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1 Stetson J. Advoc. & L. 47 (2014)

## The Debtor Said What?!

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## I. Introduction

47. Understanding the hearsay rule and its various exclusions and exceptions is a difficult task for both law students and legal practitioners. Most law students and lawyers alike generally understand the basics of hearsay. Hearsay is an out-of-court statement, which is used to prove the truth of the matter asserted in the statement.<sup>2</sup> Federal Rule of Evidence 802 does not permit hearsay to be admitted as evidence, unless the statement qualifies as an enumerated exception to the hearsay rule.<sup>3</sup> In addition to the exceptions, Federal Rule of Evidence 801 excludes certain statements from the definition of hearsay. Specifically, the out-of-court statements made by an opposing party are not hearsay.<sup>4</sup>

48. What is likely confusing to even the most skilled practitioner is the application of the opposing-party-statement exclusion of Rule<sup>5</sup> 801(d)(2) in the context of a lawsuit brought or maintained by a bankruptcy trustee. When a debtor files for bankruptcy, as discussed below, a third-party trustee may be appointed to administer the bankruptcy estate, including pursuing causes of actions for the benefit the bankruptcy estate. The

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2 [Fed. R. Evid. 801\(c\)](#).

3 [Fed. R. Evid. 802](#).

4 [Fed. R. Evid. 801\(d\)\(2\)](#).

5 Reference herein to the "Rule" or "Rules" shall mean the Federal Rules of Evidence or the specific Rule of Evidence identified therein.

introduction of this third party makes it easy to confuse who qualifies as the “opposing party” for purposes of the hearsay rule — the debtor or the bankruptcy trustee. Are the pre-petition statements of a debtor attributable to a bankruptcy trustee? Should the pre-petition statements of a debtor be attributable to a bankruptcy trustee? Does it matter if the lawsuit is one that arises out of bankruptcy law or state law? These are difficult questions to answer, and the courts applying Rule 801(d)(2) in actions brought or maintained by a bankruptcy trustee have been equally divided in their answers.

49. This Article seeks to: (i) provide a general understanding of the role of a bankruptcy trustee and an explanation of adversary proceedings; (ii) provide an overview of the evolution of privity-based admissions from common law through the enactment of the Federal Rules of Evidence; (iii) summarize and provide an understanding of the legal authorities applying Rule 801(d)(2) in proceedings brought or maintained by a bankruptcy trustee; (iv) explain the potential consequences of the decisions relying on privity to determine whether pre-petition statements of a debtor should be admissible against a bankruptcy trustee; and (v) propose the proper analysis for determining whether pre-petition statements of a debtor should be admissible against a bankruptcy trustee.

## II. The Bankruptcy Process and the Bankruptcy Trustee

50. The commencement of any bankruptcy case creates an estate generally consisting of all legal or equitable interests of a debtor in property as of the commencement of the case.<sup>6</sup> When a chapter 7 petition is filed, the United States Trustee appoints an impartial case trustee to serve as gatekeeper and administrator of the bankruptcy estate.<sup>7</sup> In a chapter 11 case, a trustee can be appointed upon the request of the United States Trustee or a party-in-interest, for cause, or if appointing a trustee would be in the best interests of the bankruptcy estate.<sup>8</sup> In either a chapter 7 or chapter 11 bankruptcy, the bankruptcy trustee’s primary role is to administer estate assets in an attempt to maximize the return available to a debtor’s unsecured creditors.<sup>9</sup> Generally, a bankruptcy trustee accomplishes this goal by selling assets of the bankruptcy estate.<sup>10</sup> Additionally, a bankruptcy trustee may recover money or property for the benefit of the bankruptcy estate by exercising his or her avoidance powers,<sup>11</sup> and by

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6 11 U.S.C. § 541(a)(1) (2012).

7 11 U.S.C. § 701 (2012); 11 U.S.C. § 704 (2012).

8 11 U.S.C. § 1104(a) (2012).

9 Corporate Assets, Inc. v. Paloian, 368 F.3d 761, 767 (7th Cir. 2004).

10 Hoffman v. Hartley (In re Hartley), 483 B.R. 700, 704 (Bankr. W.D. Wis. 2012).

11 Dawson v. Thomas (In re Dawson), 411 B.R. 1, 21 (Bankr. D.D.C. 2008).

pursuing debtors' non-bankruptcy causes of action for the benefit of the estate.<sup>12</sup>

51. Bankruptcy trustees derive their specific avoiding powers from sections 544, 545, 547, 548, and 549 of the Bankruptcy Code. More specifically, section 544 grants a bankruptcy trustee the power of a lien creditor and permits a bankruptcy trustee to exercise the power of existing creditors to avoid transfers of property of a debtor.<sup>13</sup> Section 545 grants a bankruptcy trustee the power to avoid certain statutory liens.<sup>14</sup> Section 547 of the Bankruptcy Code permits trustees to set aside preferential transfers made to creditors within 90 days and 1 year (for insiders) before the bankruptcy petition.<sup>15</sup> Section 548 of the Bankruptcy Code permits trustees to recover transfers made within two years of the filing of the bankruptcy and made either with the intent to hinder, delay or defraud creditors or where the debtor received less than reasonably equivalent value in exchange for such transfer.<sup>16</sup> Finally, section 549 permits a trustee to avoid transfers made after the filing of the bankruptcy petition without court permission.<sup>17</sup>

52. Most often, a bankruptcy trustee employs his or her avoidance powers or pursues other causes of action through an adversary proceeding.<sup>18</sup> An adversary proceeding is a lawsuit that occurs under a bankruptcy case. It is tried in a federal bankruptcy court, before a bankruptcy court judge, and under most of the same rules of both procedure and evidence as an action filed in a federal district court. Adversary proceedings are very similar to actions filed in federal district court. They begin with the filing of a complaint, proceed through the answer and discovery stages, can involve a formal trial (including the introduction of evidence, both in the form of exhibits and live testimony) and conclude with a judgment or dismissal.<sup>19</sup>

53. It is well known that all of the Federal Rules of Evidence apply to adversary proceedings.<sup>20</sup> Additionally, Federal Rule of Evidence 1101 generally provides that the Rules of Evidence apply to United States bankruptcy court judges and to proceedings and cases in bankruptcy.<sup>21</sup> This includes Rule 801(d)(2) and the exclusion to the

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12 *Moneymaker v. Coben* (In re Eisen), 31 F.3d 1447, 1451 (9th Cir. 1994).

13 11 U.S.C. § 544 (2012)

14 11 U.S.C. § 545 (2012)

15 11 U.S.C. § 547 (2012).

16 11 U.S.C. § 548 (2012).

17 11 U.S.C. § 549 (2012).

18 See generally, *Fed. R. Bankr. P. 7001*.

19 The Honorable Christopher M. Klein, *Bankruptcy Rules Made Easy* (2001): A Guide to the Federal Rules of Civil Procedure that Apply in Bankruptcy, 75 *Am. Bankr. L.J.* 35, 38 (Winter 2001).

20 See *Fed. R. Bankr. P. 9017*; *Boone v. Barnes* (In re Barnes), 266 B.R. 397, 403 (8th Cir. BAP 2001).

21 *Fed. R. Evid. 1101(a) & (b)*.

hearsay rule referred to as “opposing party statements.”<sup>22</sup> What is perhaps less well known to both bankruptcy trustees and attorneys representing bankruptcy trustees is that pre-petition statements of a debtor may be considered admissions that can be used against a bankruptcy trustee under Federal Rule of Evidence 801(d)(2).<sup>23</sup>

### III. The Admissions-By-Privity Doctrine

54. At common law, statements made by those in privity with a party to an action were considered admissions of that party.<sup>24</sup> Analogies to substantive law greatly affected the admissions-by-privity doctrine. Thus, for example, statements of predecessor-in-interest could be used against successors-in-interest, statements of one joint owner could be used against another joint owner, and statements of decedents could be used against their representatives, heirs, and next of kin; however, statements by tenants in common could not be used against another tenant in common and statements of one co-devisee could not be used against the other devisee.<sup>25</sup>

55. During the early to mid 1900s, the two leading legal scholars on evidence law, John Henry Wigmore and Edmund M. Morgan, debated the proper use and application of the admissions-by-privity doctrine.<sup>26</sup> Wigmore generally supported the admissions-by-privity doctrine stating:

So far as one person is in privity in obligation with [an]other ... there is equal reason for receiving against him such admissions of the other as furnished evidence of the act which charges them equally. Not only as a matter of principle does this seem to follow ... but also as a matter of fairness, since the person who is chargeable in his obligations by the acts of another can hardly object to the use of such evidence as the other may furnish. Moreover as a matter of probative value, the admissions of a person having virtually the same interests involved and the motive and means for obtaining knowledge will in general be likely to be equally worthy of consideration.<sup>27</sup>

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<sup>22</sup> [Fed. R. Evid. 801](#).

<sup>23</sup> *Wilen v. Bayonne/Omni Dev., LLC (In re Bayonne Med. Ctr.)*, [2011 WL 5900960 \\*1](#) (Bankr. D.N.J. Nov. 1, 2011); *Jansen v. Grossman (In re Hadlick)*, Ch. 7 Case No. 8:09-bk-22442-MGW, Adv. No. 8:10-ap-01423-MGW, slip op. at 1 (Bankr. M.D. Fla. Jan. 19, 2012).

<sup>24</sup> *Huff v. White Motor Corp.*, [609 F.2d 286, 290–91](#) (7th Cir. 1979).

<sup>25</sup> 2 Kenneth S. Broun, [McCormick on Evidence §{} 260](#) (7th ed. 2013).

<sup>26</sup> 4 John Henry Wigmore, *Evidence in Trials at Common Law* §§ 1080–1087 (Chadbourn rev. 1972); Edmund M. Morgan, *Admissions*, [12 Wash. L. Rev. 181](#) (1937); Edmund M. Morgan, *The Rationale of Vicarious Admissions*, [42 Harv. L. Rev. 462](#)(1929).

<sup>27</sup> 4 John Henry Wigmore, *Evidence in Trials at Common Law* §§ 1080–1087 (Chadbourn rev. 1972).

56. Wigmore believed that his approach applied equally to situations involving successors-in-interest, arguing that successors had the same interest and knowledge as their predecessors and such statements had the same testimonial value as if made by the successor.<sup>28</sup>

57. Morgan criticized both the admissions-by-privy doctrine and Wigmore's views arguing it was wholly improper to import the property doctrines of identity of interest and privy of estates into the law of evidence.<sup>29</sup> Specifically Morgan argued:

The dogma of vicarious admissions, as soon as it passes beyond recognized principles of representation, baffles the understanding. Joint ownership, joint obligations, privy of title, each and all furnish no criterion of credibility, no aid in the evaluation of testimony.<sup>30</sup>

58. In 1973, the Supreme Court submitted the first draft of the Federal Rules of Evidence to Congress.<sup>31</sup> The drafters of the Federal Rules of Evidence generally accepted Morgan's view, and omitted from the hearsay rule any provision for admitting declarations based on privy or identity of interest.<sup>32</sup> In 1975, after review and revision by both the House and Senate, President Ford signed into law the Federal Rules of Evidence. Neither the House nor the Senate made any substantial changes to the original draft of Rule 801(d)(2), and it was enacted without any provision for admitting declarations based on privy.<sup>33</sup>

59. In *Huff v. White Motor Corporation*, the first case to interpret Rule 801(d)(2) following the enactment of the Federal Rules of Evidence, the court noted that the admissibility of privy-based admissions in federal courts was now controlled by the Rules. The *Huff* court further noted that neither the Rules themselves nor the Advisory Committee Notes referred to any privy-based admissions, and thus the Rule represented a departure from common law. Specifically, the court stated that the explicitness of Rule 801(d) suggested that the legislature did not intend for courts to add new categories of admissions to those stated in the Rule. Accordingly, the court found that the Rules did not exclude privy-based admissions from hearsay, nor did the Rules treat privy-based admissions as an exception to hearsay. Thus,

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28 4 John Henry Wigmore, *Evidence in Trials at Common Law* §§ 1080–1087 (Chadbourn rev. 1972).

29 2 Kenneth S. Broun, [McCormick on Evidence](#) § 260 (7th ed. 2013).

30 Edmund M. Morgan, *Admissions*, 12 *Wash. L. Rev.* 181, 202 (1937).

31 119 *Cong. Rec.* 3247 (Feb. 5, 1973).

32 2 Kenneth S. Broun, [McCormick on Evidence](#) § 260 (7th ed. 2013).

33 Act to Establish the Federal Rules of Evidence, [Pub. L. No. 93-595](#) (codified under various sections of 28 U.S.C.).

privity-based admissions were not admissible following the enactment of the Federal Rules of Evidence.<sup>34</sup>

## IV. Applicability to Bankruptcy Trustees

60. Following the enactment of the Federal Rules of Evidence and the decision in *Huff v. White Motor Corporation*, it might appear to be well-settled law that privity-based admissions would no longer be admissible in federal courts. Notwithstanding, this seemingly well-settled principle becomes unsettled when an action is brought or maintained by a bankruptcy trustee. Of the five opinions discussed herein, three do not consider statements of a debtor to be admissible against a bankruptcy trustee as an admission of an opposing party. These courts employ a strict interpretation of Rule 801(d)(2), and find that regardless of the type of action brought by a bankruptcy trustee — privity and identity of interests have no bearing on the determination of whether a statement is or is not hearsay.<sup>35</sup> The remaining two opinions look to the type of action at issue, and if the cause of action is not one that belongs exclusively to the bankruptcy trustee, then these courts hold that because the bankruptcy trustee is the successor-in-interest to the debtor, the statements of the debtor can be admitted as statements of an opposing party against a bankruptcy trustee.<sup>36</sup>

### Refusing to Admit Debtors' Statements

61. The first court faced with determining the proper application Rule 801(d)(2) to a proceeding brought or maintained by a bankruptcy trustee was the Sixth Circuit in *Calhoun v. Baylor*. In *Calhoun*, the bankruptcy trustee brought suit against Baylor under Tennessee law seeking to recover payments made by the debtor to Baylor as fraudulent conveyances. During the course of the trial, Baylor attempted to use statements by Al Bell and Edward Pollack, both employees of the debtor, against the trustee. The district court refused to find that the statements of Bell and Pollack were admissions that could be used against the bankruptcy trustee as the successor-in-interest to the debtor. On appeal, Baylor argued that because Bell and Pollack were agents of the debtor, their statements were not hearsay, but rather admissions

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34 *Huff v. White Motor Corp.*, 609 F.2d 286, 290–91 (7th Cir. 1979).

35 *Calhoun v. Baylor*, 646 F.2d 1158 (6th Cir. 1981); *Anaconda-Ericsson, Inc. v. Hessen* (In re *Teltronics Servs., Inc.*), 29 B.R. 139 (Bankr. E.D.N.Y. 1983); *Jubber v. Sleater* (In re *Bedrock Mktg., LLC*), 404 B.R. 929 (Bankr. D. Utah 2009).

36 *Wilen v. Bayonne/Omni Dev., LLC* (In re *Bayonne Med. Ctr.*), 2011 WL 5900960 \*1 (Bankr. D.N.J. Nov. 1, 2011); *Jansen v. Grossman* (In re *Hadlick*), Ch. 7 Case No. 8:09-bk-22442-MGW, Adv. No. 8:10-ap-01423-MGW, slip op. at 1 (Bankr. M.D. Fla. Jan. 19, 2012).



under Rule 801(d)(2). Baylor further argued that since the trustee was the successor-in-interest to the debtor the admissions could be used against the trustee. The Sixth Circuit disagreed stating that Rule 801(d)(2) represented a departure from common law and did not permit statements by predecessors-in-interest to be admissible against successors. The Sixth Circuit further noted that there was no “magic in privity” and “that acceptance of privity principles leads to dubious distinctions, particularly in bankruptcies.”<sup>37</sup>

62. In *In re Teltronics*, the bankruptcy court for the Eastern District of New York, relying on Huff, also held that Rule 801(d)(2) expressly rejected privity as a ground for the admissibility of a debtor’s statement against a bankruptcy trustee. Anaconda-Ericsson, Inc. commenced an adversary proceeding against the debtor, Teltronics Services, Inc., seeking a declaration of its rights in certain property of the bankruptcy estate and relief from the automatic stay to enforce any such rights in the property. After appointment, the bankruptcy trustee served an answer to the complaint and asserted a counterclaim, under applicable non-bankruptcy law, for equitable subrogation and imposition of construction trust upon money and property already received by Anaconda-Ericsson. During the course of the trial, Anaconda-Ericsson attempted to offer into evidence certain conversations by and among various officers of the debtor, for the purpose of demonstrating the understanding of the parties as to the property in question. The bankruptcy trustee objected on hearsay grounds, arguing that the statements made by the debtor’s officers were not binding admissions on the trustee. Anaconda-Ericsson argued that the trustee was in privity with the debtor’s officers and that the Second Circuit long accepted privity as a basis for binding a trustee to statements made by a debtor prior to bankruptcy. The court noted that the admissibility of the statements was determined by Rule 801(d)(2) and found that the Federal Rules of Evidence expressly rejected privity as a ground of admissibility, and thus, for any statements formerly recognized as privity-based admissions to be admissible, they must fall within a recognized exception to the hearsay rule.<sup>38</sup>

63. Finally, the bankruptcy court for the District of Utah, in *In re Bedrock*, also held that Rule 801(d)(2) rejects privity as a ground for the admissibility of statements against a bankruptcy trustee. In *In re Bedrock*, the debtor originally commenced an action against Weston Sleater in the Third District Court, Salt Lake City County, seeking to enforce two defaulted promissory notes executed by Sleater in favor of the debtor. After the filing of the bankruptcy petition, the chapter 7 trustee removed the action to the bankruptcy court. The chapter 7 trustee moved for summary judgment and also sought to have the declarations submitted by Sleater in opposition to the motion for summary judgment struck because they contained inadmissible hearsay.

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<sup>37</sup> Calhoun v. Baylor, 646 F.2d 1158, 1158–62 (6th Cir. 1981).

<sup>38</sup> Anaconda-Ericsson, Inc. v. Hessen (*In re Teltronics Servs., Inc.*), 29 B.R. 139, 143–44, 165 (Bankr. E.D.N.Y. 1983).

Sleater argued that the statements contained in the declarations were not hearsay pursuant to Rule 801(d)(2) as they were made by Rex Wheeler, an employee of the debtor and were attributable to the chapter 7 trustee by virtue of his succession to the interests of the debtor in the lawsuit. The court noted that the fact that the action was originally commenced by the debtor under state law, but is now one being prosecuted by a bankruptcy trustee added some interesting nuances to the application of Rule 801(d)(2). Specifically, the court noted that if the case were still pending in state court the statements of Wheeler would be non-hearsay under Rule 801(d)(2), but since the action was removed and was being prosecuted by the chapter 7 trustee, the question became one of privity and successor-in-interest. After considering these nuances, the court found that a trustee is not bound by the statements of a debtor or his agents because a trustee is not the debtor. Although a trustee does, in certain instances, succeed to the interests of a debtor, Rule 801(d)(2) does not include statements of predecessors-in-interest as statements by a party opponent and such statements cannot be used against a trustee.<sup>39</sup>

64. Importantly, in both *In re Teltronics* and *In re Bedrock* the bankruptcy courts ultimately analyzed the statements at issue under the residual exception to the hearsay rule.<sup>40</sup> In *In re Teletronics*, the bankruptcy court admitted the statements under the residual exception after determining that the officer's statements were offered as evidence of a material fact, were more probative on the issues at the heart of the trial, and that the trustee was on notice that Anaconda-Ericsson intended to use the conversations at trial.<sup>41</sup> Much like the *In re Teltronics* court, the *In re Bedrock* court found the appropriate test to determine whether the statement of a debtor could be used against a bankruptcy trustee was through Rule 807 and the residual exception to the hearsay rule. However, after employing the test set forth in Rule 807, the court determined that the test was not satisfied and thus the statements of the debtor could not be used against the trustee because the statements were hearsay.<sup>42</sup> As discussed more fully in Section VI, this Article proposes that the proper test for determining whether pre-petition statements of a debtor are appropriately admitted against a bankruptcy trustee is the standard set forth in Rule 807, and not an analysis based on privity of relationship.

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39 *Jubber v. Sleater (In re Bedrock Mktg., LLC)*, 404 B.R. 929, 933, 935–36 (Bankr. D. Utah 2009).

40 *Anaconda-Ericsson, Inc. v. Hessen (In re Teltronics Servs., Inc.)*, 29 B.R. 139, 165 (Bankr. E.D.N.Y. 1983); *Jubber v. Sleater (In re Bedrock Mktg., LLC)*, 404 B.R. 929, 936 (Bankr. D. Utah 2009).

41 *Anaconda-Ericsson, Inc. v. Hessen (In re Teltronics Servs., Inc.)*, 29 B.R. 139, 165 (Bankr. E.D.N.Y. 1983) (analyzing the residual exception to the hearsay rule under former rule 803(24), which has been subsumed by and is substantially similar to the current rule found in Rule 807).

42 *Jubber v. Sleater (In re Bedrock Mktg., LLC)*, 404 B.R. 929, 936 (Bankr. D. Utah 2009).

## Admitting Debtors' Statements

65. The first court to hold contrary to the decisions of Huff, *In re Teltronics*, and *In re Bedrock* was the bankruptcy court for the District of New Jersey in *In re Bayonne Medical Center*. In *In re Bayonne Medical Center*, the liquidating trustee brought suit against various defendants under New Jersey law, seeking to enforce, among other things, pledge agreements made by the various defendants in favor of the debtor. The defendants sought to introduce the statements of the chairman of the board of the debtor to refute certain allegations made by the liquidating trustee in his various pleadings. The trustee objected to the admissibility of the statement as hearsay. The court ruled that the statements were admissible against the trustee, as the trustee could not avoid the admissions because he stood in the stead of the debtor. Because the cause of action derived directly from the debtor, the trustee was the successor-in-interest to the debtor and thus statements by the debtor's officers were properly admitted against the trustee.<sup>43</sup>

66. Relying on the reasoning of *In re Bayonne Medical Center*, the bankruptcy court for the Middle District of Florida also found that when a cause of action derives directly from the debtor and not from the Bankruptcy Code, statements made by the debtor would be admissible against a bankruptcy trustee as admissions under Rule 801(d)(2). In *In re Hadlick*, the chapter 7 trustee brought suit against Timothy Grossman seeking, among other things, to collect the amounts due and owing the debtors under a promissory note executed by Grossman. Through the course of the trial, Grossman sought to introduce several statements of the debtors to refute the allegations asserted by the trustee in her complaint. The trustee objected to the admission of these statements on the basis of hearsay. Grossman argued that the statements were not hearsay under Rule 801(d)(2) because the trustee was the successor-in-interest to the debtors. The court noted that if this action were commenced by the debtors, all of the statements made by the debtors would be admissible under Rule 801(d)(2). Further, the court stated that a trustee, as a representative of a debtor's estate, succeeds to the rights of a debtor and obtains standing to bring any suit that a debtor could have brought outside of bankruptcy. Additionally, the court stated that the trustee takes property subject to any and all restrictions that exist at the commencement of a bankruptcy case. Relying on these statements and the reasoning of *In re Bayonne Medical Center*, the bankruptcy court found that the statements of the debtor were admissible against the chapter 7 trustee because the trustee could not avoid the admissions as she stood in the shoes of the debtor and the action derived directly from the debtor.<sup>44</sup>

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<sup>43</sup> *Wilen v. Bayonne/Omni Dev., LLC (In re Bayonne Med. Ctr.)*, 2011 WL 5900960 \*1, \*3-11 (Bankr. D.N.J. Nov. 1, 2011)

<sup>44</sup> *Jansen v. Grossman (In re Hadlick)*, Ch. 7 Case No. 8:09-bk-22442-MGW, Adv. No. 8:10-ap-01423-MGW, slip op. at 1, 3-8, 17-21 (Bankr. M.D. Fla. Jan. 19, 2012).

## V. Potential Consequences

67. Both the *In re Bayonne Medical Center* and the *In re Hadlick* cases fail to acknowledge the explicit departure from the common-law tradition of the admissions-by-privity doctrine with the enactment of the Federal Rule of Evidence 801(d)(2). The drafters of Rule 801(d)(2) and Congress were well aware of both the common law acceptance of privity in determinations of hearsay and the arguments of Wigmore and Morgan. Rule 801(d)(2) represents a departure from the common law and an acceptance of the Morgan views on the inappropriateness of a privity analysis in determining whether a statement is or is not hearsay.<sup>45</sup> Instead, both the *In re Bayonne Medical Center* and the *In re Hadlick* courts place great weight on the fact that that a trustee takes property subject to any and all restrictions at the commencement of the bankruptcy, and thus, privity properly has a place in determining whether or not evidence is hearsay.<sup>46</sup> A privity analysis offers no standards for testing credibility and trustworthiness of statements, and thus, should have no role in the determination of the admissibility of evidence. Permitting statements of a debtor to be used against a trustee solely based on privity provides greater control to debtors over causes of action that a trustee may pursue, and creates an unworkable burden for estate administration and sanction trap for trustees and their counsel.

### Manipulation and Control of a Trustee's Role

68. In relying only on privity as a basis for allowing the statements of a debtor to be used against a trustee, the courts in *In re Bayonne Medical Center* and *In re Hadlick* instill in debtors a greater control over the ability of a bankruptcy trustee to maintain causes of action, both arising out of bankruptcy law and arising outside of bankruptcy law. The premise of both the *In re Bayonne Medical Center* and *In re Hadlick* decisions is that statements of a debtor are admissible against a bankruptcy trustee solely because a trustee is the successor-in-interest to a debtor, and as such, a trustee takes property subject to any and all restrictions at the commencement of the bankruptcy. Following this logic, debtors' pre-petition statements must attach to their causes of action, and accordingly trustees take those causes of actions subject to the debtors' pre-petition statements.<sup>47</sup> These decisions permit debtors to manipulate what causes of action a bankruptcy trustee can pursue. If all that is necessary for a

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45 2 Kenneth S. Broun, [McCormick on Evidence §{} 260](#) (7th ed. 2013).

46 *Wilen v. Bayonne/Omni Dev., LLC (In re Bayonne Med. Ctr.)*, [2011 WL 5900960 \\*11](#) (Bankr. D.N.J. Nov. 1, 2011); *In re Hadlick*, Ch. 7 Case No. 8:09-bk-22442-MGW, Adv. No. 8:10-ap-01423-MGW, slip op. at 17–21.

47 *Wilen v. Bayonne/Omni Dev., LLC (In re Bayonne Med. Ctr.)*, [2011 WL 5900960 \\*11](#) (Bankr. D.N.J. Nov. 1, 2011); *In re Hadlick*, Ch. 7 Case No. 8:09-bk-22442-MGW, Adv. No. 8:10-ap-01423-MGW, slip op. at 17–21.

statement of a debtor to be used against a bankruptcy trustee is the fact that the bankruptcy trustee is in privity with the debtor, this permits a debtor to knowingly make pre-petition statements that will be detrimental to a trustee's ability to maintain causes of action.

69. Specifically, let us look at constructively fraudulent transfers under section 548 of the Bankruptcy Code. A constructively fraudulent transfer occurs when a debtor does not receive reasonably equivalent value in a pre-bankruptcy transaction. Constructively fraudulent transfers are recoverable by a trustee pursuant to section 548(a)(1)(B) of the Bankruptcy Code.<sup>48</sup> A trustee has the burden of establishing the elements of a constructively fraudulent transfer.<sup>49</sup> A debtor, knowing that what it says will be admissible as an admission of a bankruptcy trustee, can ensure that a trustee will not be able to maintain a cause of action by making statements regarding the value received in exchange for the transfers, making statements about its solvency at the time of the transfer, and/or making statements regarding obligations that it never intended to incur or believed would be beyond its ability to pay. Additionally, since the Bankruptcy Code provides subsequent pre-bankruptcy transferees with a good faith defense, a debtor can make statements that could either establish or bolster affirmative defenses available to creditors.<sup>50</sup> According to *In re Bayonne Medical Center* and *In re Hadlick*, regardless of the veracity of the statements, because the trustee is a successor to the debtor, the trustee is burdened by these statements.

70. The same can be said for preference actions under section 547(b) of the Bankruptcy Code. The purpose of section 547 is to create an even ground for all creditors. Accordingly, section 547(b) provides creditors with a mechanism for ensuring that a debtor cannot prefer one creditor over another during the ninety-day period prior to the filing of a bankruptcy petition.<sup>51</sup> With the *In re Bayonne Medical Center* and *In re Hadlick* decisions, debtors can controvert the purpose behind section 547 by making statements that effectively prefer certain creditors over others. A debtor, knowing that its statements will attach to these causes of action and bind trustees, can make statements to negate an element of a preference action or otherwise bolster the defenses of a creditor, thus eliminating the ability of a trustee to maintain a cause of action.

71. The same can be said for non-bankruptcy actions. Let us look at an action by a trustee to enforce a promissory note. Assume that John Smith executes and delivers

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48 11 U.S.C. § 548(a)(1)(B) (2012).

49 *Pension Transfer Corp. v. Fruehauf Trailer Corp.* (In re *Fruehauf Trailer Corp.*), 444 F.3d 203, 211 (3d Cir. 2006); *Bustamante v. Johnson* (In re *McConnell*), 934 F.2d 662, 665 (5th Cir. 1991); *Barber v. Golden Seed Co.*, 129 F.3d 382, 387 (7th Cir. 1997).

50 11 U.S.C. § 548(c) (2012).

51 *Bank of America, N.A. v. Mukamai* (In re *Egidi*), 571 F.3d 1156, 1159–60 (11th Cir. 2009).

to James Jones a promissory note. Mr. Smith makes a few payments under the note but fails to pay the note at maturity. Mr. Jones is worried that he may have to file bankruptcy but wants to ensure that Mr. Smith is protected. About six months prior to his bankruptcy filing, Mr. Jones says to Mr. Smith “Don’t worry about the note, I know that you haven’t been able to make all the payments but you can have another five years to pay it.” Mr. Jones then files bankruptcy and his trustee wants to pursue an action on the defaulted promissory note. Does this statement negate the default? Does it matter that the statement was made to protect Mr. Smith in the event of a bankruptcy filing? Should this statement be permitted to be used against the bankruptcy trustee solely because it was made? According to *In re Bayonne Medical Center* and *In re Hadlick*, there is no room for questions about intent or motives of the debtor because the trustee takes such a cause of action with all statements of the debtor attaching thereto. Thus, it would appear that Mr. Jones’ statement could be used to negate the default under the promissory note and the bankruptcy trustee would not be able to maintain a cause of action against Mr. Smith.

72. These decisions remove the ability of a bankruptcy trustee to effectively administer all assets of a bankruptcy estate. Instead, the power is with debtors to manipulate which, if any, causes of action can be pursued by a bankruptcy trustee.

## Unworkable Burdens and Potential Sanctions

73. The decisions of *In re Bayonne Medical Center* and *In re Hadlick* place an additional burden on bankruptcy trustees and their counsel when determining whether or not to pursue a cause of action. In addition to investigating the facts and evidence to support a cause of action, a bankruptcy trustee and their counsel must now also ensure that he/she has investigated and is aware of each and every statement made by the debtor that may impact a specific cause of action. Failure to do so may subject a bankruptcy trustee and their attorney to sanctions. With this additional burden and risk of sanctions, bankruptcy trustees will be less likely to pursue causes of action for the benefit of a bankruptcy estate.

74. Investigating whether a debtor has made any statements that impact the ability of a trustee to bring a cause of action is a daunting undertaking. How far back must a bankruptcy trustee investigate? What exactly constitutes a proper investigation? For example, is it sufficient for a bankruptcy trustee to generally inquire whether the debtor made any statements at any time that may impact the trustee’s ability to bring a cause of action, or must the bankruptcy trustee depose the debtor when he or she becomes aware of a potential cause of action? If the debtor answers in the negative is that the end of the inquiry, or does the trustee have an affirmative duty to investigate further? Neither *In re Bayonne Medical Center* nor *In re Hadlick* shed any light on these very important questions. Depending on the answers, it may prove

cost prohibitive for a bankruptcy trustee to pursue a cause of action, in that it may cost more to undertake the investigation than the potential recovery under the cause of action.

75. Additionally, not every debtor is available for questioning by a bankruptcy trustee. If a debtor dies during the pendency of a bankruptcy or if the bankruptcy is instituted through use of an involuntary petition, a trustee may have no ability to investigate whether the debtor has made any statements that would impact his or her ability to bring a cause of action on behalf of the bankruptcy estate.

76. Perhaps the most important question left unanswered by both the *In re Bayonne Medical Center* and the *In re Hadlick* decisions is what are the potential consequences to a trustee and their attorneys if this extensive investigation is not sufficiently performed or cannot otherwise be performed? If the statements of a debtor are attributable to a trustee because of privity, then a trustee and counsel should have serious concerns about running afoul of Federal Rule of Bankruptcy Procedure 9011 when filing any cause of action on behalf of a bankruptcy estate.<sup>52</sup> FRBP 9011 provides, that by filing a complaint, the person signing the complaint is certifying to the court that the claim or other legal contention being presented is warranted by existing law.<sup>53</sup> A bankruptcy trustee and counsel will need to make sure that the debtor has not made any statement that would negate the cause of action being pursued; otherwise, the complaint may not be warranted under existing law and might expose the trustee and counsel to sanctions.

## VI. The Proper Approach

77. With the enactment of Rule 801(d)(2), privity should have no role in the determination of the admissibility of evidence against a bankruptcy trustee. As Professor Morgan noted, privity offers no standards for testing credibility and trustworthiness.<sup>54</sup> Further, as can be seen with the potential implications of the decisions in *In re Bayonne Medical Center* and *In re Hadlick*, privity does nothing more than create uncertainty for bankruptcy trustees and provide potential avenues for abuse of the Bankruptcy Code by debtors. Statements of a debtor should never be admissible against a trustee solely because of privity. Rather, as set forth by the courts in *Huff v. White Motor Corporation*, *In re Teltronics*, and *In re Bedrock*, the appropriate test for determining whether such statements should be admissible is under the residual exception to the hearsay rule now contained in Rule 807.

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<sup>52</sup> References to the Federal Rules of Bankruptcy Procedure are referred to herein as FRBP.

<sup>53</sup> [Fed. R. Bankr. P. 9011\(b\)\(2\)](#).

<sup>54</sup> Edmund M. Morgan, Admissions, [12 Wash. L. Rev. 181, 202](#) (1937).



78. Before a statement is admitted as an exception to the hearsay rule, Rule 807 requires: (1) the statement to have the equivalent circumstantial guarantees of trustworthiness; (2) the statement to be offered as evidence of a material fact; (3) the statement to be more probative than any other evidence that the proponent can obtain through reasonable efforts; (4) the statement to best serve the interests of justice; and (5) the proponent give the adverse party reasonable notice of intent to offer the statement and its particulars.<sup>55</sup> Since the second and fourth requirements merely reaffirm that evidence must be relevant and serve the interests of justice,<sup>56</sup> out of the five requirements, courts look primarily to the trustworthiness of the statement, the necessity of the statement, and the notice requirement contained in the Rule.<sup>57</sup>

79. The trustworthiness of the statement tends to be the most important factor under the Rule 807 analysis.<sup>58</sup> In determining the trustworthiness of statements, courts generally examine whether the declarant had a motivation to speak truthfully or otherwise;<sup>59</sup> how spontaneous the statement was;<sup>60</sup> the relationship between the declarant and the person to whom the statement was made;<sup>61</sup> and whether the declarant has recanted or reaffirmed the statement.<sup>62</sup> These factors permit courts to examine the motive and intent of the declarant.<sup>63</sup> Next, courts look to whether the statement is “more probative on the point for which it is offered than any other evidence that the proponent can obtain through reasonable efforts.”<sup>64</sup> This is often interpreted as a general necessity requirement.<sup>65</sup> The necessity factor permits a court to evaluate the need for the statement against the costs and ability to obtain alternative evidence.<sup>66</sup> The last important requirement of the test set forth in Rule 807 is the notice requirement. Rule 807(b) requires that notice be given sufficiently in advance of trial to an adverse party of the intent to use a statement and the particulars of a statement that

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<sup>55</sup> Fed. R. Evid. 807.

<sup>56</sup> *Robinson v. Shapiro*, 646 F.2d 734, 743 (2d Cir. 1981).

<sup>57</sup> *Huff v. White Motor Corp.*, 609 F.2d 286, 286–91 (7th Cir. 1979).

<sup>58</sup> *Huff v. White Motor Corp.*, 609 F.2d 286, 292 (7th Cir. 1979).

<sup>59</sup> *Huff v. White Motor Corp.*, 609 F.2d 286, 292 (7th Cir. 1979); *Page v. Barko Hydraulics*, 673 F.2d 134, 140 (5th Cir. 1982); *United States v. Lentz*, 282 F. Supp. 2d 399, 425–26 (E.D. Va. 2002); *United States v. Bryce*, 208 F.3d 346, 351 (2d Cir. 1999).

<sup>60</sup> *United States v. Ellis*, 935 F.2d 385, 394 (1st Cir. 1991).

<sup>61</sup> *United States v. Vretta*, 790 F.2d 651, 659 (7th Cir. 1986).

<sup>62</sup> *United States v. Barlow*, 693 F.2d 954 (6th Cir. 1982); *United States v. Carlson*, 547 F.2d 1346 (8th Cir. 1976).

<sup>63</sup> *Huff v. White Motor Corp.*, 609 F.2d 286, 292–94 (7th Cir. 1979)

<sup>64</sup> Fed. R. Evid. 807(a)(3).

<sup>65</sup> *United States v. Mathis*, 559 F.2d 294, 299 (5th Cir. 1977).

<sup>66</sup> *United States v. Simmons*, 773 F.2d 1455, 1459 (4th Cir. 1985); *Federal Trade Commission v. Figgie Int’l Inc.*, 994 F.2d 595, 608 (9th Cir. 1993).



would otherwise be considered hearsay.<sup>67</sup> This ensures that the adverse party has the opportunity to prepare for and meet the hearsay evidence.<sup>68</sup>

80. The test of Rule 807 does not rely upon the relationship between a debtor and a bankruptcy trustee to determine whether evidence will be admissible against the bankruptcy trustee. Instead, Rule 807 sets forth a clear and concise test that must be met before any statements of a debtor will be admissible against a trustee. This ensures that a debtor will not have the ability to dictate which causes of action a trustee may pursue and avoids the unworkable burden for estate administration that may occur as a result of the *In re Bayonne Medical Center* and *In re Hadlick* decisions.

81. Examining the trustworthiness factors, it is easy to see that these factors would play an important role when determining whether the statements of a debtor should be attributable to a bankruptcy trustee. Applying these factors to the statements of a debtor allows a court to determine the intent and motives of a debtor in making the statement. Additionally, these factors allow a court to test the veracity of a debtor's statement. These factors ensure that a debtor will not be able to make statements that negate a trustee's ability to bring a cause of action or otherwise provide or bolster a defense to a creditor or defendant. These factors also ensure that creditors do not attempt to coerce debtors into making statements that would otherwise undermine a trustee's ability to maintain a cause of action against that creditor. Turning to the necessity requirement, the court again has the ability to weigh the importance of a debtor's statement versus the cost of obtaining other evidence. Finally, the notice requirement of the rule ensures that a trustee and their counsel will have sufficient notice of the statements made by a debtor and the intended use of those statements by a defendant. With the notice requirement, there will be no surprises for a bankruptcy trustee or their counsel. This allows a trustee to have the ability to investigate the specific statement, rather than attempting to uncover each and every statement made by the debtor, and attempt to find evidence to contradict the statement or to otherwise prepare for and meet the evidence.

## VII. Conclusion

82. Privity should not be used as a basis for the admissibility of evidence under the hearsay rule. Relying on privity may lead to dubious consequences. This is particularly true in the context of debtors and bankruptcy trustees. Permitting statements of a debtor to be used against a trustee solely based on privity provides greater control to debtors over causes of action that a trustee may pursue for the benefit of the

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<sup>67</sup> Fed. R. Evid. 807(b).

<sup>68</sup> *Huff v. White Motor Corp.*, 609 F.2d 286, 295 (7th Cir. 1979); *Anaconda-Ericsson, Inc. v. Hessen (In re Teltronics Servs., Inc.)*, 29 B.R. 139, 165 (Bankr. E.D.N.Y. 1983).

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estate. Additionally, privity-based admissions create an unworkable burden for estate administration and sanction trap for trustees and their counsel. Before any statement of a debtor is admitted against a bankruptcy trustee under the hearsay rule, these statements should be tested under Rule 807. Rule 807 sets forth a clear and concise test that will ensure that a debtor will not have the ability to dictate which causes of action a trustee may pursue and avoids the unworkable burden for estate administration that may occur as a result of the *In re Bayonne Medical Center* and *In re Hadlick* decisions.