Fiduciary Principles in Bankruptcy and Insolvency

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I. Introduction

Although mentioned nowhere in the U.S. Bankruptcy Code, "fiduciary duties" play a central role in guiding the administration of an insolvent debtor's assets. The chief actor doing that administration is the bankruptcy trustee, who is subject to a host of duties, some of which are unquestionably fiduciary. One of the greatest challenges a bankruptcy trustee faces in the discharge of these duties, however, is the widely divergent interests of the heterogeneous creditor constituency. Regarding that difficulty, fiduciary law offers varying degrees of help to bankruptcy trustees in their unenviable task. Even when fiduciary law rears its head with respect to these conflicts, disagreement is rife in the case law regarding its mandate, with courts often repairing to broad platitudes.¹ Yet the system still seems to work tolerably, in spite of all this chaos, with a pragmatic quasi-implicit recognition that conflicted interests are just endemic to bankruptcy.

This chapter will canvass the bankruptcy trustee's duties, which are triggered by virtue of appointment in a case. It focuses on the fiduciary duties of care and especially loyalty, given these inescapable conflicts, proceeding as follows. First, it offers a bankruptcy law primer on the role of the trustee and debtor-in-possession to enable more critical understanding of the fiduciary duty discussion to follow. Second, it discusses the trustee's various duties, focusing first on the degree to which they can be characterized as fiduciary, and then on the specific content of the duties of care and loyalty. The exquisite loyalty challenges the trustee faces are explored in some depth, broken into a taxonomy of

¹ See, e.g., In re AFI Holding, Inc., 530 F.3d 832, 844 (9th Cir. 2008) ("[T]rustee 'may not be the representative of any particular creditor, but must represent all...."").
“external” duties to the debtor’s estate broadly and “internal” duties to the differing classes of creditors therein (with the conflicts of these differing classes illustrated in even greater detail). The analysis shows that the help fiduciary law can provide is varying. Next, this chapter explains the byzantine protective remedies doctrines trustees face from litigation that implicitly recognize the difficulty of their task given these conflicts. Finally, it comments upon miscellaneous additional duties of the trustee and reflects upon the unique challenges the debtor-in-possession faces with its duty of loyalty, suggesting the bankruptcy system has pragmatic structural safeguards that not only mitigate some of these tensions but may even provide a model for conflict-laden fiduciaries elsewhere.

II. Bankruptcy Primer

To understand the various doctrines and rules affecting fiduciary responsibilities in bankruptcy, a quick bankruptcy terrain overview is required. One overarching consideration at the outset is that bankruptcy law is designed as a collective resolution mechanism: it corrals multiple claimants on a debtor’s property into one compulsory proceeding, and so much of its design is about centralizing control over unruly creditors (and debtors). The filing of a bankruptcy petition triggers several legal consequences in so centralizing multiple disputes. First, it imposes an automatic stay on any legal and extralegal collection activities. Second, it creates an “estate” of all the debtor’s property, divesting the debtor of control over the res, albeit with title remaining in the debtor’s name. Third, it assigns control of the estate to the “trustee,” who has authority under various provisions of the Bankruptcy Code to oversee these assets. The trustee will be the focus of our attention in this analysis of fiduciary duties.

The Bankruptcy Code also contains various chapters for specific types of proceedings. The most relevant include chapters 7, 11, and 13.

Chapter 7 is the “primordial” disposition of debtor assets: the trustee’s job is to inventory the assets, review claims filed against the estate, carve out exempt assets for return to the debtor, and pay out dividends to unsecured creditors based on the liquidation of nonexempt property. The Code specifies a hierarchy of creditor claims, which can generally be grouped into four classes: secured, priority unsecured, general unsecured, and subordinated.

Chapter 11 is a reorganization proceeding, chiefly for businesses, in which the debtor proposes voluntary debt concessions to creditors, who are separated into classes and subjected to supermajoritarian voting rules for approving (or vetoing) a plan of

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2 See generally Thomas Jackson, The Logic and Limits of Bankruptcy Law (1986).
4 Id. § 541.
5 See id. §§ 702, 704, 1104, 1106, 1302.
6 See id. §§ 701 et seq.
7 Id. §§ 506, 507, 510.
reorganization.\(^8\) (One requirement of Chapter 11 is a minimum dividend not falling below what would be achieved in a hypothetical Chapter 7 liquidation.\(^9\))

Chapter 13 is a special reorganization for individual debtors, where they may propose their own repayment plan spanning three to five years, paying over net income to their creditors but retaining all their property—including nonexempt property that otherwise would be liquidated in a Chapter 7—in exchange for debt discharge at plan completion.\(^10\) Although the trustee is primarily regulated in Chapter 7, separate provisions of the Code prescribe special rules for trustees in Chapters 11 and 13.\(^11\)

The identity of the trustee depends upon under which chapter the debtor files. In Chapter 7 proceedings, the trustee at the start of the case is technically the "interim" trustee, who is selected usually randomly from a panel mostly composed of bankruptcy lawyers established by the U.S. Trustee's Office.\(^12\) (The U.S. Trustee is a federal Department of Justice official, like a U.S. Attorney, who oversees bankruptcy cases proceeding in his or her district and reports to the D.C.-based "Executive Office of the United States Trustee" (EOUST)).\(^13\) Although nominally creditors can vote for a trustee, the interim trustee functionally becomes the trustee upon creditor nonvote.\(^14\)

In Chapter 13, because the debtor will be languishing in bankruptcy for three to five years, control of property stays with the debtor, who revests in the estate property upon plan confirmation.\(^15\) There is also an officer, also appointed by the U.S. Trustee, called the "Standing Trustee" for the district.\(^16\) As a logistical matter, the debtor's monthly payments are funneled through the Standing Trustee's Office, although some secured creditors (e.g., mortgagees) are often paid directly, "outside" the plan.\(^17\)

In Chapter 11, U.S. law demonstrates its remarkable vision, subject to increasing global replication: the "debtor-in-possession" (DIP) concept.\(^18\) Under the DIP model, no trustee is appointed; the debtor remains in control of its property and its estate, vesting in most—but importantly, not all—of the trustee's responsibilities.\(^19\) There is some debate in bankruptcy literature whether the DIP is a separate entity from the debtor or just the debtor with additional responsibilities and powers, but the point remains that the DIP runs the show.\(^20\) Under certain circumstances, the DIP can be displaced and an external trustee appointed (generally known as a debtor "out of possession"), but those cases are rare.\(^21\) The U.S. experience serves as marked contrast to many other systems of insolvency, such as U.K. "administration," in which the first thing that happens upon filing is

\(^8\) Id. §§ 1124, 1129.  
\(^9\) Id. § 1129(a)(7).  
\(^10\) Id. §§ 1325, 1328.  
\(^11\) See id. §§ 704, 1106, 1302.  
\(^12\) Id. §§ 322(b)(1), 701.  
\(^15\) Id. § 1327(b).  
\(^19\) Id. § 1106.  
\(^21\) 11 U.S.C. § 1104 (focusing specifically on beneficiaries of the estate, not broader considerations of public interest).
divestiture of authority of debtor's management and appointment of the British analogue to a trustee.\textsuperscript{22}

One final point in this bankruptcy law primer: the trustee (and DIP in Chapter 11) enjoys special powers under federal bankruptcy law usually referred to as "avoiding powers." Generally, federal bankruptcy law takes state law property and contract rights as it finds them, although subject to an important caveat of countervailing federal bankruptcy purposes.\textsuperscript{23} That said, the Code confers various instances of redistributive power that allow trustees to claw back some transactions. For example, an unsecured creditor who receives an eve-of-bankruptcy (usually ninety days) transfer of debtor property that allows a better payout than would otherwise be achieved through pro rata distribution has received a "voidable preference," which the trustee can choose to rescind for the benefit of the estate.\textsuperscript{24} Thus, DIPs in Chapter 11 can suddenly find themselves armed with powers to undo transactions with their creditors pursuant to laws that exist only in federal bankruptcy cases.

One of the most significant of these powers pertaining to payment status is what is colloquially called the "strong-arm" clause, which allows trustees to pick off unperfected liens on estate collateral.\textsuperscript{25} A flawed security interest, if avoided under the strong-arm power, has the lien transferred to the estate with the consequence of rendering the erstwhile secured creditor a general unsecured creditor, entitled only to whatever meager dividend that trickles down to the unwashed.\textsuperscript{26} The strong-arm clause implicates a classic internal duty of loyalty tension that will be discussed in the following part.

\section*{III. Trustee Duties}

\subsection*{A. Classification: Fiduciary, Non-Fiduciary, and Anti-Fiduciary Obligations}

The trustee faces a congeries of duties under the Bankruptcy Code, which contains a fulsome list of responsibilities under Section 704 (a provision too long to reproduce here).\textsuperscript{27} None of these are explicitly described as "fiduciary," but commentators have previously argued that at least some are. For example, retired bankruptcy judge (and frequent author) Steven Rhodes divides trustees' obligations into "fiduciary" obligations, owed to the "bankruptcy court and the parties in cases in which the trustee serves," and "institutional" obligations, owed "to the bankruptcy process itself," a serviceable if

\begin{itemize}
  \item \textsuperscript{22} Insolvency Act 1986 c. 45, Schedule B1, §§ 1, 10, 59(1), 61, and 64 (UK).
  \item \textsuperscript{23} See Butner v. United States, 440 U.S. 48, 54 (1979).
  \item \textsuperscript{24} 11 U.S.C. § 547.
  \item \textsuperscript{25} Id. § 544.
  \item \textsuperscript{26} Id. § 550.
  \item \textsuperscript{27} 11 U.S.C. § 704. Section 704 is not exhaustive. The trustee has myriad other obligations scattered throughout other Code provisions. See, e.g., id. § 341.
\end{itemize}
slightly overbroad typology. While I agree with Rhodes that only some are fiduciary, I think analyzing the other obligations is equally as important because some are not just neutral, but thrust trustees into an antagonistic posture with the natural beneficiaries to whom they owe a duty of loyalty. Thus, my preferred sorting would be to say that the trustee has fiduciary, non-fiduciary, and (at the risk of being insufferable) “anti-fiduciary” obligations under the Code.

1. **Non-Fiduciary Duties**

Let’s start with non-fiduciary duties. Although one can debate the correct labeling and classification, some obligations, while important, are clearly not fiduciary. For example, furnishing notice to certain domestic support creditors or transferring patients to health care facilities falls toward the ministerial/administrative end of a continuum building up to fiduciary obligations.

2. **Fiduciary Duties**

As for what I would consider fiduciary duties, the absence of an explicit label of “fiduciary” does not undermine the Code’s language that is clearly amenable to trigger such responsibility, such as the obligation “to be accountable for all property received.” Even neutral-sounding assignments, such as the primary instruction to “collect and reduce to money the property of the estate for which such trustee serves,” can be interpreted—as this one indeed has by courts—to impress upon trustees a fiduciary role.

The corollary is that some obligations that might sound like they are fiduciary “in the air” are not, upon closer inspection, in light of the trustee’s primary obligation to administer an estate. Consider perhaps the most vivid one from the debtor’s perspective—the obligation “if advisable, to oppose the debtor’s discharge.” One could conceive of this as yet another obligation of the trustee to help creditors, and so fully consonant with the trustee’s role as a fiduciary to creditors seeking collection. But that analysis is too quick, because the trustee has no obligation to improve the general welfare of creditors (they are not his general wards), nor even to cajole the debtor to offer voluntary repayments to creditors whose debts will be discharged by operation of federal law.

Rather, the trustee has a fiduciary obligation to creditors limited to the property of the estate; what the debtor does in a post-bankruptcy world is of no concern to the trustee. By contrast, creditors may well care, because a debtor whose discharge is denied not only contributes bankruptcy estate property to the creditors but also continues to have a legal obligation to pay post-bankruptcy. On the other hand, creditors with an uncollectible

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30 Id. § (a)(2).
debtor don't want their dividends reduced by the trustee's (estate-compensated) public-spirited pursuit of a discharge denial motion that yields them no more money. The trustee is thus given specific discretion to determine whether discharge opposition is "advisable," which some courts have interpreted to mean the trustee can let a discharge investigation drop if the creditors don't care (or have settled with the debtor for a compromise payment), while others have held an objection cannot be dropped if creditors have been bought off (at the very least, say these courts, it must be reported to the U.S. Trustee's Office). "No-drop" courts clearly rely on something beyond a trustee's fiduciary obligation to creditors, making the trustee a hybrid fiduciary/non-fiduciary to creditors under Section 704. Thus, some obligations might be considered "faux fiduciary."

3. Anti-Fiduciary Duties

But non- (or faux-) fiduciary obligations are not the end of the matter, as some obligations are clearly antithetical to the creditors, the ostensible beneficiaries of the trustee's fiduciary duties. These might be considered "anti-fiduciary." Consider Section 704(a)(4)'s instruction that "if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper." Few creditors relish the prospect of the trustee sniffing around their claims, let alone objecting, which situates the usually supportive trustee in a sometimes adversarial posture. This necessary awkwardness underscores the intrinsically conflicting nature of the multiparty nature of bankruptcy: when there is collective resolution of a debtor's general default, a menagerie of heterogeneous creditors emerges. A creditor whose claim objection is sustained gets less money, which trickles down to other co-creditors. Trustees thus find themselves sometimes opposed to creditors they normally champion.

Appreciating the complexity of the trustee's duties, which are sometimes downright anti-fiduciary in my characterization, do bankruptcy courts nonetheless generally tend to consider them on the whole as triggering fiduciary obligations? Absolutely. Courts repeatedly remark that trustees—and hence Chapter 11 DIPs—are "fiduciaries" who owe


34 See Rhodes, supra note 28, at 202–209 (opining trustees must "protect the integrity of the bankruptcy process").


36 The conflict is only relevant in "intermediate" cases with some unsecured distribution. If the estate is solvent and all creditors are getting fully paid, only the debtor cares about claims inflation, not the trustee. And if the estate has no assets, the trustee also should not care about the proper calculation of claims that will all be discharged without payment anyway. (The only reason for pursuing review of claims in no asset cases would be trustee fee-churning. In re Riverside-Linden Investors, 925 F.2d 320, 322 (9th Cir. 1991).) Courts have settled on a pragmatic "prima facie" standard: if a claim looks prima facie appropriate, there is no further investigation required absent party objection. E.g., In re Atcall, 284 B.R. 791, 799 (Bankr. E.D. Va. 2002).
traditional obligations of care and loyalty to the estate and its creditors.\textsuperscript{37} Even the professional canons concede many trustee obligations are fiduciary.\textsuperscript{38} Accordingly, while noting these complex nuances on the trustee's responsibilities, it is appropriate now to consider the primary duties of care and loyalty and how they constrain the trustee, flagging especially how the structural tension of the trustee as fiduciary/anti-fiduciary manifests itself when beneficiary interests conflict.\textsuperscript{39}

B. Content of the Duty of Care: Relative Clarity

As mentioned, characterization of trustee duties as "fiduciary" does not appear in the Code, and so it is unsurprising the statute lacks explication of the duty of care. Indeed, bankruptcy courts repeatedly reference non-Code "general" provisions of fiduciary law, suggesting trustees are governed by a federal common law. The U.S. Supreme Court has pronounced, "By the common law, every trustee or receiver of an estate has the duty of exercising reasonable care in the custody of the fiduciary estate."\textsuperscript{40} This common law standard, drawing from trust law, has been articulated as that required by "an ordinarily prudent person."\textsuperscript{41}

Common law fiduciary duties of care supplement statutory obligations imposed by the Code. Courts emphasize Section 704 as a floor, not a ceiling, to the proper discharge of bankruptcy trustees qua fiduciaries. "Beyond the statutory duties, bankruptcy trustees owe to the beneficiaries of the estate the usual common law trust duties...."\textsuperscript{42} Because the content of the duty of care is federal common law, courts have turned to general principles, such as the Restatement of Trusts, to delineate its content.\textsuperscript{43} (There are, however, some dissenters.\textsuperscript{44}) Finally, it should be noted that duty of care issues are functionally regulated by the statutory "competence" requirement for trustees under the Code.\textsuperscript{45} Thus, the real work typical duty of care litigation performs in regular trust law is probably done offstage in insolvency, such as by the empaneling procedures of the U.S. Trustee's office and administrative proceedings removing trustees,\textsuperscript{46} which

\textsuperscript{37} E.g., Stalnaker v. DLC, Ltd., 376 F.3d 819, 825 (8th Cir. 2004).
\textsuperscript{38} See NABT Canon of Ethics, Canon 2 (2005).
\textsuperscript{39} Some cases hold corporate DIPs only to a business judgment rule duty of care, e.g., In re Mirant Corp., 348 B.R. 725, 744 (Bankr. N.D. Tex. 2006), but this line has been criticized. See Kelch, supra note 20, at 1342 n.88.
\textsuperscript{41} In re Ebel, 338 B.R. 862, 875 (Bankr. D. Colo. 2005).
\textsuperscript{42} In re Markos Gurnee P'ship, 182 B.R. 211, 219 (Bankr. N.D. Ill. 1995).
\textsuperscript{43} See, e.g., In re Ferrante, 51 F.3d 1473, 1479–1480 (9th Cir. 1995).
\textsuperscript{44} See In re Schipper, 933 F.2d 513, 516 (7th Cir. 1991) (declining to supplement Code's text).
\textsuperscript{45} 11 U.S.C. § 321(a).
\textsuperscript{46} See 28 C.F.R. § 58.6; Case No. 05-0004, Decision by Acting Director Clifford J. White III, 6 (Nov. 1, 2005), http://www.usdoj.gov/ust/eo/rules_regulations/admin_decisions/docs/case050004.htm (four-month suspension for inadequate debtor investigation).
are designed to police competence. As such, duty of care cases raise few noteworthy issues in insolvency law.

C. Content (and Beneficiaries) of the Duty of Loyalty: Relative Chaos

The duty of loyalty raises far more complex (and intractable) issues in bankruptcy. As previously mentioned, bankruptcy raises unique conflicts among claimants, all of whom are ostensibly served by the trustee. The thornier those conflicts get, the less certainty the fiduciary duty of loyalty (or even impartiality) seems to provide courts. In considering these trustee’s loyalty difficulties, it might be helpful first to distinguish “external” from “internal” conflicts of trustee loyalty.

1. External Conflicts: (Mostly) Clear Fiduciary Obligations

By “external” conflicts, I mean adversarial conflicts between a trustee himself and the bankruptcy estate stakeholders. For example, a self-dealing trustee who profits on his own account violates a duty of loyalty to the beneficiaries. To guard against such temptations, the Code explicitly requires “disinterestedness” as an eligibility criterion to serve. This statutory requirement replicates the common law of trusts, and Congress provides extensive (and fairly rigid) definitional guidance on disinterestedness.

Case law, however, has glossed some flexibility on this statutory definition. Trustees, for example, can serve in multiple related estates under certain circumstances, even if there is a potential for cross-claims. And trustees can, and often do, employ themselves as lawyers for the bankruptcy estate. (The requirement of disinterestedness also applies to attorneys who seek to serve the estate, beyond whatever constraints are imposed by apposite rules of professional conduct.) The DIP, of course, could never satisfy the 47 See In re Lowery, 215 B.R. 140, 141-142 (Bankr. N.D. Ohio 1997) (finding trustee “obviously” competent “by virtue of being a member of the United States Trustee’s panel”).

48 Cf. Kelch, supra note 20, at 1340 (“In attempting to find . . . a definition of the content of the fiduciary duty of the debtor in possession, the lack of any unified concept becomes evident.”).

49 See In re San Juan Hotel Corp., 71 B.R. 413, 423 (D.P.R. 1987), aff’d in part and rev’d in part on other grounds, 847 F.Zd 931, 950 (1st Cir. 1988) (holding trustee’s relative’s freebie marriage reception on estate property was “self-dealing” and “conflict of interest”).


51 In re Palm Coast, Matanza Shores Ltd. P’ship, 101 F.3d 253, 258 (2d Cir. 1996).


55 11 U.S.C. § 327(d); see also Rhodes, supra note 28, at 161 n.67 (referencing poll where 78% of trustees reported employing themselves under Section 327(d)); Restatement (Third) of Trusts § 78 cmt. (c)(5) (Am. Law Inst. 2003) (condoning self-employment).

disinterestedness test, and so has no requirement of disinterestedness imposed.\textsuperscript{57} In sum, the duty of loyalty for “external” temptations to the trustees is largely what might be expected, perhaps with some overspecificity accorded by the statutory strictures of the Code. Fiduciary law (trusts) robustly supplements the Code, aided by the administrative apparatus of the EOUST.

2. Internal Conflicts: Divided Case Law with Uncertain Fiduciary Obligations

“Internal” loyalty issues raise different concerns that, if not unique, are somewhat intrinsic to insolvency: how the trustee polices competing conflicts among the constitutive beneficiaries he serves. Three illustrative skirmishes demonstrate the difficulties courts have deploying the duties of loyalty and impartiality regarding the trustee’s divergent beneficiaries: secured creditor versus unsecured creditor, unsecured creditor versus unsecured creditor, and creditors generally versus the debtor.

To start, the trustee is supposed to be “impartial,” in the language of trust law:

A Chapter 7 trustee occupies a unique position. He is charged with impartially administering the estate entrusted to him. He is the representative of all the creditors.... At times he must propose action that may be detrimental to particular creditors or oppose requests that may be favorable to others.\textsuperscript{58}

Thus, bankruptcy judges are sympathetic to the competing demands on trustee loyalties. But this sympathy has not resulted in detailed specification in case law, just vague incantations of impartiality. And trust law’s translation of the duty of impartiality into not, in fact, requiring impartiality but rather “due regard” for the divergent interests of beneficiaries has not been picked up in bankruptcy (although I am doubtful it could offer much help).\textsuperscript{59} Rather, judicial solicitude for the trustee’s plight simply manifests itself in the diffuse generalization of the trustee’s fiduciary duties being owed to “the estate.”\textsuperscript{60} The Supreme Court concurs that, in insolvency, a corporate DIP’s fiduciary duties run expansively to “the corporation,” including its shareholders and its creditors.\textsuperscript{61} As one commentator laments, “[T]he fiduciary duty that adheres to this

\textsuperscript{57} Cf. id. § 1104(b) (permitting DIP’s professionals to have previously represented debtor).
\textsuperscript{60} See, e.g., In re JMW Auto Sales, 494 B.R. 877, 893 (Bankr. S.D. Tex. 2013).
\textsuperscript{61} CFTC v. Weintraub, 471 U.S. 343, 355 (1985) (“The fiduciary duty of the trustee runs to shareholders are well as creditors.... One of the painful facts of bankruptcy is that the interests of shareholders become subordinated to the interests of creditors.”). Note even the Supreme Court’s vacillation between shifting
role of debtor in possession is a broad one with a host of beneficiaries. It is the number and diversity of beneficiaries of this fiduciary duty that causes its undoing as a useful concept for analysis for conduct.\footnote{Kelch, supra note 20, at 1336.}

I. SECURED CREDITORS

Notwithstanding this broad obligation to maximize the interests of everyone, there are repeat scenarios in which constituencies conflict, and bankruptcy law has struggled to apply "winners" of the fiduciary duty. Consider the tension immanent in the strong-arm clause and its consequences for the trustee's duty of loyalty. This avoiding power pits secured creditor against unsecured creditor, both apparent beneficiaries of the trustee's loyalty. Moreover, an unsecured creditor generally lacks standing to pursue an avoidance action. Thus, only if the trustee decides to move forward will the secured creditor be at risk. Why should a trustee expend time and effort litigating against one beneficiary for the benefit of another (more likely, others)?\footnote{Cf. 11 U.S.C. § 726(a) (tying trustee's compensation to recovery).}

Nothing in the Code dictates an obligation to do so other than the general command to examine claims,\footnote{Id. § 704(a)(5).} which could subsume an obligation to examine the perfected status of a secured claim. Yet case law has created just such a duty, albeit tempered. Indeed, most cases considering the matter do not see secured and unsecured creditors as equal subjects of the trustee's protections. On the contrary, they say that secured creditors can look out for themselves, and thus the trustee's "primary" obligation is to unsecured creditors.\footnote{In re Dinh, 80 B.R. 819, 822 (Bankr. S.D. Miss. 1987) ("It is a fundamental concept in bankruptcy that a trustee's primary duty is to the unsecured creditors rather than to the secured creditors. The secured creditors...should be able to look to their collateral for satisfaction of their claims."); In re Schwen's, Inc., 19 B.R. 681, 694 (Bankr. D. Minn. 1981) ("Secured creditors have a duty and responsibility to monitor the bankruptcy proceedings and to keep informed of the action taken with respect to property in which they claim an interest.").} This approach is tempered, however, by a plausibility threshold, suggesting the trustee's obligation is not to rack up fees scouring every single lien on the estate, but only when some initial indicia of litigability is raised. The bankruptcy rules reflect this thinking.\footnote{See Fed. R. Bankr. P. 3001(f).} (Of course, this tempering of the trustee's obligation is coupled with an unsecured creditors committee in Chapter 11, which has a greater watchdog role in policing the conduct of the "trustee" that is a DIP.\footnote{11. U.S.C. §§ 1102, 1103.}) The corollary, then, is that if the validity of a secured creditor's perfected status is doubtful, the trustee, acting for the unsecured creditors, should object.

The strong-arm clause perhaps is a special case: What's the point of having the strong-arm avoiding power that only the trustee has standing to implement if the trustee has no exclusively to creditors versus shifting diffusely to creditors in addition to shareholders. As one of the bankruptcy bar's senior statesmen observes, the corporate board retains residual duties even when a Chapter 11 trustee is appointed. Martin J. Bienenstock, Conflicts Between Management and the Debtor in Possession's Fiduciary Duties, 61 U. Cin. L. Rev. 543, 547 (1992).
fiduciary obligation to use it? 68 But the case law talking about the trustee's "primary"
duty to the unsecured creditors and not the secureds is far from limited to the strong-
arm clause. Another area in which the trustee's obligations to a secured creditor arise
involves the maintenance and preservation of collateral. 69 Recall that the bankruptcy
estate comprises all property of the debtor, even that fully encumbered by consensual
lien. Why would a trustee want to hold onto such property, let alone incur expenses to
maintain it? The short answer is, he doesn't, and, indeed, often abandons it back to the
secured creditor (if the secured creditor doesn't beat him to the punch with a lift-stay
motion). 70 But unless and until that happens, the secured creditor cannot take the
property back without violating the automatic stay. 71

So what happens in the interim if the property requires upkeep? Consider a property
insurance premium: Should the trustee pay it? If the estate is deeply insolvent, perhaps
even to the point where recovery of the trustee's own fees are in question, there is no
incentive to waste scarce funds on collateral that will not generate any return to the
estate (recall the trustee himself takes fees out of the estate). Congress has included Section
506(c) to allow the trustee to "surcharge" the collateral with such expenses, exactly to
combat this economic disincentive. 72 But Section 506 does not answer the question of
fiduciary duty. While the question might be seen as pertaining to the duty of care (Does
the trustee have to do X?), it really is a question of the duty of loyalty (Does the trustee
have to do X for Y?). 73 Section 506 simply states what to do if the trustee does incur the
cost of the premium. But it doesn't answer the fiduciary question: Must the trustee act
because of his fiduciary duty to the secured creditor? 74

Some courts have said so. "Procuring insurance would ordinarily be an integral part
of the trustee's duty [to secured creditors]." 75 They build upon general principles that the
"fiduciary duty [flows] to all creditors, not just the unsecured creditors." 76 On the other
hand, contrary cases pick favorites and hold that although the duty extends to all creditors,
the "primary duty" is to fight for the unsecured creditors and not the secured creditors. 77

68 Cf. In re Pearson Indus., 178 B.R. 753, 767 (Bankr. C.D. Ill. 1995) (no duty to pursue voidable prefer-
ence absent benefit to estate); see generally In re Nettel Corp., 364 B.R. 433, 441-442 (Bankr. D.D.C. 2006)
taking capacious definition of "estate" to include secured creditor).
70 Id. §§ 362(d), 554.
71 See, e.g., In re Burns, 503 B.R. 666, 673-675, 680 (Bankr. S.D. Miss. 2013) (holding refrigerator
repossession willful stay violation).
72 11 U.S.C. § 506(c) (requiring expenses "benefit" secured creditor).
73 Substantial case law holds that the trustee is not supposed to represent any individual creditor, but
the collective. See, e.g., In re DigitalBridge Holdings, Inc., No. 10-34499, 2015 WL 5766761 at *4 (Bankr.
D. Utah Sept. 30, 2015) (holding trustee pursuing adversary proceeding must represent all or no creditors
but may not represent only some). Relatedly, the trustee has no obligation to "save" individual creditors
and indeed must object to late-filed claims. See, e.g., In re Lyon, No. 11-50343, 2011 WL 5299229, at *2
74 Cf. Sitkoff & Dukeminier, supra note 59, at 595 ("Difference Between Power and Duty").
76 In re Troy Dodson Constr. Co., 993 F.2d 1211, 1216 (5th Cir. 1993).
77 Some go so far to abjure any duty to secureds. See, e.g., In re NETtel Corp., Inc., 364 B.R. 433, 441
(Bankr. D.C. 2006) (holding trustee's fiduciary obligations "run only to a debtor's unsecured creditors.").
Thus, some have held precisely the opposite: when no value will to flow to the estate (as the secured creditor will reap all the collateral's benefit), the trustee has no duty to expend estate funds to procure insurance. "The secured creditor must exercise reasonable diligence to protect the property serving as security. The trustee must also exercise diligence to conserve the assets of the bankruptcy estate, but he is not relegated to the role of 'babysitter' for the secured creditors." These courts believe the secured creditor can just as easily—more easily, in fact—pay the premium if it wants the collateral to be insured. In sum, whatever the jurisprudential platitudes about trustees being fiduciaries to "all creditors," when loyalty-dividing issues of secured creditor versus unsecured creditors arise, it seems that some fiduciary conflicts are resolved in favor of unsecured creditors on the backs of the secureds, with many courts unapologetically touting the trustee's "primary" obligation toward the unsecureds. One court has gone so far to call secured creditors "the trustee's statutory adversaries.

Normative theory is sadly beyond the scope of this chapter, but a few quick explanations for this jurisprudential line of beneficiary stratification present themselves. On a redistributive impulses level, it could be that bankruptcy judges generally favor the unsecured creditor as the "little guy," given the numerous Code provisions that treat secured credit so favorably; they believe that otherwise hapless unsecureds need all the help they can get (or, more precisely, in a near-zero-sum distributive bankruptcy world, the secured creditors don't need the trustee's help as much as a zealous fiduciary). Or it could be an armchair empirical assumption that unsecured creditors of an insolvent estate are often the "residual claimants," and hence the fulcrum class to whom the trustee's obligations ought be owed in cases of inter-creditor conflict. This assumption has been rightly questioned. For example, it is more likely to be true in consumer cases than in uncertain corporate valuation cases. Whatever the justification, a strand of fiduciary law may be emerging: the trustee is "more beneficial" for unsecured creditors than secured. But it is contested.

II. PRIORITY UNSECURED CREDITORS

Slicing the bologna even finer, what happens when there are conflicts among unsecured creditors inter se? Section 507 accords special priority to certain unsecured

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79 See In re Peckinpah, 50 B.R. 865, 869 (Bankr. N.D. Ohio 1985) (holding otherwise "would shift the Trustee's role from custodian to investment manager thereby encouraging secured creditors to avoid the responsibility for their investments").
82 See Henry T.C. Hu & Jay Lawrence Westbrook, Abolition of the Corporate Duty to Creditors, 107 Colum. L. Rev. 1321, 1390 (2007) ("We would be astonished to hear that VISA has claimed a breach of fiduciary duty when one of its subprime customers started a risky new business or took up skydiving."). Hu and Westbrook also challenge the casual assumption that corporate creditors prefer less risky investment decisions than stockholders. Id. at 1351.
83 The ostensible "duty" to maximize distributions is not found in Section 704's duty list. The Supreme Court in Weintraub talked about the trustee's "seeking to maximize the value of the estate," CFTC v. Weintraub, 471 U.S. 343, 353 (1985), which the Seventh Circuit economically glosses as maximizing "net assets" after considering collection costs. In re Taxman Clothing Co., 49 F.3d 310, 315 (7th Cir. 1995). It receives mention in the trustee's handbook. Rhodes, supra note 28, at 168 n.92.
creditors' claims. Does the trustee have an obligation to investigate these claims, too, perhaps to uncover whether priority assertions are trumped up? Or may the trustee take a passive role unless and until someone pipes up? Here, the case law is scanter, so I reached out to some bankruptcy judges, trustees, and counsel for anecdotal guidance. I am informed that while the issue doesn't arise frequently and that many overworked trustees usually just take claims as given if nobody fusses, occasionally trustees do dig in on a bold creditor proclamation of priority status. One sage colleague who has worked as a trustee in complex cases for decades said this:

As to priority claims, I have to object to a number of claims in which the creditor alleges priority. An unsecured creditor will often file as a priority claim hoping that I will miss the lack of priority. Wage claimants will often overstate their priority when wages are generally limited to priority for ninety days prior to filing. Usually I am the person filing a claim objection because of claimed priority or as an administrative expense claim.

Why would there not be the same enthusiasm to go after priority creditors as secured creditors? If the theoretical foundation for the rule that unsecured creditors get "primary" trustee loyalty over secured creditors is the unsecured creditors' occupation as the fulcrum class of residual claimants, then one would expect an equal application to general unsecureds when a conflict is with a priority unsecured: the trustee should presumably look out for residual claimants and fight the priority claim. Yet this does not seem to be uniformly the case, at least based on my anecdotal survey, which might be evidence for the judicially favored redistribution hypothesis. Many priority unsecured creditors are from disempowered constituencies (domestic support, employees, etc.). Or perhaps simply trustees remember that they, too, receive priority repayment! The point is that once again, fiduciary law is doing limited work, with no uniform case law on how to resolve these conflicts.

III. DEBTOR

Finally, conflicts between creditors and the debtor seem to run in the opposite direction. Here, cases repeatedly hold that the trustee's fiduciary loyalty does not flow to the debtor, even though technically the debtor is the estate's ultimate residual beneficiary. For example, even though not in the trustee's list of responsibilities under Section 704, courts have created a trustee duty to scrutinize (and if indicated, object to) the debtor's

85 Email from Christopher Redmond, Esq., Partner, Husch Blackwell, to author (June 14, 2017, 8:45 EST) (on file with author). Chris estimates claims objection incidence as 95% of the time the trustee, 4% the debtor, and 1% some other party (e.g., another creditor). Id. This obligation to kick the beneficiary's tires might surprise trust lawyers; it stems from a deep-rooted bankruptcy norm of pro rata distribution.
87 Id. § (a)(2). Note that the compensation structure for trustees incentivizes recoveries for the unsecured creditors, with no special treatment for priority. See id. § 326(a); cf. id. § 507(a)(1)(C) (special trustee priority for domestic support creditors).
88 Id. § 726.
This cannot be explained away by the Code's instruction to trustees to object when advisable to the debtor's discharge, because trustees have an equal if not more explicit statutory instruction to examine creditors' claims. Courts upholding this obligation candidly admit it comes indirectly from the Code, gamely trying various hooks. The weak statutory foundations mean that courts are driven by what they see as the trustee's duty to unsecured creditors, and to work for unsecured creditors against the debtor when their interests disalign. At least sometimes, therefore, conflicting demands on a trustee's loyalty are not so difficult to resolve: the debtor loses. Fiduciary duty, however, is not guiding, but providing constructed ex post justification, for resolution of this conflict.

3. Debtor-in-Possession Redux: A Pragmatic Refocus?

The foregoing loyalty discussion has considered the typical Chapter 7 case with an appointed trustee. The Chapter 11 (DIP) context presents a noteworthy contrast: where fiduciary law, beyond ritual incantations, does even less work than structural provisions of the bankruptcy system that may be designed as a pragmatic mitigation of these loyalty conflicts.

Consider that the DIP-controlled debtor nominally holds the same fiduciary duties to creditors, albeit with some exceptions. First, the DIP (absent self-loathing) is unlikely to vigorously pursue actions against the debtor. Fortunately, the paradigmatic case from consumer bankruptcy of trustee v. debtor—an exemption fight—won't arise in a corporate Chapter 11 because corporations don't get exemptions. Nonetheless, it would be foolish to deny the policy tension with the DIP serving as fiduciary for often antithetically situated stakeholders; few Chapter 11 debtors enjoy rosy relations with their creditors when they file for bankruptcy.

The Code responds to this structural tension with some built-in safety valves. First, the Code allows for DIP removal for "cause," which includes incompetence and misconduct. Although incompetence more aptly invokes the fiduciary duty of care, the duty of loyalty is also implicated. For example, a glaring security

91 Id. § 704(a)(5).
92 In re Bell, 225 F.3d 203, 221 ("The duty to review and, if necessary object to, claimed exemptions is nowhere specifically mentioned—although it is subsumed within the general duty to 'investigate the financial affairs of the debtor.'" (quoting § 707(a)(4)); see also In re Edmonston, 107 F.3d 74, 76-77 (1st Cir. 1997) (referencing § 707(a)(1)'s obligation as "implicitly" providing basis for duty).
93 No court wants to go so far as to say the trustee owes no loyalty duties to the debtor at all. Cf. CFTC v. Weintraub, 471 U.S. 343, 353 (1985) (corporate debtor's loyalty duty is to the "corporation"). And some courts have taken the debtor as co-beneficiary of fiduciary duty seriously. See In re Central Ice Cream Co., 836 F.2d 1068, 1072 (7th Cir. 1987) (faulting trustee for taking easy settlement on appeal of judgment; complaining trustee was unduly focused on creditors' risk-aversion, not debtor's shareholder's residual interest).
94 Some suggest the tension is so stark as to make the fiduciary obligations questionable. See Kelch, supra note 20, at 1351–1352, 1352 n.131.
interest imperfection—perhaps a lapsed financing statement—not pursued by the DIP would surely ground a motion to appoint a trustee as inexplicable secured creditor favoritism.  

Now, who would cajole the DIP to bring such a motion? This question segues into the second Chapter 11 safeguard: the Official Committee of Unsecured Creditors. As its name suggests, the Creditors Committee participates formally and may access the DIP’s records. It can weigh in on pending litigation and can even recommend approval/disapproval of a reorganization plan (and, when the exclusivity period expires, propose its own plan). Perhaps most importantly, it draws funding from the estate to employ counsel to scrutinize the DIP’s actions—a considerable henhouse check on the fox. Cases have explicitly held that the Committee can bring litigation otherwise available to the DIP if the DIP wrongly refuses to do so.

A final structural check is the bankruptcy court itself, which, by statute, must approve certain transactions that outside bankruptcy would escape scrutiny. For example, sale/use of estate property outside the ordinary course of business, or use of cash collateral, requires court approval. Thus, numerous Code provisions seem designed to acknowledge the intrinsic “external” loyalty tension of the DIP model’s fiduciary obligation to erstwhile adversaries. These offsetting checks also address “internal” loyalty conflicts by inserting the judge as arbiter, thus serving as a pragmatic response to the DIP’s conflicting allegiances (as opposed to relying on litigation to delineate the scope of the fiduciary duty of loyalty).

IV. Remedies

Among the more convoluted topics in bankruptcy are the rules for when trustees can be sued for breaches of their duties (fiduciary and others). The case law is often contradictory, but some coherence emerges, and there is a recurrent theme of trustee solicitude, likely reflecting a recognition of the impossibility of the trustee serving every divergent constituent satisfactorily.

To begin, however, we should pause to consider nonlitigation sanctions. The U.S. Trustee’s office can strike trustees from their rolls and so repeat play/reputational

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97 Note that in Chapter 13, there is dispute whether the debtor or standing trustee has standing to pursue lien avoidance given the Chapter 13 debtor’s vesting in many of the trustee’s powers. Compare In re Cohen, 305 B.R. 886, 900 (B.A.P. 9th Cir. 2004) (debtor), with In re Binghi, 299 B.R. 300, 306 (Bankr. S.D.N.Y. 2003) (standing trustee).
99 Id. § 1121(c).
100 Id. §§ 330, 1103.
103 See generally Bienenstock, supra note 61 (cataloging other DIP loyalty checks).
constraints provide strong administrative discipline. And trustees are required to post a bond for exercising their duties “faithful[ly],” which trigger forfeiture upon proper showing. Thus, even aside from case law, there are nonlitigation constraints on trustee fiduciary behavior. Nonetheless, litigation abounds. Perhaps recognizing the conflict-laden challenges trustees structurally face (and the baseline unhappiness of creditors in bankruptcy), numerous protective doctrines for trustees exist that should be understood before considering the grounds upon which trustees can be sued for breach.

A. Defense: Immunities and Bars

The principal issue in trustee litigation is the trustee’s personal liability. The trustee does, however, have standing to sue and be sued on behalf of the estate in her official capacity, which can be addressed quickly.

1. Official Capacity Bar: The Barton Doctrine

The two types of lawsuits the trustee officially pursues are actions of the debtor—causes to which the trustee succeeds as plaintiff—and actions for all creditors’ collective benefit, such as fraudulent conveyance suits. Lawsuits against the trustee in his official capacity face a jurisdictional common law bar called the Barton rule. In Barton v. Barbour, the Supreme Court established that suits against trustees in connection with estate administration require the appointing court’s leave. For example, a state court tort action against the receiver in her official capacity had to be dismissed absent the receiver court’s leave. Thus, as a pleading matter, most putative plaintiffs sue the trustee in their personal capacities.

2. Personal Capacity Bar: The Derivative Immunity Doctrine

Even if sued personally, a trustee can always assert immunity, which will also be grounds for denying Barton leave. This “absolute quasi-judicial immunity,” or immunity “derived” from the trustee’s appointing court, immunizes the trustee from suit within the scope of her official capacities. Congress has a statutory overlay, which clarifies that trustees/DIPs can be sued for “carrying on business.” This is refinement, not abrogation, of Barton, because it merely confers ordinary jurisdiction for civil suits (e.g., if the DIP enters and then breaches a contract to supply goods). See In re Crown Vantage, 421 F.3d 963, 971 (9th Cir. 2005) (“[Section 959’s] limited exception applies only if the trustee or other officer is actually operating the business....”).

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104 28 C.F.R. § 58.6 (outlining suspension and termination procedures).
106 11 U.S.C. § 323; see also id. § 322(c) (immunizing trustee for debtor’s malfeasance).
107 Id. §§ 541, 548.
110 Congress has a statutory overlay, 28 U.S.C. § 959(a), which clarifies that trustees/DIPs can be sued for “carrying on business.” This is refinement, not abrogation, of Barton, because it merely confers ordinary jurisdiction for civil suits (e.g., if the DIP enters and then breaches a contract to supply goods). See In re Crown Vantage, 421 F.3d 963, 971 (9th Cir. 2005) (“[Section 959’s] limited exception applies only if the trustee or other officer is actually operating the business....”).
trustees build upon Supreme Court precedents on judicial immunity, which protect the free exercise of official discretion without fear of litigation. For example, trustees have an obligation (clearly institutional, not fiduciary) to refer to criminal prosecution conduct they believe is suspicious and so enjoy an absolute bar to malicious prosecution suit.

Not all exercises of trustee authority trigger derivative immunity. Which ones do depends upon classification along an "administrative/functional" to "judicial/discretionary" continuum, stemming from the Court's decision in *Forrester v. White*, as refined by a more categorical historical two-part test in *Antoine v. Byers & Anderson*. This division follows from the trustee's immunity's conceptual origin in judicial immunity, as not all judges' actions enjoy absolute judicial immunity. (*Forrester* involved the judge demoting a probation officer, which was not an exercise of judicial power needing protection.) Bankruptcy trustees, like judges, are "hybrid official[s]" who exercise some judicial-discretionary functions but also many administrative tasks, thus requiring case-by-case immunity analysis.

3. **Scope of the Duty Bar: The McNulta Doctrine (and Instructions Defense)**

Moreover, even if the trustee's authority is on the nonjudicial side of the *Forrester-Antoine* ledger and hence unprotected by derivative immunity, the trustee still enjoys alternative immunity from personal suit under the *McNulta* doctrine. Dating back to the Supreme Court case *McNulta v. Lochridge*, this additional immunity depends on the plaintiff: third parties are treated more dismissively than creditors to whom the trustee owes a fiduciary duty. If a third party sues the trustee in her personal capacity, the trustee can assert *McNulta*, which immunizes the trustee for actions performed within the scope of his duties. The only exception is ultra vires conduct, i.e., that the trustee was acting outside the scope of his assigned responsibilities. Such cases are uncommon, but always interesting.

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112 See, e.g., Boullion v. McClanahan, 639 F.2d 213, 214 (5th Cir. 1981); Howard v. Leonard, 101 B.R. 421, 423 (D. N.J. 1989) ("[T]rustee's immunity is derived from that afforded to the bankruptcy judge.…"); Gonzalez v. Musso, No. 08-CV-3026, 2008 WL 3194179, at *2 (E.D.N.Y. Aug. 6, 2008) ("[T]rustee will enjoy absolute immunity so long as he does not act in the clear absence of all jurisdiction, or at least acts under the supervision of the bankruptcy judge." (internal quotation marks and citation omitted).

113 See *Forrester v. White*, 484 U.S. 219, 223 (1988) ("[T]hreat of liability can create perverse incentives that operate to inhibit officials in the proper performance of their duties.").


116 508 U.S. 429, 432, 436 (1993) (assessing “immunity historically accorded [to] the relevant official” and whether official's discretionary judgments are “functionally comparable to that of a judge”) (internal citations omitted).

117 484 U.S. at 230 (noting judge might enjoy qualified immunity).

118 In re Castillo, 397 F.3d 940, 951 (9th Cir. 2002).

119 141 U.S. 327 (1891).

120 See id. at 332.


Finally, even if the trustee's conduct is not immune under the foregoing doctrines, there is still one final bite at the apple: immunity by virtue of court approval. This doctrine harks back to the seminal case of *Morris v. Darrow*, in which the Supreme Court in finding a trustee liable for breach of fiduciary duty chided the trustee for not following "well established" practice in trust law of "seek[ing] instructions from the court, given upon notice to creditors and other interested parties, as to matters which involve difficult questions of judgment." Building on this rationale, modern courts have granted trustees immunity when acting "with the explicit approval of a bankruptcy court... as long as there has been full and frank disclosure to creditors and the court."

B. Offense: Standard of Care for Breach

So what is left for a trustee to be sued upon in his personal capacity? Breach of fiduciary duty. This is only available to "second party" plaintiffs, e.g., creditors to whom the bankruptcy trustee owes fiduciary obligations. But the extent of the trustee's duty is once again unclear due to convoluted precedent. The cryptic *Mosser* case is to blame, and has caused a three-way circuit split. In *Mosser*, a railroad reorganization receiver poorly supervised his employees, who ended up trading in securities they sold the estate. The case is interesting because the trustee appeared hapless: he made no personal gain himself, just the faithless agents did. In fact, it's not clear the estate itself lost money (the agents "merely" profited, although the Court acknowledged the estate's foregone opportunity).

In holding the trustee liable, the Court used language that has puzzled subsequent analysts: "[W]e see no room for the operation of principles of negligence in a case in which conduct has been knowingly authorized." In the Court's view, this was an easy case of surcharging the trustee with personal liability because the agents were not going behind his back, but following a plan to trade securities the trustee himself innocently but unwisely approved. But "no room for negligence" could be read to mean that negligence should not be the relevant standard, only something higher, before a trustee is personally liable. Or it could mean that it was deferring the question of what level of culpability would need to be shown for a transgression of the duty of care, evincing trustee solicitude with comments like "[c]ourt[s] are quite likely to protect trustees against heavy liabilities for disinterested mistakes in business judgment" from "obstreperous creditors aided by hindsight." Or something else.

A three-way circuit split has indeed emerged trying to divine the standard for trustee liability—each claiming to draw support from *Mosser's* terse opinion—with some courts seeing *Mosser* as requiring knowing/intentional wrongful conduct to predicate trustee

124 In re Mailman Steam Carpet Cleaning Corp., 196 F.3d 1, 8 (1st Cir. 1999).
126 Id.
127 Id. at 274.
personal liability for breach of fiduciary duty;\textsuperscript{128} some requiring mere negligence in the discharge of duties (\textit{Mosser} uses the fiduciary-laden term “surcharge”);\textsuperscript{129} and still others taking a middle ground of gross negligence (following the ignored recommendations of the 1997 National Bankruptcy Review Commission).\textsuperscript{130} Someday, albeit perhaps a long way off, the Supreme Court will clear this up.

\section*{V. Miscellaneous Issues with Fiduciary Duties in Insolvency}

As said, Section 704 is too long to explore in detail, but quick mention can be made of less prominent duties sometimes considered fiduciary. Specifically, the Code provides an explicit duty to account,\textsuperscript{131} a duty to collect and preserve assets,\textsuperscript{132} and a general duty to inform and respond.\textsuperscript{134} The open-court aspect of bankruptcy lessens the need of fiduciary law to compel free information flow,\textsuperscript{135} and, indeed, this open-court nature renders any “duty to inquire” of the needs of represented litigants inapposite.\textsuperscript{136} The trustee also may statutorily delegate operation of the estate to professionals,\textsuperscript{137} but must submit a written resignation to the U.S. Trustee to resign effectively.\textsuperscript{138} Case law has generally held that trustees may not delegate the “essential decision-making responsibility” of administering a case.\textsuperscript{139}

Finally, revisiting the DIP’s fiduciary duty in the (common) context of a corporate debtor is in order before concluding. General corporate law has its own concerns of agency challenges and temptations of corporate management exercising their fiduciary duties for shareholders.\textsuperscript{140} Under influential Delaware law, however, this duty to shareholders shifts to encompassing creditors as well when the corporation enters the zone of insolvency.\textsuperscript{141} Different systems saddle corporate fiduciaries with analogous responsibilities.\textsuperscript{142} While

\textsuperscript{128} See, e.g., \textit{In re Chicago Pac. Corp}, 773 F.2d 909 (7th Cir. 1985). This line of cases has been criticized for conflating trustee’s personal liability standards (finding the willful/intentional threshold required) with the trustee’s liability threshold for official liability, which, bizarrely, would be recoverable against the estate. See, e.g., \textit{McCullough}, supra note 28, at 177–179 (citing E. Allan Tiller, \textit{Personal Liability of Trustees and Receivers in Bankruptcy}, 53 Am. Bankr. L.J. 75, 100 (1979)).

\textsuperscript{129} See, e.g., \textit{In re Cochise College Park, Inc.}, 703 F.3d 1339, 1357 (9th Cir. 1983).

\textsuperscript{130} See, e.g., \textit{In re Smyth}, 207 R3d 758, 762 (9th Cir. 2000).

\textsuperscript{131} 11 U.S.C. § 704(a)(2), (9).

\textsuperscript{132} Id at (a)(1).

\textsuperscript{133} Id. at (a)(8).

\textsuperscript{134} Id. at (a)(7).

\textsuperscript{135} Id. at (a)(10).


\textsuperscript{140} See generally Adolph A. Berle, Jr. & Gardiner C. Means, \textit{The Modern Corporation and Private Property} (1932). On the current state of corporate law, see Julian Velasco, \textit{Fiduciary Principles in Corporate Law}, this volume.

\textsuperscript{141} See Hu & Westbrook, supra note 82, at 1338 n.55. This doctrine finds historical pedigree in the trust fund doctrine that, prior to statutory regulation, policed improper corporate dividends from insolvent debtors. Id. at 1332–1333.

\textsuperscript{142} Id. at 1383 n.226, 1400 n.299.
this doctrine has undergone some revision (and retrenchment) in recent cases, the proposition remains that shareholders lose their exclusive beneficiary status when this "zone" has been entered (which now appears to be restricted to just straight "insolvency").143

Legions of commentators in the corporate field have attacked and defended this duty-shifting rule,144 and the bankruptcy community has had its share of insights, too,145 including Professors Hu and Westbrook. They point out the poor fit of expanding fiduciary obligations to multiple stakeholders at state law, which they contend is ill-equipped institutionally to handle policing duties to multiple and antagonistic beneficiaries. Rather, say Hu and Westbrook, expanding fiduciary duties to creditors when a corporation becomes insolvent (actually or just "zonally") should be abandoned. No duty to creditors should obtain unless and until the debtor files a bankruptcy petition.146 This proposal is grounded in a belief that the bankruptcy system is better suited to handle the endemic conflicts of interest between corporate constituencies through the various bankruptcy-specific mechanisms discussed previously, such as the corporation-funded creditors committee, the ability to displace wayward fiduciaries with an external trustee, and, most importantly, bankruptcy judge oversight, aided by an automatic stay that freezes all creditor conduct and corrals matters into her courtroom.147

VI. CONCLUSION

Whatever the generalizability of the Hu/Westbrook proposal beyond Chapter 11, it is certainly the case that the Bankruptcy Code does indeed have many safeguards designed to confront conflicting creditor incentives, both against the DIP and inter se, in the swirling chaos of insolvency. While bankruptcy courts aren't perfect, they are at least used to shifting allegiances and disalignments of interest in their everyday dockets. The Bankruptcy Code allows transparency of the process, committee watchdogs, and replacement of the DIP fiduciary of "internal" loyalty with an external trustee all as an

143 See id. at 1344 (explaining seminal Giahwalla case and nominal difference regarding derivative claims).
145 See Kelch, supra note 20, at 1350–1363 (discussing inherent conflict). Kelch proposes a prescriptive taxonomy that includes "Group Favoritism" (pick one constituency); "Diffuse Loyalty" (help everyone, through the corporation); and even "Stakeholder-Mediation" (remain neutral and transparent about fights). Kelch himself supports an Adversarial Model, contending that DIP discharge of corporate fiduciary duties is impossible.
146 See Hu & Westbrook, supra note 82, passim.
attempt to manage the challenging fiduciary obligation of "internal" loyalty in the tense context of general default. It may even do so more effectively than explicit litigation reliance on the fiduciary duties of loyalty and impartiality (with protective doctrines to spare the trustee from hindsight). Perhaps scholars of fiduciary duties in high-conflict environments could learn from bankruptcy's pragmatic approach.

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