

**Presented:**

2008 Jay L. Westbrook Bankruptcy Conference

November 14-15, 2008  
Austin, TX**An Overview of Privilege Issues  
in the Bankruptcy Arena****Elliott S. Cappuccio  
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# I. Introduction

Evidentiary privileges often undergo special adjustments in bankruptcy. Many of these adjustments result from the unique ways in which bankruptcy proceedings alter underlying legal relationships.

The first part of this paper focuses on common evidentiary privileges, including the attorney-client privilege, the qualified immunity for attorney work-product, and the Fifth Amendment right against self-incrimination. Emphasis is given to the special challenges faced by bankruptcy courts trying to evaluate privilege claims while also attempting to balance the competing rights of bankruptcy estates, debtors, and creditors.

Part two explores effective methods for dealing with privilege issues in bankruptcy, including creation of joint defense agreements and protective orders. For reference, an Appendix is also included which contains: (1) new Federal Rule of Evidence 502; (2) Explanatory Notes on Rule 502 from the Advisory Committee; and (2) Texas Rule of Evidence 503.

## II. Evidentiary Privileges

### A. Sources

Evidentiary privileges in bankruptcy cases may arise from both state and federal law. Before evaluating evidentiary privilege issues in a bankruptcy proceeding, counsel should first locate the source of the privilege and the specific law that will be applied in the proceeding.

### 1. Federal Rule of Evidence 501

Federal Rule of Evidence 501 provides:

Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience. However, in civil actions and proceedings, with respect to an element of a claim or defense as to which State law supplies the rule of decision, the privilege of a witness, person, government, State, or political subdivision thereof shall be determined in accordance with State law.

Thus, pursuant to Rule 501, federal common law governs evidentiary privileges in federal court unless federal law provides otherwise. However, when an element of a claim or defense includes a rule of decision determined under State law, then the relevant state privilege law will typically apply.

For example, federal law will typically apply to privilege issues that arise in connection with the Bankruptcy Code. *In re Oxford Royal Mushroom Products, Inc.*, 41 B.R. 86 3 (Bankr. E.D.Pa. 1984)(declining to recognize Pennsylvania

accountant-client privilege when a trustee issued a subpoena to determine the size of the debtor's estate). However, state law is more likely to provide a "rule of decision" in certain adversary actions with state law causes of action. *See In re Lenard*, 849 F.2d 974, 978 (5th Cir. 1988)(considering Louisiana law to find that the requirements of LA. REV. STAT. ANN. §6.333 on the confidentiality of bank records did not create an evidentiary privilege), *and see Whittaker v. Carmean*, 135 B.R. 985, 991 (Bankr. S.D. Oh. 1993) (applying Ohio law on spousal privilege in an adversary proceeding under the Ohio Uniform Fraudulent Transfer Act).<sup>1</sup>

Application of work-product protections, as opposed to attorney-client privilege, is usually a question of federal law. *See United States v. Ary*, 518 F.3d 775, 782 fn.4 (10<sup>th</sup> Cir. 2008)("unlike the attorney-client privilege, the work-product doctrine is distinguishable from the testimonial 'true' privileges. [citation omitted]. The work-product doctrine is codified in Fed. R. Civ. P. 26(b)(3) and is therefore excepted from Fed. R. Evid. 501"). *See e.g. Clover Staffing LLC v. Johnson Controls World Services, Inc.*, 238 F.R.D. 576, 578 (S.D. Tex. 2007)("parties agree that Texas law governs the attorney-client privilege claim and federal law determines the work-product protection claim").

## 2. New Federal Rule of Evidence 502 – Attorney-

<sup>1</sup> *See also Perkins v. United States*, 877 F. Supp. 330 (E.D. Tex. 1995)(applying the Texas physician-patient privilege in TEX. R. EVID. 509(b) to a Federal Tort Claims Act case even though there is no federal physician-patient privilege); and *United States v. Moore*, 970 F.2d 48 (5th Cir.)(considering but rejecting a taxpayer's assertion of the Louisiana state physician-patient privilege in response to a summons issued under federal statute).

## Client Privilege and Work Product: Limitations on Waiver

On September 19, 2008, President Bush signed Senate Bill 2450, enacting Federal Rule of Evidence 502 – "Attorney-Client Privilege and Work-Product: Limitations on Waiver." Unlike other Federal Rules, which are promulgated by the Supreme Court and transmitted to Congress, Federal Rules dealing with evidentiary privilege must be approved by "Act of Congress." *See* 28 U.S.C § 2074.

Rule 502 came about in response to two related problems. First, the complexity of contemporary electronic discovery often requires inordinate amounts of attorney time and judicial effort to preserve privileges and prevent inadvertent waivers. Second, courts were developing inconsistent standards in response to these problems, which created uncertainty with different standards in various jurisdictions.

The new rule contains seven subdivisions "a" through "g." Subdivision (a) generally does away with the potential catastrophe of inadvertently disclosed documents leading to "subject matter waiver" for all privileged material. The new rule provides that the privilege is only waived as to the disclosed communication, not the entire subject matter. Some courts had already approved this result in earlier decisions. *See U.S. v. Citgo Petroleum Corp.*, 2007 WL 1125792 (S.D. Tex. Apr 16, 2007).

However, Rule 502(a)(3) makes an exception if non-disclosed material "ought in fairness be considered together." The drafting Committee's comments compared this exception to the "rule of optional completeness" in Rule 106. Thus, when disclosure of only part of a document would make that document misleading if partially

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First appeared as part of the conference materials for the  
27<sup>th</sup> Annual Bankruptcy Conference session

"An Overview on Privilege Issues in the Bankruptcy Arena"