtor-corporation to waive the Company's attorney-client privilege, whereas a trustee in an individual case cannot waive the individual debtor's attorney-client privilege. 722 F.2d at 342.
156. 24 Bankr. 3 (S.D. Fla. 1982).
157. 722 F.2d at 343, note 9.
158. 24 Bankr. at 5.
159. Federal Rule of Evidence 501 provides that "the privilege of a witness . . . shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in light of reason and experience." 28 U.S.C. App. R. 501 (1982).
of new and important bankruptcy issues as the bankruptcy and district courts, still in the early stages of developing a body of case law under the Bankruptcy Code, struggle to revise and expand their initial interpretations to implement the new and amended provisions contained in BAFJA.