

# **Some Considerations in Preparing a Liquidating Trust Agreement**

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## **I. Structuring the Agreement for Tax Purposes**

One of the most important factors to take into account in preparing a liquidating trust agreement is whether it will meet requirements of the Internal Revenue Code for treatment as a grantor trust. That will avoid double taxation at both the trust and beneficiary levels, enabling more money to reach the estate creditors who are trust beneficiaries.

Treasury Regulation Section 301.7701-4(d) provides that certain organizations commonly known as liquidating trusts are treated as trusts for purposes of the Internal Revenue Code. The liquidating trust must be organized for the primary purpose of liquidating and distributing the assets transferred to it, and its activities must all be reasonably necessary to, and consistent with, the accomplishment of that purpose. The objective may not be carrying on a profit-making business, although a profitable business may be operated temporarily while efforts are made to sell it. If the liquidation is unreasonably prolonged or if the liquidation purpose becomes so obscured by business activities that the declared purpose of liquidation can be said to be lost or abandoned, the status of the organization will no longer be that of a liquidating trust.

The Internal Revenue Service (“IRS”) will issue advance rulings classifying entities created pursuant to Chapter 11 bankruptcy plans as liquidating trusts under Revenue Procedure 94-45. That Revenue Procedure also outlines the income tax reporting requirements for a liquidating trust. It does not define, as a matter of law, the circumstances under which an organization will be classified as a liquidating trust for federal income tax purposes. That determination can only be made after an examination of all facts and circumstances in connection with the operation and activities of the trust. However, the IRS is bound by its advance ruling unless the taxpayer misrepresented the facts in the request for an advance ruling. Revenue Procedure 94-45 provides a safe-harbor list of conditions which, if met, should ensure the treatment of a trust as a liquidating trust:

1. The trust is or will be created pursuant to a confirmed plan under Chapter 11 of the Bankruptcy Code for the primary purpose, as stated in its governing instrument, of liquidating the assets transferred to it with no objective to continue or engage in the conduct of a

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<sup>1</sup> Glenn Forcucci, a partner at Lewis and Roca, LLP, assisted in preparation of the tax section of this paper.

trade or business, except to the extent reasonably necessary to, and consistent with, the liquidating purpose of the trust.

2. The plan and disclosure statement must explain how the bankruptcy estate will treat the transfer of its assets to the trust for federal income tax purposes. Revenue Procedure 94-45 provides that a transfer to a liquidating trust for the benefit of creditors must be treated for all purposes of the Internal Revenue Code as a transfer to the creditors to the extent that the creditors are beneficiaries of the trust. The transfer will be treated as a deemed transfer to the beneficiary-creditors followed by a deemed transfer by the beneficiary-creditors to the trust. Accordingly, the transfer of property to the liquidating trust will be treated as a deemed transfer from the debtor to the beneficiary-creditors followed by a deemed transfer by the beneficiary-creditors to the liquidating trust.

3. The plan, disclosure statement and any separate trust instrument must provide that the beneficiaries of the trust will be treated as the grantors and deemed owners of the trust. The trust instrument must require that the trustee file tax returns for the trust as a grantor trust pursuant to Treasury Regulation Section 1.671-4(a).

4. The plan, disclosure statement and any separate trust instrument must provide for consistent valuations of the transferred property by the trustee and the creditors, and those valuations must be used for all federal income tax purposes.

5. Whether or not a reserve is established for disputed claims, all of the trust's income must be treated as subject to tax on a current basis.

6. The trust instrument must contain a fixed or determinable termination date that is generally not more than five years from the date of creation of the trust and that is reasonable based on all facts and circumstances. If warranted by the facts and circumstances, provided for in the plan and trust instrument, and subject to the approval of the bankruptcy court with jurisdiction over the case upon a finding that the extension is necessary to the liquidating purpose of the trust, the term of the trust may be extended for a finite term based on its particular facts and circumstances. The trust instrument must require that each extension be approved by the court within six months of the extended term.

7. The trust is not permitted to receive or retain cash or cash equivalents in excess of a reasonable amount to meet claims and contingent liabilities (including disputed claims) or to maintain the value of the assets during liquidation.

8. The investment powers of the trustee, other than those reasonably necessary to maintain the value of the assets and to further the liquidating purpose of the trust, must be limited to powers to invest in demand and time deposits, such as short-term certificates of deposit in banks or other savings institutions, or other temporary, liquid investments, such as Treasury bills.

9. The trust must be required to distribute at least annually to the beneficiaries its net income plus all net proceeds from the sale of assets, except that the trust may retain an

amount of net proceeds or net income reasonably necessary to maintain the value of its assets or to meet claims and contingent liabilities (including disputed claims).

In addition to the foregoing, Revenue Procedure 94-45 provides that if the trust is to hold any operating assets of a going business, a partnership interest in a partnership that holds operating assets, or 50% or more of the stock of a corporation with operating assets, the ruling request must explain why it is necessary to retain these assets. Also, if the trust is to receive transfers of listed stocks or securities or other readily marketable assets, the ruling request must explain the necessity for doing so.

If the plan, disclosure statement and the provisions of the liquidating trust are drafted to comply with the conditions of Revenue Procedure 94-45, the liquidating trust should be treated as a liquidating trust for federal income tax purposes as long as its operations and activities are consistent with those of a liquidating trust. Accordingly, the transfer of the debtor's assets to the liquidating trust will first be treated as a deemed transfer from the debtor to the creditors. This transaction should be treated as the debtor satisfying its debts for an amount equal to the fair market value of the property deemed transferred to the creditors. As to the debtor, this transaction may give rise to income from the cancellation of indebtedness and gain or loss from the sale or exchange of property. The tax characterization of the transaction will depend on the fair market value of the property transferred, the debtor's adjusted tax basis in the property, and whether a creditor's claim represents a recourse or non-recourse liability. A creditor will generally be treated as having its claim satisfied in an amount equal to the creditor's interest in the fair market value of the property deemed transferred to the creditor. This may give rise to gain or loss to the creditor (*e.g.*, a bad debt deduction – tax treatment will depend on particular facts applicable to a creditor). Accordingly, the creditor's adjusted tax basis in the property deemed transferred to the creditor will be equal to the fair market value of the property on the date of the deemed transfer.

Pursuant to this analysis and Revenue Procedure 94-45, the beneficiary-creditors are next treated as transferring to the liquidating trust the property deemed received from the debtor's estate. This should be treated as a nontaxable transaction. Accordingly, the adjusted tax basis of such property to the liquidating trust will be equal to the adjusted tax basis of such property in the hands of the beneficiary-creditor (*i.e.* the fair market value of the property on the date of the deemed transfer). It may be useful for the trustee of a liquidating trust to obtain an appraisal, as of the date of transfer, of the fair market value of the assets transferred to the liquidating trust. Causes of action may be transferred to a liquidating trust under a plan for prosecution; these often cannot be valued until the parties have obtained a judgment or at least proceeded substantially toward one. Revenue Procedure 94-45 requires only that the plan, disclosure statement and any trust instrument provide for consistent valuations of the transferred property by the trustee and creditors, and that the valuations be used for all federal income tax purposes.

When the trustee of a liquidating trust files returns for the trust as a grantor trust pursuant to Treasury Regulation Section 1.671-4(a), the items of income, deduction and credit attributable to the liquidating trust are not reported on Form 1041, but are shown on a separate statement to be attached to that form. Treasury Regulation Section 1.671-3(a)(2) provides that where a grantor is treated as owning an interest in specific trust property, the grantor takes into

account all items directly related to that property for purposes of computing the grantor's tax liability.

The IRS recently issued new regulations that govern “disputed ownership funds” under Internal Revenue Code § 468(B), which provides that amounts earned by an escrow agent, settlement fund or similar fund must be subject to current tax. Under Treasury Regulation 1.468B-9(c)(2)(ii), the trustee of a liquidating trust may, in its first tax year, elect to treat an escrow account, trust or fund that holds assets of the liquidating trust that are subject to disputed claims as a disputed ownership fund. If this election is made, then with respect to a reserve for disputed claims pending court rulings on claims allowance maintained within a liquidating trust, a separate income tax return must be prepared and filed for the disputed claims reserve and for the trust. Any income with respect to the cash and trust interests in the disputed claims reserve will be taxable to the reserve as a separate entity.

## II. Status as Estate Representative and Disbursing Agent

A liquidating trustee may be charged with tasks associated with winding up a bankruptcy estate, such as filing corporate dissolution papers, and paying administrative and priority claims once allowed, or such estate responsibilities may be retained by the post-confirmation debtor or delegated to a separate designated agent or plan administrator. To accomplish such tasks, a liquidating trustee may be designated in the plan and trust agreement as a disbursing agent.<sup>2</sup> Some plans expressly separate these tasks and funds to accomplish them from those in the name of the trustee, to ensure that trust assets are not used for non-trust beneficiaries, and require that the trustee accomplish them in a separate capacity if the same person is to do both.<sup>3</sup> This separation of tasks appears consistent with the requirement that the assets of the liquidating trust be limited to assets in which creditor/beneficiaries are treated as the grantors and deemed owners.

To undergird authority to prosecute estate causes of action, a liquidating trustee may be designated in the plan and trust agreement as the appointed representative of the estate. 11 U.S.C. § 1123(a)(5), (a)(7), (b)(3)(B). The *Refco* Litigation Trust Agreement includes the following descriptive paragraph:

Pursuant to section 1123(b) of the Bankruptcy Code, the Plan appointed the Litigation Trustee as the duly appointed representative of the Estates, and, as such, the Litigation Trustee succeeds to all of the rights and powers of a trustee in

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<sup>2</sup> E.g. Declaration of Trust, Estate Administration and Liquidating Trust Agreement ResMAE Mortgage Corporation (“*ResMAE* Liquidating Trust Agreement”) § 3.1 (Dkt. 415, Ex. 9), *In re ResMAE Mortgage Corp.*, No. 07-1077, U.S. Bankr. D. Del., available through PACER at [ecf.deb.uscourts.gov](http://ecf.deb.uscourts.gov); *Crown Pacific* Estate Administration and Liquidating Trust Agreement and Declaration of Trust (“*Crown Pacific* Liquidating Trust Agreement”) § 3.3(e), (f), (k) (Dkt. 653 Ex. A), *In re CP Acquisition Co.*, No. 2-03-11258-PHX-RJH, U.S. Bankr. D. Az, available through PACER at [ecf.azb.uscourts.gov](http://ecf.azb.uscourts.gov).

<sup>3</sup> E.g. *USA Commercial Mortgage* Estate Administration and Liquidating Trust Agreement and Declaration of Trust (“*USACM* Liquidating Trust Agreement”) § 3.5(e) (Dkt. 3335), and Amended Disbursing Agent Agreement (Dkt. 4044), *In re USA Commercial Mortgage Company*, No. BK-S-06-10725, U.S. Bankr. D. Nev., available at <http://www.bmccorp.net/Docket.aspx?ClientID=113>

bankruptcy with respect to prosecution of the Contributed Claims for the ratable benefit of the Litigation Trust Beneficiaries. To the extent that any Contributed Claims cannot be transferred to the Litigation Trust because of a restriction on transferability under applicable non-bankruptcy law that is not superseded or preempted by section 1123 of the Bankruptcy Code or any other provision of the Bankruptcy Code, such Contributed Claims shall be deemed to have been retained by the Reorganized Debtors and RCM, as applicable, and the Litigation Trustee shall be deemed to have been designated as a representative of the Estates pursuant to section 1123(b)(3)(B) of the Bankruptcy Code to enforce and pursue such Contributed Claims on behalf of the Estates. Notwithstanding the foregoing, all net proceeds of the Contributed Claims shall be transferred to the Effective Beneficiaries consistent with the provisions of the Plan and this Litigation Trust Agreement.<sup>4</sup>

An estate representative is endowed only with estate causes of action. Another way to shore up standing to pursue litigation for the benefit of creditors is through transfer of creditor causes of action to a liquidating trust. The *Refco* plan provided for a second, Non-Estate Private Actions Trust Agreement, under which causes of action held by creditors alone against third parties were contributed to a trust for joint prosecution, in coordination with prosecution of estate causes of action by the *Refco* Litigation Trustee.<sup>5</sup> If the Private Actions Trustee declined to prosecute an individual creditor-assignor's cause of action or actively settle it, the cause of action was subject to reassignment back to the creditor.<sup>6</sup>

### **III. Bankruptcy Court Jurisdiction and Court Approval of Liquidating Trust Actions**

There is nothing in the Internal Revenue Code or Bankruptcy Code that requires a liquidating trustee to obtain court approval for any transaction, unlike Bankruptcy Code Section 363(b), which requires a Chapter 11 trustee or debtor in possession to obtain court approval for actions outside the ordinary course of business. It is impractical and costly to require frequent court approval of liquidating trust decisions, but the trustee and any oversight committee of trust beneficiaries may want the liability protection resulting from court approval of major transactions and decisions, such as settlement of significant causes of action or sales of substantial property interests. In some cases, creditors also may want to maintain court oversight over professional fees incurred on behalf of a liquidating trust. A liquidating trustee or oversight committee may also seek bankruptcy court resolution of disputes between them over trust decisions. The plan and liquidating trust agreement should accordingly provide for bankruptcy court access and bankruptcy court jurisdiction.

Provisions on retention of jurisdiction are desirable to increase the likelihood of the bankruptcy court agreeing to hear and decide liquidating trust litigation against the debtor's

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<sup>4</sup> *Refco* Litigation Trust Agreement § 1.7, *In re Refco Inc.*, Case No. 05-60006, U.S. Bankr. S.D.N.Y. (Dkt. 3688, Ex. F) available at

<http://www.refcodoCKET.com/Default.aspx?SearchType=Advanced&DocNum=3688>

<sup>5</sup> *Refco* Private Actions Trust Agreement § 1.2(h), available at *Id.*, Ex. G.

<sup>6</sup> *Id.* § 1.2(e)-(g).

former officers and directors, professionals, and other target defendants. Bankruptcy court post-confirmation jurisdiction is limited, and has been held by some courts not to encompass disputes over reorganized debtor operations and collection of assets.<sup>7</sup> The United States Supreme Court's 2006 *Katz* decision on sovereign immunity relied on a theory of ancillary jurisdiction, that may prove helpful to liquidating trust pursuit of estate claims in bankruptcy courts.<sup>8</sup> A pre-*Katz* case on ancillary jurisdiction, *Kokkonen*, shows the importance of including jurisdictional provisions in the plan and trust documents approved by the confirmation order.<sup>9</sup>

In *Kokkonen*, the Supreme Court held that ancillary jurisdiction did not extend to a lawsuit to enforce a settlement agreement that had resolved a federal diversity lawsuit and resulted in a simple dismissal of the complaint.<sup>10</sup> The Court noted that the case involved only enforcement of the settlement agreement, and not reopening the original suit by reason of breach of the agreement that was the basis for dismissal.<sup>11</sup> It said that “[t]he facts to be determined with regard to such alleged breaches of contract are quite separate from the facts to be determined in the principal suit, and automatic jurisdiction over such contracts is in no way essential to the conduct of federal court business.” While the facts in post-confirmation litigation by liquidating trusts to collect recoveries for creditors are often distinct from facts involved in the bankruptcy case itself, the litigation may be essential to the plan. Indeed, it may be just as important for creditor distributions as equivalent litigation by a trustee during a Chapter 7 liquidation case. Critically for bankruptcy cases, the *Kokkonen* Court expressly recognized that

The situation would be quite different if the parties’ obligation to comply with the terms of the settlement agreement had been made part of the order of dismissal – either by separate provision (such as a provision ‘retaining jurisdiction’ over the settlement agreement) or by incorporating the terms of the settlement agreement in the order. In that event, a breach of the agreement would be a violation of the order, and ancillary jurisdiction to enforce the agreement would therefore exist.<sup>12</sup>

Reorganization plans must expressly provide for the means by which the plan will be implemented, such as through liquidating trust litigation as a successor entity to a debtor to liquidate causes of action and other assets for distribution to creditors.<sup>13</sup> Plans and confirmation orders generally include provisions for bankruptcy court jurisdiction over litigation to enforce and implement plan terms. Parties cannot confer subject matter jurisdiction by agreement, but bankruptcy *in rem* and ancillary jurisdiction is a mixture of subject matter and personal

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<sup>7</sup> See *In re Pegasus Gold Corp.*, 394 F.3d 1189 (9<sup>th</sup> Cir. 2005) (upholding such jurisdiction); *In re Resorts Int'l, Inc.*, 372 F.3d 154 (3d Cir. 2004) (no post-confirmation jurisdiction over accounting malpractice action).

<sup>8</sup> See Susan Freeman and Marvin Ruth, “The Scope of Bankruptcy Ancillary Jurisdiction After *Katz* as Informed by Pre-*Katz* Ancillary Jurisdiction Cases,” 15 ABI Law Review 155 (Spring 2007), analyzing *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356 (2006).

<sup>9</sup> *Kokkonen v. Guardian Life Ins. Co. of Amer.*, 511 U.S. 375, 379-80 (1994).

<sup>10</sup> *Kokkonen*, 511 U.S. at 381-82.

<sup>11</sup> *Id.* at 378.

<sup>12</sup> *Id.* at 381.

<sup>13</sup> 11 U.S.C. § 1123(a)(5).

jurisdiction,<sup>14</sup> and the Bankruptcy Code provides statutory authority for a bankruptcy court to “direct the debtor and any other necessary party...to perform any other act...that is necessary for consummation of the plan,”<sup>15</sup> and to “collect and reduce to money the property of the estate.”<sup>16</sup> A district court sitting in a bankruptcy case may also have ancillary jurisdiction over such litigation through the federal supplemental jurisdiction statute, which at least one circuit has held may be exercised by the bankruptcy court.<sup>17</sup>

The circuit courts analyzing whether bankruptcy courts have “related to” jurisdiction over litigation by a post-confirmation trust established under a reorganization plan have analyzed their jurisdiction under the widely adopted test set forth by the Third Circuit in *Pacor, Inc. v. Higgins*<sup>18</sup>. The Supreme Court recently approved the *Pacor* test in *Celotex*, and applied it in a broader way than the Third Circuit in *Pacor* itself.<sup>19</sup> That holding tends to support a broader reach of post-confirmation jurisdiction, as does the *Katz* decision’s focus on bankruptcy court ancillary jurisdiction. Indeed, *Katz* may reach even further than *Pacor* and *Celotex*, given the types of connections encompassed by ancillary jurisdiction in non-bankruptcy cases and in receivership and pre-Code bankruptcy cases.<sup>20</sup>

#### IV. Trust Committee Oversight and Decision-Making Authority

In most cases, the reorganization plan provides for a group of interested creditors to consult regularly with the liquidating trustee and provide oversight and guidance to the trustee as decisions are made affecting disposition of assets. The degree to which the committee will supervise and control trustee decisions is a matter of preference and negotiation between proposed trustees and parties in interest negotiating the liquidating trust agreement and plan terms. In some cases, retention of attorneys and other professionals, sale of assets or settlement of litigation (sometimes only when exceeding threshold values) is subject to approval of the oversight board.<sup>21</sup> In some cases, the liquidating trustee consults with and seeks the advice and guidance of the oversight board on a regular basis, but they have no authority.<sup>22</sup>

When the trustee has responsibility for decisions, he or she may want control over decision-making, and be unwilling to delegate it to a committee. Liability for poor decisions

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<sup>14</sup> See Freeman and Ruth at 158-61.

<sup>15</sup> 11 U.S.C. § 1142(b). The statute does not specify where the bankruptcy court could direct that post-confirmation litigation be filed, however.

<sup>16</sup> 11 U.S.C. § 704 (Chapter 7 trustee), incorporated by reference as duty of Chapter 11 trustee in 11 U.S.C. § 1106(a)(1); 11 U.S.C. § 1123(b)(3)(B) (plan may provide for retention and enforcement by debtor, trustee, or representative of the estate of any estate claim or interest).

<sup>17</sup> 28 U.S.C. § 1367; *Pegasus Gold*, 394 F.3d at 1195.

<sup>18</sup> *Pacor, Inc. v. Higgins*, 743 F.2d 984 (1984), discussed in *Pegasus Gold*, 394 F.3d at 1193-94; *Resorts Int’l.*, 372 F.3d at 163-65.

<sup>19</sup> *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995), approving *Pacor*.

<sup>20</sup> See Freeman and Ruth, *passim*.

<sup>21</sup> See, e.g. *Simplot* Creditors Trust Agreement § 6.19.5, (Dkt. 577, Ex. 1.2.20) *In re Don J. Simplot*, No. 06-00002, U.S. Bankr. D. Idaho, available through PACER at [ecf.idb.uscourts.gov](http://ecf.idb.uscourts.gov); *ResMAE* Liquidating Trust Agreement §§ 2.15, 2.17(b), 6.2; *Refco* Litigation Trust §§ 3.12, 4.2; *Crown Pacific* Liquidating Trust Agreement §§ 3.3(a), 4.4(b).

<sup>22</sup> See, e.g. *USACM* Liquidating Trust Agreement § 3.5(a).

accompanies authority to make them. Reorganization plans providing for liquidating trusts and oversight committees generally include exculpation and release provisions, protecting trustees and oversight committees from liability for decisions made with due care, setting a standard of care that exposes them only for fraud, gross negligence, breach of fiduciary duties and intentionally wrongful conduct.<sup>23</sup> An oversight committee that has the right to override a trustee's decisions should consider obtaining insurance coverage like a corporate board, to provide protection comparable to the trustee's bond.

## V. Preservation and Transfer of the Debtor's Privileges

The Supreme Court has held that a bankruptcy trustee is empowered to waive the attorney-client privilege of a corporate debtor just as prior corporate management could waive it.<sup>24</sup> It reasoned that a trustee in bankruptcy steps into the shoes of the debtor in many respects, taking over management of a corporate debtor. Further, it noted that reposing the privilege in the trustee would promote maximization of estate value by facilitating the trustee's investigation of prior management's conduct, and noted that the privilege must be exercised in accordance with the trustee's fiduciary duties to both creditors and shareholders. The latter justification, and sometimes also the former one, apply to a liquidating trustee appointed under a reorganization plan, and at least one court has expressly held that a liquidating trustee may control exercise of the debtor's privilege.<sup>25</sup>

There is a split of authority on whether the attorney-client privilege always passes by operation of law to the bankruptcy trustee, so that the trustee may unilaterally waive the privilege of an individual debtor. The Supreme Court expressly declined to rule on the issue, but pointed out that since individuals do not act through agents like corporations, the rationale of taking over management's privilege rights would not apply, and other reasons would have to support any trustee waiver of an individual debtor's privilege.<sup>26</sup> Some courts hold the trustee always may waive;<sup>27</sup> some that the trustee may never waive, including in the *Hunt* case brought by a liquidating trustee appointed under a confirmed plan.<sup>28</sup> A growing trend holds that the trustee's power to

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<sup>23</sup> *Simplot* Trust Agreement § 6.9; *ResMAE* Trust Agreement § 8.1; *Refco* Litigation Trust §§ 1.4(b), 3.20, 4.9; *Crown Pacific* Liquidating Trust Agreement § 6.3.

<sup>24</sup> *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343 (1985). See *In re Gold & Appel Transfer S.A.*, 342 B.R. 386 (Bankr. D. D.C. 2006) (liquidator of foreign debtor controls privilege in § 304 proceeding). The *Weintraub* case concerned a chapter 7 bankruptcy. The reasoning has been held equally applicable to chapter 11 cases. *In re Michigan Boiler & Engineering Co.*, 87 B.R. 465 (Bankr. E.D. Mich. 1988). A bankruptcy trustee of a partnership can waive its privilege, since a partnership is an entity. *United States v. Campbell*, 73 F.3d 44 (5th Cir. 1996); *Meoli v. American Medical Service of San Diego*, 287 B.R. 808 (S.D. Cal. 2003). A trustee appointed under the SIPA is empowered to waive the debtor's privilege. *Securities Investor Protection Corp. v. Strattoon Oakmont, Inc.*, 213 B.R. 433 (Bankr. S.D.N.Y. 1997). An examiner may also assume so many of the DIP's functions (in conjunction with the creditors' committee) that he may control exercise of the privilege as well. *In re Boileau*, 736 F.2d 503 (9th Cir. 1984).

<sup>25</sup> *In re Hechinger Inv. Co. of Del.*, 285 B.R. 601 (D. Del. 2002).

<sup>26</sup> *CFTC v. Weintraub*, 471 U.S. at 356-57.

<sup>27</sup> *In re Smith*, 24 B.R. 3 (Bankr. S.D. Fla. 1982); see *In re Fairbanks*, 135 B.R. 717 (Bankr. D. N.H. 1991) (chapter 7 debtor left state and could not act for himself; trustee could waive privilege).

<sup>28</sup> *McClarty v. Gudenau*, 166 B.R. 101 (E.D. Mich. 1994); *In re Tippy Togs of Miami, Inc.*, 237 B.R. 236

waive the attorney-client privilege depends on the facts and circumstances of the case.<sup>29</sup> As one court analyzed the cases, the individual debtor alone should hold privilege waiver power when potential harm to or control over his person may exist from a disclosure; the trustee should hold waiver power when he is only seeking to discover and recover assets for the estate.<sup>30</sup> And as the Tenth Circuit noted, that means the court must actually analyze the harm to the debtor and balance it against the trustee's need for information.<sup>31</sup> The court may direct measures to protect the debtor while allowing the trustee to obtain privileged documents, *e.g.* directing counsel to redact statements or documents which could expose the debtor to criminal liability and providing them to the court for an *in camera* review, with the court balancing their relevance against likelihood of harm to the debtor.<sup>32</sup> In many cases, liquidating trust litigation will focus on collection of assets for creditors, and courts engaging in a balancing test will recognize the propriety of allowing the liquidating trustee to take control over the debtor's privilege and delve into information in the control of former attorneys of the debtor.

The liquidating trust agreement should include terms preserving and transferring the debtor in possession's or Chapter 11 trustee's control over the attorney-client privilege to the liquidating trust along with causes of action and other assets.<sup>33</sup> The USA Commercial Mortgage Liquidating Trust Agreement provides as follows:

Preservation of Privilege and Exercise by Liquidating Trustee. To the full extent permitted by law, USACM will be deemed to irrevocably transfer to the Liquidating Trustee, as its legal successor, all rights of USACM and the USACM Estate (including the USACM Estate after the Confirmation Date) to exercise or waive any attorney-client privilege, accountant-client privilege, work-product privilege or other privilege or immunity attaching to any documents or communications (whether written or oral) (collectively, the "Privileges"), and USACM and the Liquidating Trustee are authorized to take all necessary actions to effectuate the transfer of the Privileges. All such Privileges also shall vest in the USACM Liquidating Trust and its representatives, to the full extent permitted by law. This transfer is self-executing, provided however, that the Liquidating Trustee and USACM are authorized and directed to take any and all necessary actions to effectuate the transfer of such Privileges. After the Effective Date the

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(Bankr. S.D. Fla. 1999); *In re Hunt*, 153 B.R. 445 (Bankr. N.D. Tex. 1992); *In re Silvio de Lindegg Ocean Developments of America, Inc.*, 27 B.R. 28 (Bankr. S.D. Fla. 1982).

<sup>29</sup> *In re Foster*, 188 F.3d 1259 (10<sup>th</sup> Cir. 1999), *reversing and remanding* 217 B.R. 631 (Bankr. D. Colo. 1997); *In re Courtney*, 372 B.R. 519 (Bankr. M.D. Fla. 2007); *In re Bame*, 251 B.R. 367 (Bankr. D. Minn. 2000); *In re Miller*, 247 B.R. 704 (Bankr. N.D. Ohio 2000); *In re Bazemore*, 216 B.R. 1020 (Bankr. S.D. Ga. 1998); *In re Williams*, 152 B.R. 123 (Bankr. N.D. Tex. 1992); *see In re Rice*, 224 B.R. 464 (Bankr. D. Or. 1998) (trustee may not waive privilege if debtor continues to hold interest in litigation through exemption).

<sup>30</sup> *Bazemore*, 216 B.R. at 1025; *Foster*, 217 B.R. at 638 (privilege passes to trustee to recover estate assets in nature of prepetition civil actions); *see also In re Eddy*, 304 B.R. 591 (Bankr. D. Mass. 2004) (chapter 7 trustee may waive privilege of individual formerly Chapter 11 DIP with respect to communications relating to administration of property of the estate).

<sup>31</sup> *Foster*, 188 F.3d at 1268-69.

<sup>32</sup> *In re Courtney*, 372 B.R. 519 (Bankr. M.D. Fla. 2007).

<sup>33</sup> *See, e.g. Simplot Creditors Trust Agreement* § 9.12; *Refco Litigation Trust Agreement* § 1.2(a)

Liquidating Trustee shall have the exclusive power and authority to assert or waive the Privileges. Likewise, to the fullest extent permitted by law, FTDF, with respect to the FTDF Litigation Claims only, will be deemed to irrevocably transfer to the Liquidating Trustee, as its legal successor, all rights of FTDF and the FTDF Estate (including the FTDF Estate after the Confirmation Date) to exercise or waive any Privileges relating in any manner to the FTDF Litigation Claims, and FTDF and the Liquidating Trustee are authorized to take all necessary actions to effectuate the transfer of such Privileges, which also shall vest in the USACM Liquidating Trust and its representatives, to the full extent permitted by law. This transfer is self-executing, provided however, that the Liquidating Trustee and FTDF are authorized and directed to take any and all necessary actions to effectuate the transfer of such Privileges. After the Effective Date the Liquidating Trustee shall have the exclusive power and authority to assert or waive any Privileges relating exclusively to the FTDF Litigation Claims.<sup>34</sup>

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<sup>34</sup> *USACM Liquidating Trust Agreement § 9.4; Crown Pacific Liquidating Trust Agreement § 9.4.*