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Fiduciary Duties in Bankruptcy and Insolvency
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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. This chapter will briefly outline the principal applications of fiduciary duty law in bankruptcy to inform the subsequent analysis of more generalized principles in this treatise.

I. Bankruptcy Principles

To understand the various doctrines and rules affecting fiduciary responsibilities in bankruptcy, general oversight of some features of the bankruptcy system is required. The overarching consideration is that bankruptcy law is designed as a collective resolution mechanism: it corrals multiple claimants on a debtor's property into one compulsory group proceeding.[1]

The filing of a bankruptcy petitions triggers several legal consequences in so centralizing multiple disputes. First, it imposes an automatic stay on any legal and extra-legal collection activities against a struggling debtor.[2] Second, it creates an "estate" of all property of the debtor (with extraterritorial application), divesting the debtor of control over the res, albeit with title remaining in the debtor's name.[3] Third, it assigns control of the estate to the "trustee," who has authority under various provision of the Bankruptcy Code to oversee the assets.[4] The trustee owes fiduciary duties to the stakeholders of the estate.[5]

The Bankruptcy Code 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 then pay out

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[1] *See, e.g.*, THOMAS JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986).

[2] *See* 11 U.S.C. § 362 (staying all collection activities against the debtor upon filing).

[3] *Id.* § 541; Thomas G. Kelch, *The Phantom Fiduciary: The Debtor in Possession in Chapter 11*, 38 WAYNE L. REV. 1323, 1330–35 (1992) (critiquing the "new entity" theory of the debtor in possession).

[4] *See* 11 U.S.C. §§ 702, 704, 1104, 1106, 1302.

[5] *See, e.g.,* AFI Holding, Inc. v. Brown et al. (In re AFI Holding, Inc.), 530 F.3d 832, 844 (9th Cir. 2008) ("[T]he trustee may not be the representative of any particular creditor, but must represent all . . . .") (internal quotation marks and citation omitted); *see also* Martin v. Martin (In re Martin), 91 F.3d 389, 394 (3d Cir. 1996) ("[I]t is the trustee's duty to both the debtor and the creditor to realize from the estate all that is possible for distribution . . . .") (internal citations omitted).

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dividends to unsecured creditors based on the liquidation of non-exempt property.[6] The Code specifies a hierarchy of creditor claims, which can generally be grouped into four classes: secured, priority unsecured, general unsecured, and subordinated.[7] 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 super-majoritarian voting rules for approving (or vetoing) a plan of 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 type of reorganization for individual debtors, where they may propose their own repayment plan of three to five years' duration, paying over net income to their creditors but retaining all their property—including non-exempt property that otherwise would be liquidated in a chapter 7—in exchange for the 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's case proceeds. In a chapter 7 proceeding, the trustee at the start of the case is technically the "interim" trustee, who is selected usually randomly from a panel of trustees—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 the United States Attorney, who oversees bankruptcy cases proceeding in his or her district; U.S. Trustees report to the D.C.-based "Executive Office of the United States Trustee.")[13] Although nominally the creditors can vote for a trustee, the interim trustee functionally becomes the trustee upon non-vote of the creditors.[14]

In chapter 13, because the debtor will be languishing around in bankruptcy for three to five years, control of property mostly remains with the debtor, who revests in the property of the estate 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 will be funneled through the Standing Trustee's

[6] *See* 11 U.S.C. §§ 701 et seq.
[7] *Id.* §§ 506, 507, 510.
[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.
[13] *See* 28 U.S.C. §§ 581, 586; 28 C.F.R. §§ 58.1 et seq.
[14] 11 U.S.C. §§ 701, 702.
[15] *Id.* § 1327(b).
[16] 28 U.S.C. § 586(b); 11 U.S.C. § 1302.

Office, although some secured creditors (e.g., mortgagees) are often paid just directly outside the plan.[17]

In chapter 11, U.S. law demonstrates its remarkable vision, subject to increasing replication around the globe: the concept of the "Debtor in Possession" (or "DIP").[18] Under the DIP model, a trustee is not appointed, and the debtor remains in control of its property and its estate, vesting in most—but importantly not all—of the responsibilities of a trustee.[19] Some debate has bounced around 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 a U.K. administration, in which the first thing that happens upon filing is the divestiture of authority from the debtor's management and the appointment of the British analogue to a trustee.[22]

One final point in this bankruptcy law primer: the trustee (and DIP in a 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.[23] That said, the Code confers various instances of redistributive power that allow the trustee to claw back certain transactions. For example, an unsecured creditor who receives an eve-of-bankruptcy (usually 90 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.[24] Thus, DIPs in chapter 11 can suddenly find themselves armed with powers to undo transactions with their creditors pursuant to laws that exist nowhere outside a federal bankruptcy case. One of the most significant of these powers pertaining to payment status is what is colloquially known as the "strong arm" clause, which allows the trustee to pick off an unperfected lien of a secured creditor on estate collateral by according the trustee priority rights of a hypothetical lien creditor at state law.[25] A

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[17] *See, e.g.,* In re Clay, 339339 B.R. 784, 789789 (Bankr. D. Utah 2006) ("A debtor may choose not to provide for one or more secured claims and elect instead to pay those claims directly to the creditor outside the plan.") (quoting In re Harris, 107 B.R. 204, 206 (Bankr. D. Nebr. 1989)).
[18] 11 U.S.C. § 1107.
[19] *Id.* § 1106.
[20] *See* Kelch, *supra* note 3, at 1331 ("[R]esistance to the [new entity] theory arose in various courts and has grown over time.").
[21] 11 U.S.C. § 1104.
[22] Insolvency Act 1986, Schedule B1, ¶¶ 1, 10, 59(1), 61, and 64.
[23] *See* Butner v. United States, 440 U.S. 48, 54 (1979).
[24] 11 U.S.C. § 547.
[25] *Id.* § 544.

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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 of the estate, entitled only to whatever meager dividend (usually paltry) that trickles down to the unsecured.[26]

II. Trustee Duties

A. Classification: Fiduciary, Non-Fiduciary, and Antagonistic Obligations

The trustee faces a host of duties under the Bankruptcy Code of varying significance, some more functionary and some more fiduciary. For example, Retired Bankruptcy Judge (and frequent author) Steven Rhodes divides the trustee's obligations into "fiduciary" obligations, which are to the "bankruptcy court and the parties in cases in which the trustee serves," and "institutional" obligations, which are "to the bankruptcy process itself."[27] Considering the chapter 7 trustee as the prototypical trustee, the trustee's statutory obligations can be found in section 704.[28] That provision is too long to reproduce in this discussion, but three specific points arise from review of these duties. First, although one can debate the correct labeling and classification, there are some duties that, while important, would be unlikely to be considered fiduciary undertakings. 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 that builds up to fiduciary obligations.[29] By corollary, some obligations, while not explicitly phrased as invoking fiduciary obligations, sound in language amenable to trigger such responsibility, such as the obligation "to be accountable for all property received."[30] And 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 has—to impress upon trustees a fiduciary obligation to the beneficiaries of the estate, namely, the creditors (and possibly debtor).[31]

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[26] *Id.* § 550.
[27] Steven W. Rhodes, *The Fiduciary and Institutional Obligations of a Chapter 7 Bankruptcy Trustee*, 80 AM. BANKR. L.J. 147, 147–48 (2006). Rhodes' analysis of trustee fiduciary obligations is exhaustive; the reader hungering for more than this overview is directed there. Others use different labels; McCullough calls some of the trustee's less heady obligations "functionary." Elizabeth H. McCullough, *Bankruptcy Trustee Liability: Is There a Method in the Madness?*, 15 LEWIS & CLARK L. REV. 153, 162 (2011) (citation omitted).
[28] 11 U.S.C. § 704. Section 704 is by no means exhaustive. The trustee has myriad other obligations scattered throughout other passages of the Code. *See, e.g., id.* § 341.
[29] *Id.* § 704(a)(10), (12).
[30] *Id.* § (a)(2).
[31] *Id.* § (a)(1). *See, e.g.*, Hartford Underwriters Ins. Co. v. Union Planters Bank, 530 U.S. 1, 12 (2000) ("[T]he trustee is obliged to seek recovery . . . whenever his fiduciary duties so require.").

Second, if indeed the creditors making claims on the estate are construed to be the beneficiaries of a trustee's fiduciary obligations, then it is clear that some of the trustee's obligations are non-fiduciary (or, perhaps, extra-fiduciary). Consider perhaps the most vivid one from the debtor's perspective—the obligation "if advisable, to oppose the debtor's discharge."[32] One could conceive this as yet another obligation of the trustee to help the creditors, and so fully consonant with the trustee's role as a fiduciary to creditors seeking collection from the debtor. But that analysis is too quick, because of course the trustee has no obligation to improve the general welfare of creditors, 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 the 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, the creditors may well care, because a debtor whose discharge is denied not only contributes the bankruptcy estate property to the creditors but also continues to have legal obligation to pay post-bankruptcy. On the other hand, creditors with an uncollectible debtor don't want their dividends reduced by the trustee's 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).[33] "No-drop" courts clearly rely on something beyond a trustee's fiduciary obligation to creditors, making the trustee a hybrid fiduciary/non-fiduciary to the creditors under the commands of section 704.

Finally, the trustee's responsibilities include not just obligations that are "institutional" in nature, irrespective of the creditors' interests, but that are even antithetical to them. 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."[34] Few creditors relish the prospect that the trustee might object to their claims, which situates the usually supportive trustee in a sometimes adversarial posture to her beneficiaries. This necessary awkwardness underscores the intrinsically conflicting nature of the multi-party nature of bankruptcy proceedings: when there is collective

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[32] 11 U.S.C. § 704(a)(6).

[33] *Compare* Hass v. Hass (In re Hass), 273 B.R. 45 (Bankr. S.D.N.Y. 2002) (approving settlement of discharge objection), *with* In re Levine, 287 B.R. 683 (Bankr. E.D. Mich. 2002) (disapproving settlement of discharge objection notwithstanding creditor acquiescence). *See generally* U.S. DEP'T OF JUSTICE, EXECUTIVE OFFICE FOR U.S. TRUSTEES, HANDBOOK FOR CHAPTER 7 TRUSTEES § 4.G, 29 (2002), http://www.usdoj.gov/ust/eo/private_trustee/library/chapter07/docs/forms/Ch7hb0702-2005.pdf [hereinafter HANDBOOK] ("If the trustee has information that would support an objection to discharge but deems such an action inadvisable, the trustee should promptly bring such facts to the attention of the United States Trustee.").

[34] 11 U.S.C. § 704(a)(4).

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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 face an unenviable task, finding themselves sometimes *opposed* to creditors they normally champion.[35]

Appreciating the complexity of the trustee's duties, do bankruptcy courts nonetheless consider them as triggering fiduciary obligations? Absolutely. Courts repeatedly remark that the trustee—and hence the DIP, too, in a chapter 11 case—are "fiduciaries" who owe the traditional obligations of care and loyalty to the estate and its creditors.[36] Even the professional canons concede the trustee's obligations are primarily fiduciary.[37] Accordingly, discussion will now turn to the insolvency law considerations of the two primary fiduciary duties as applied to trustees.[38]

B. Content of the Duty of Care

As mentioned, the characterization of trustee duties as "fiduciary" does not appear in the Code itself, and so it is unsurprising that neither is there any statutory explication of the duty of care. Indeed, bankruptcy courts repeatedly make reference to general provisions of fiduciary duty law, suggesting that trustees are governed by a federal common law of fiduciary duty. In the words of the Supreme Court, "By the common law, every trustee or receiver of an estate has the duty of exercising reasonable care in the

[35] The conflict and need to object to claims is only relevant in "intermediate" cases with some distribution to unsecured creditors. If the estate is solvent and all creditors are getting paid, the trustee doesn't care about filed claims (only the debtor does). And if the estate has no assets, the trustee also should not care about the calculation of possibly inflated claims that will all be discharged without payment anyway. In fact, the only reason for pursuing review of claims in a no asset case would be fee-churning by the trustee; when "the only parties who will likely benefit from an investigation of a claims are the trustees and his professionals, investigation is unwarranted." Riverside-Linden Investment Co. v. Crake (In re Riverside-Linden Investors), 925 F.2d 320, 322 (9th Cir. 1991) (quoting Riverside-Linden Investment Co. v. Crake (In re Riverside-Linden Investors), 99 B.R. 439, 443 (9th Cir. B.A.P. 1989)). Courts have settled on a pragmatic "prima facie" standard in delineating the trustee's duty here: if a claim looks prima facie appropriate, there is no further investigation required absent objection by some party. *E.g.*, In re Atcall, 284 B.R. 791, 799 (Bankr. E.D. Va. 2002).

[36] Stalnaker v. DLC, Ltd., 376 F.3d 819, 825 (8th Cir. 2004) (confirming that "the trustee had a fiduciary obligation").

[37] *See* NABT CANON OF ETHICS, Canon 2 (2005).

[38] One strand of case law is worth flagging: cases holding the duty of care for a corporate DIP implicates the mere business judgment rule standard. *See, e.g.*, In re Mirant Corp., 348 B.R. 725, 744 (Bankr. N.D. Tex. 2006) (approving proposed settlement because it was in "management's best judgment"). This line has been criticized. *See* Kelch, *supra* note 3, at 1342 n.88.

custody of the fiduciary estate."[39] This common law standard has been articulated as that required by "an ordinarily prudent person."[40]

These common law fiduciary duties clearly exist in addition to statutory obligations imposed by the Code. Courts have, indeed, emphasized the role of section 704 as a floor, not a ceiling, to the proper discharge of the bankruptcy trustee qua fiduciary. "Beyond the statutory duties, bankruptcy trustees owe to the beneficiaries of the estate the usual common law trust duties. . . ."[41] 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.[42] (There are, however, some dissenters.)[43] Finally, it should be noted that duty of care issues are functionally regulated by the statutory requirement of "competence" for trustees under the Code.[44] Thus, the real work typical duty of care litigation performs in regular trust law might be done "offstage" in insolvency, such as by the empanelling procedures of the U.S. Trustee's office and administrative proceedings removing trustees,[45] which are designed to police competence.[46] As such, duty of care cases raise few exciting issues in insolvency law.[47]

C. Content (and Beneficiaries) of the Duty of Loyalty.

The duty of loyalty raises far more complex (and intractable) issues in bankruptcy. As alluded to above, bankruptcy raises unique conflicts among claimants, all

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[39] United States ex rel. Willoughby v. Howard, 302 U.S. 445, 450 (1938).
[40] Ebel v. King (In re Ebel), 338 B.R. 862, 875 (Bankr. D. Colo. 2005) (quoting Sherr v. Winkler, 552 F.2d 1367, 1375 (10th Cir. 1997)).
[41] Schecter v. Illinois (In re Markos Gurnee P'ship), 182 B.R. 211, 219 (Bankr. N.D. Ill. 1995) (citing Mosser v. Darrow, 341 U.S. 267, 271 (1951)).
[42] *See, e.g.*, Walsh v. Northwestern Nat'l Ins. Co. (In re Ferrante), 51 F.3d 1473 (9th Cir 1995); *cf.* Martin J. Bienenstock, *Conflicts Between Management and the Debtor in Possession's Fiduciary Duties*, 61 U. CIN. L. REV. 543, 551 (1992) ("[S]tate laws and jurisprudence governing the conduct of officers and directors remain effective, except to the extent preempted by federal law.").
[43] *See* Fulton State Bank v. Schipper (In re Schipper), 933 F.3d 513 (7th Cir. 1991) (declining to apply common law of trusts in preference for the text of the Code).
[44] 11 U.S.C. § 321(a).
[45] *See* 28 C.F.R. § 58.6; Case No. 05-0004, Decision by Acting Director Clifford J. White III, 6 (November 1, 2005) http://www.usdoj.gov/ust/eo/rules_regulations/admin_decisions/docs/case050004.htm (suspending the trustee from the trustee panel for four months in part for conducting inadequate investigations at meeting of creditors).
[46] *See* In re Lowery, 215 B.R. 140, 141–42 (Bankr. N.D. Ohio 1997) (finding trustee "obviously" competent "by virtue of being a member of the United States Trustee's panel of trustees").
[47] *Cf.* Kelch, *supra* note 3, at 1340 ("In attempting to find within the case law a definition of the content of the fiduciary duty of the debtor in possession, the lack of any unified concept becomes evident.").

of whom are ostensibly served by the trustee. In considering the trustee's loyalty obligations, it might be helpful to distinguish "external" and "internal" conflicts of trustee loyalty at the outset.

a. *External conflicts.*

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.[48] To guard against such temptations, the Code explicitly requires "disinterestedness" as an eligibility criterion to serve as an appointed trustee.[49] This statutory requirement replicates the common law of trusts,[50] and Congress has extensive (and fairly rigid) definitional guidance on disinterestedness in bankruptcy.[51] Even criminal law is implicated.[52]

Case law, however, has glossed some flexibility on this statutory definition. Trustees, for example, can serve as trustees of multiple related estates under certain circumstances, even if there is a potential for cross-claims.[53] And trustees can, and often do, employ themselves as lawyers for the bankruptcy estate.[54] (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.)[55] The DIP, of course, could never satisfy the disinterestedness test, and so has no requirement of disinterestedness imposed.[56] In sum, the duty of loyalty for "external" temptations to the trustees is largely what might be expected, perhaps with some over-specificity accorded by the statutory strictures of the Code.

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[48] *See* Stubbe v. Rodriguez-Estrada (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.2d 931, 950 (1st Cir. 1988) (holding that trustee's relative's freebie marriage reception on estate property was "self-dealing" and "conflict of interest").
[49] 11 U.S.C. § 701(a)(1).
[50] "[T]he law of trusts requires that the trustee . . . be disinterested." Palm Coast, Matanza Shores Ltd. P'ship v. Bloom (In re Palm Coast, Matanza Shores Ltd. P'ship), 101 F.3d 253, 258 (2d. Cir. 1996) (applying principle to bankruptcy case).
[51] 11 U.S.C. § 101(14).
[52] 18 U.S.C. § 154.
[53] *See, e.g.*, In re Petters Co., Inc., 401 B.R. 391, 412 (Bankr. D. Minn. 2009) ("Rule 2009(c)(2) clearly recognizes the considerations that can support the appointment of a single trustee for related cases. . . ."); In re BH&P, Inc., 949 F.2d 1300, 1312 (3d Cir. 1991) ("Considering the advantages of joint administration and the place for single trustees in that process, we are not prepared to say that interdebtor claims mandate disqualification of the trustee in every instance.").
[54] 11 U.S.C. § 327(d); *see also* Rhodes, *supra* note 27, at 161 n.67 (reporting 1997 poll in which 78% of trustees reported employing themselves under section 327(d)).
[55] 11 U.S.C. § 327(a).
[56] *Cf. id.* § 1104(b) (excusing DIP's professionals from disinterestedness bar that might be triggered by prior representation of the debtor).

b. *Internal conflicts.*

"Internal" loyalty issues raise different concerns that, if not unique, are somewhat intrinsic to insolvency: how the trustee is to police competing conflicts among the constitutive beneficiaries she serves. Three illustrative scenarios ought to be addressed in considering the trustee's allegiances: secured creditor vs. unsecured creditor, unsecured creditor vs. unsecured creditor, and creditors generally vs. 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 request that may be favorable to others.").[57] Thus, bankruptcy judges are sympathetic to the competing demands on a trustee's loyalties. This inclination frequently manifests itself in the articulation of the trustee's fiduciary duties as being owed to "the estate" as a diffuse generalization.[58] The Supreme Court, for example, says that in insolvency, a corporate DIP's fiduciary duties run to "the corporation," including its shareholders and its creditors.[59] As one commentator laments, "[T]he fiduciary duty that adheres to this 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."[60]

i. Secured creditors.

Notwithstanding the broad obligation to maximize the interests of the estate, there are repeat scenarios in which constituencies come into conflict. Consider the tension endemic in the aforementioned 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 (absent extraordinary reasons, the existence of which would likely ground removal of the trustee, or more likely, replacement of the DIP with an external trustee). Thus, only if the trustee decides to seek to set aside a lien will the secured creditor be at risk. Why should a trustee expend time and effort pursuing litigation against one beneficiary for the benefit of another (more

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[57] In re Computer Learning Ctrs., Inc., 268 B.R. 468, 473 (Bankr. E.D. Va. 2001) (holding the Code requires "balance among the creditors").

[58] *See, e.g.*, In re JMW Auto Sales, 494494 B.R. 877, 893 (Bankr. S.D. Tex. 2013) ("Trustee diligently executed his fiduciary duties to the estate.").

[59] 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 exclusively to creditors vs. shifting diffusely to creditors in addition to shareholders. As one of the bankruptcy bar's (now) senior statesmen observes, the board of directors still retains certain residual duties even when a chapter 11 trustee is appointed. Bienenstock, *supra* note 43, at 547.

[60] Kelch, *supra* note 3, at 1336.

likely, others)?[61] Nothing in the Code dictates an obligation to do so other than the vague command to examine claims,[62] 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 the 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 the unsecured creditors.[63] This approach is tempered, however, by a plausibility threshold, suggesting that 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. This thinking is reflected in the bankruptcy rules.[64] (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.[65]) The corollary, then, is that if doubt has been cast over the validity of a secured creditor's perfected status, the trustee, acting on behalf of 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 fiduciary obligation to use it?[66] But the case law talking about the trustee's "primary" duty to the unsecured creditors and not the secureds is far from limited to application of the strong-arm clause. For example, another area in which the trustee's obligations to a secured creditor arises is with respect to the maintenance and preservation of collateral during a case.[67] Recall that the bankruptcy estate comprises all property of the debtor, even that fully encumbered by a 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

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[61] *Cf.* 11 U.S.C. § 726(a) (suggesting trustee's compensation may increase for so doing).
[62] *Id.* § 704(a)(5).
[63] "[I]t 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, for the most part, should be able to look to their collateral for satisfaction of their claims." Fox v. Anderson (In re Dinh), 80 B.R. 819, 822 (Bankr. S.D. Miss. 1987) (citation omitted). "Secured creditors have a duty to 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." Schwen's, Inc. v. Lovett (In re Schwen's, Inc.), 19 B.R. 681, 694 (Bankr. D. Minn. 1981).
[64] *See* FED. R. BANKR. P. 3001(f).
[65] 11. U.S.C. §§ 1102, 1103.
[66] *Cf.* Barber v. McCord Auto Supply, Inc. (In re Pearson Indus.), 178 B.R. 753 (Bankr. C.D. Ill. 1995) (no duty to pursue voidable preference if no benefit to the estate); *cf. also* Webster v. Management Network Group, Inc. (In re Nettel Corp.), 364 B.R. 433 (Bankr. D.D.C. 2006) (taking capacious definition of "estate" to include secured creditor).
[67] 11 U.S.C. § 704(a)(2).

the secured creditor doesn't beat him to the punch with a lift-stay motion).[68] But unless and until that happens, the secured creditor cannot take the property back without violating the automatic stay.[69]

So what happens, in the interim, if the property requires expenses? 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.[70] 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?*).[71] Section 506 simply tells us what to do if the trustee does incur the cost of the premium. But it doesn't answer the fiduciary question: *must* the trustee do so as part of his fiduciary duty to the secured creditor?

Some courts have said so. "Procuring insurance would ordinarily be an integral part of the trustee's duty [to secured creditor]."[72] They build upon general principles that the "fiduciary duty [flows] to all creditors, not just the unsecured creditors."[73] On the other hand, contrary cases pick favorites among the trustee's beneficiaries and hold that although the duty extends to all creditors, the "primary duty" is to represent the interests

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[68] *Id.* §§ 362(d), 554.

[69] *See, e.g.*, Burns v. Home Zone Sales & Lease Purchase, LLC (In re Burns), 503 B.R. 666 (Bankr. S.D. Miss. 2013) (holding repossession of refrigerator willful violation of stay that warranted emotional distress and punitive damage awards).

[70] 11 U.S.C. § 506(c). The contested case law over 506 surcharges is too in-the-weeds for this discussion. Briefly, courts squabble over the requirement of "benefit to the secured creditor" when the trustee incurs investigation and valuation costs to decide whether to hold onto the property (because residual equity goes to the estate) or abandon it to the secured creditor (because it is fully encumbered).

[71] Substantial case law holds that the trustee is not supposed to represent any individual creditor, but the creditor collective. *See, e.g.*, DigitalBridge Holdings, Inc. v. SKR Credit, Ltd. (In re DigitalBridge Holdings, Inc.), No. 10-34499, 2015 WL 5766761 (Bankr. D. Utah Sept. 30, 2015) (holding trustee pursuing adversary proceeding must represent all creditors or no creditors but may not represent only some). Relatedly, the trustee has no obligation to "save" individual creditors; for example, the trustee need not help—and indeed should object to—a creditor who files late claim. *See, e.g.,* In re Lyon, No. 11-50343, 2011 WL 5299229, at *2 (Bankr. W.D. N.C. Nov. 2, 2011).

[72] United States v. Lasich (In re Kinross Mfg. Corp.), 174 B.R. 702, 706 (Bankr. W.D. Mich. 1994).

[73] United Pac. Ins. Co. v. McClelland (In re Troy Dodson Constr. Co.), 993 F.2d 1211, 1216 (5th Cir. 1993).

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of the unsecured creditors and *not* the secured creditors.[74] Thus, some have held precisely the opposite: when there is not any value to flow to the estate and so the secured creditor will reap all the benefit of the collateral, 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."[75] Courts of this view believe that the secured creditor, can just as easily—more easily, in fact—pay the premium if it wants the collateral to be insured. [76] (Surely a different question would arise in a hypothetical situation in which the trustee for some reason was the only permissible party who could pay the premium, but generally insurance companies are not choosy about whom they cash cheques from.) In sum, whatever the broad jurisprudential platitudes about trustees being fiduciaries to "all creditors," when loyalty-dividing issues of secured creditor vs. unsecured creditors arise, it seems that, from a fiduciary duty perspective, conflicts are resolved in favor of the unsecured creditors on the backs of the secureds, with many courts unapologetically touting the "primary" obligation of the trustee toward the unsecureds. One court has gone so far to say, "Secured creditors are the trustee's statutory adversaries."[77]

Deep normative theory is sadly beyond the scope of this chapter, but at least one or two quick explanations for this line of jurisprudential 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 to unsecured,[78] and so believe that the otherwise hapless unsecureds need all the help they can get (or, more precisely, in a near-zero-sum distributive world in bankruptcy, 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 the unsecured creditors of an insolvent estate are often the "residual claimants," and hence the fulcrum class to whom the trustee's obligations ought best be owed in cases of inter-creditor conflict. This assumption has itself been questioned in the thoughtful

[74] Some go so far to abjure any duty to secureds. *See, e.g.*, NETtel Corp., Inc. v. Mgmt. Network Group, Inc. (In re NETtel Corp., Inc.), 364 B.R. 433, 441 (Bankr. D.C. 2006) ("[T]he fiduciary duties of a chapter 7 trustee . . . run only to a debtor's unsecured creditors.").

[75] Fox v. Anderson (In re Dinh), 80 B.R. 819, 823 (Bankr. S.D. Miss. 1987).

[76] *See* Peckinpaugh v. Derryberry, II (In re Peckinpaugh), 50 B.R. 865, 869 (Bankr. N.D. Ohio 1985) (finding trustee has no duty to manage assets, just preserve them until sale, otherwise "it would shift the Trustee's role from custodian to investment manager thereby encouraging secured creditors to avoid the responsibility for their investments").

[77] DiStefano v. Stern (In re J.F.D. Enterprises), 223 B.R. 610, 628 (Bankr. D. Mass. 1998).

[78] *See, e.g.*, 11 U.S.C. §§ 506, 1129(b)(1).

Hu/Westbrook critique.[79] For example, it is more likely to be true in consumer cases than in corporate ones of uncertain enterprise valuation. Whatever the justification, the case law's trajectory seems clear: the trustee is "more beneficial" for some creditors than others.[80]

ii. Priority unsecured creditors.

Slicing the bologna even finer, what happens when there are conflicts among unsecured creditors themselves? Section 507 of the Code accords special priority of distribution to claims of certain unsecured creditors.[81] Does the trustee have an obligation to investigate these claims, too, perhaps to see if the assertions to priority status are legitimate or trumped-up? Or may the trustee take a passive role and simply wait for some other party to object? 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 raises a fuss, occasionally trustees do indeed dig in on a bold creditor proclamation of entitlement to priority status. One sage colleague who has taken work 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."[82]

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

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[79] *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 well-diversified stockholders. *Id.* at 1351.

[80] The so-called duty to maximize distributions of the estate (to unsecured creditors) 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 (1986), 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). Rhodes notes that it is referenced in the trustee's handbook. Rhodes, *supra* note 27, at 168 n.92.

[81] 11 U.S.C. § 507.

[82] Email from Christopher Redmond, Esq., Partner, Husch Blackwell, to author (June 14, 2017, 8:45 EST) (on file with author). Chris also advises that in terms of who files claims objections: 95% of the time the trustee, 4% of the time the debtor, and 1% some other party in interest (e.g., another creditor). *Id.*

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the fulcrum class of residual claimants, then one would expect an equal application to the general unsecureds when a conflict is with a priority unsecured: the trustee should presumably look out for the residual claimants and fight the priority claim. Yet this does not seem to be uniformly the case, at least based on my skimpy anecdotal survey, which might be evidence for the judicially favored redistribution hypothesis. Many priority unsecured creditors are from disempowered classes already (domestic support, employees, etc.).[83] Perhaps trustees are mindful that they, too, receive priority repayment![84]

iii. Debtor.

Finally, the conflicts between creditors and the debtor seem to run in the opposite direction from the prior case law discussing the trustee's duty of loyalty. Here, cases repeatedly hold that the trustee's fiduciary loyalty does not flow to the debtor, even though technically the debtor is the ultimate residual beneficiary of the estate.[85] For example, even though not found 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 exemptions.[86] This cannot be explained away by "structural" differences in the Code's instruction to the trustee to object when advisable to the debtor's discharge,[87] because the trustee has an equal if not more explicit statutory instruction to examine the claims of creditors.[88] Courts upholding this obligation candidly admit it comes more indirectly from the Code, gamely trying various hooks.[89] The weak statutory foundations mean that the courts are driven by what they see as the trustee's duty to the unsecured creditors, and to work for the unsecured creditors against the debtor when their interests disalign. At least sometimes, therefore, the conflicting demands on a trustee's loyalty are not so difficult to resolve: the debtor loses.[90]

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[83] 11 U.S.C. §§ 507(a)(1), (a)(3).
[84] *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 priority for trustee fees for domestic creditor distributions).
[85] *Id.* § 726.
[86] *See, e.g.*, Bell v. Bell (In re Bell), 225 F.3d 203 (2d Cir. 2000); In re Dreibelbis, No. 14-61483, 2015 WL 3536102, at *4 n.5 (Bankr. N.D. Ohio 2015) ("[O]bjecting to exemptions will normally be a 'routine' trustee duty.") (citations omitted).
[87] 11 U.S.C. § 704(a)(6).
[88] *Id.* § 704(a)(5).
[89] *Bell*, 225 F.3d at 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* Edmonston v. Murphy (In re Edmonston), 107 F.3d 74, 76–77 (1st Cir. 1997) (referencing § 707(a)(1)'s obligation to administer and distribute the estate's property as "implicitly" providing legal basis for this duty).
[90] Note that no court wants to go so far as to say the trustee owes no duty to the debtor at all. *Cf.* CFTC v. Weintraub, 471 U.S. 343, 353 (1986) (fiduciary duty of loyalty of corporate debtor is to the "corporation"). And some courts have taken the debtor as co-

c. *Debtor-in-possession redux.*

The foregoing loyalty discussion has mostly considered the typical chapter 7 case with a disinterested trustee appointed. All the general principles hold true for a DIP-controlled chapter 11, with some obvious 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—will not arise in a corporate chapter 11 because corporations don't get exemptions. Nonetheless, it would be foolish to suggest there is no policy tension with the DIP serving as fiduciary for often antithetically situated stakeholders; few chapter 11 debtors are enjoying rosy relations with their creditors at the moment of filing their bankruptcy petitions.[91] The Bankruptcy Code responds to this structural tension with some built-in safety valves. First, the Code allows for removal of the DIP for "cause," which can include incompetence and wrongful conduct.[92] Although incompetence more aptly invokes the fiduciary duty of care, the duty of loyalty is also implicated. For example, a glaring imperfection in a security interest—perhaps a lapsed financing statement—not pursued by the DIP would surely ground a motion to appoint a trustee as inexplicable favoritism of the secured creditor.[93] (Of course, a deal to overlook the imperfection in exchange for post-petition DIP financing is in essence just a roll-up, which is de rigeur in some financial circles, and could be eminently defended as an exercise of business judgment.)

Now, who would cajole the DIP to bring such a motion?[94] This question segues into the second structural protection in chapter 11: the Official Committee of Unsecured Creditors. As its name suggests, the creditors committee participates as an official entity and is entitled to access the DIP's records.[95] It can weigh in on pending litigation matters and can even recommend approval/disapproval of a reorganization plan (or, when the

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beneficiary of fiduciary duty seriously. *See* In re Central Ice Cream Co., 836 F.2d 1068 (7th Cir. 1987) (faulting trustee for taking easy settlement on appeal of a $52-million judgment the debtor was defending; noting trustee was unduly focused on creditors' interest and risk-aversion, not debtor's residual interest).

[91] Some suggest the tension is so stark as to make the fiduciary obligations questionable. *See* Kelch, *supra* note 3, at 1351–52, 1352 n.131.

[92] 11 U.S.C. § 1104(a)(1).

[93] *Cf.* In re Biolitec, Inc., No. 13-11157, 2013 WL 1352302, at *9 (Bankr. D. N.J. April 3, 2013) (appointing trustee for pre-petition transfers to insiders and secured creditors when the debtor-in-possession had not sued to avoid them) (citing In re Sharon Steel Corp., 871 F.2d 1217, 1218 (3d Cir. 1989)).

[94] Weeds: in chapter 13, there is dispute whether the debtor or the standing trustee has standing to pursue lien avoidance given the chapter 13 debtor's vesting in many of the trustee's powers. *Compare* Houstin v. Eiler (In re Cohen), 305 B.R. 886 (B.A.P. 9th Cir. 2004) (debtor), *with* In re Binghi, 299 B.R. 300 (Bankr. S.D.N.Y. 2003) (standing trustee).

[95] 11 U.S.C. § 1103.

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exclusivity period expires, propose its own plan).[96] Perhaps most importantly, it draws funding from the estate to staff up with counsel to scrutinize just what the DIP is up to—a considerable check on the fox guarding the henhouse.[97] And cases have explicitly held that the creditors committee can bring litigation otherwise available to the DIP if the DIP wrongly refuses to do so.[98]

Finally as a structural safeguard, there is the bankruptcy court itself, which is statutorily injected into approval of certain estate transactions that outside bankruptcy would otherwise be generally immune from scrutiny. For example, sales or use of estate property outside the ordinary course of business, or use of estate cash that is collateral of a security interest, requires court approval.[99] In sum, numerous provision of the Code seem designed to acknowledge the intrinsic loyalty tension of the DIP model of fiduciary obligation to erstwhile adversaries. These offsetting checks serve as a pragmatic response to the DIP's conflicted allegiance.[100]

III. Remedies.

Among the more convoluted topics of bankruptcy law are the rules for when trustees can be sued for breaches of their duties—fiduciary and other ones—either by their beneficiary creditors of the bankruptcy estate or by third parties. The case law is often contradictory, but there are some coherent doctrines.

To begin, however, we should pause to consider non-litigation sanctions. The U.S. Trustee's office can strike trustees from their rolls and so repeat play/reputational constraints play a strong policing role.[101] And trustees are required to post a bond for the "faithful" exercise of their duties, which can be forfeited upon proper showing.[102] Thus,

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[96] *Id.* § 1121(c).
[97] *Id.* §§ 330, 1103.
[98] *See, e.g.*, Enron Corp. v. Lavorato (In re Enron Corp.), 319 B.R. 128, 132 (Bankr. S.D. Tex. 2004) (authorizing creditors committee to bring claims when DIP's conduct constituted an unjustifiable refusal to prosecute claims).
[99] 11 U.S.C. §§ 363(b)(1), (c)(2).
[100] *See generally* Bienenstock*, supra* note 43 (cataloging other checks on DIP loyalty).
[101] 28 C.F.R. § 58.6 (outlining procedures for suspension and termination); 28 U.S.C. § 586(d)(2) ("A trustee whose appointment . . . is terminated . . . may obtain judicial review . . . .").
[102] 11 U.S.C. § 322; R. Woolsey & Assocs., Inc. v. Gugino (In re R. Woolsey & Assocs., Inc.), 454 B.R. 782, 785–86 (Bankr. D. Idaho 2011) ("The purpose of the bond is to [en]sure faithful performance by the trustee and to indemnify the estate for any loss that might be sustained as a result of the misfeasance or malfeasance of the trustee."). (quoting 3 Collier on Bankruptcy ¶ 322.02 [2] at 322–4 (Alan N. Resnick and Henry J. Sommer eds., 16th ed. 2010)); *see also* Schooler v. Liberty Mutual Surety (In re Schooler), 449 B.R. 502, 517 (Bankr. N.D. Tex. 2010) (finding liability of surety under blanket bond triggered by gross negligence on trustee's part).

even aside from the canons and guidelines, there are plenty of non-litigation constraints on trustee fiduciary behavior.

But of course, lawsuits are more fun, and so discussion duly turns. To be specific, the litigation issue is the trustee's *personal* liability. The trustee of course has standing to sue and be sued on behalf of the estate in her *official* capacity.[103] The two types of lawsuits the trustee officially pursues are actions of the debtor—to which she succeeds as the relevant party in interest—and actions for the collective benefit of all creditors, such as fraudulent conveyance actions.[104] Lawsuits against the trustee in her official capacity face a common law procedural bar of jurisdiction called the *Barton* rule. Under the case of *Barton v. Barbour*, the Supreme Court established that lawsuits against trustees (back then, receivers) in connection with administration of the estate require leave of the appointing court. Accordingly, a tort action in state court against the receiver in her official capacity had to be dismissed absent leave of the (now bankruptcy) court.[105] Thus, as a pleading matter alone, most putative plaintiffs try to go after the trustee in her personal capacity.[106]

Even if sued in his personal capacity, however, a trustee can always assert immunity to dismiss a suit, which will of course also often be grounds for denying *Barton* leave. This "absolute quasi-judicial immunity," or immunity "derived" from the trustee's appointing court, generally immunizes the trustee from suit within the scope of his official capacities.[107] Courts uniformly extending this immunity to bankruptcy trustees build upon the Supreme Court precedents on judicial immunity.[108] This immunity

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[103] 11 U.S.C. § 323; *see also id.* § 322(c) (immunizing trustee for debtor's malfeasance).
[104] *Id.* §§ 541, 548.
[105] *See* Barton v. Barbour, 104 U.S. 126 (1881); Villegas v. Schmidt, 788 F.3d 156 (5th Cir. 2015) (applying *Barton* doctrine to hold plaintiffs required to seek leave prior to bringing state-law claims).
[106] Congress has a statutory overlay, 28 U.S.C. § 959(a), which clarifies that trustees (and DIPs) can be sued for "carrying on business." This is a refinement, not an abrogation, of *Barton*, because it merely prevents blanket immunity for a trustee running a business from ordinary jurisdiction from civil suit (e.g., if the DIP enters into and then breaches a contract to supply goods). *See* In re VistaCare Group*,* 678 F.3d 218 (3d Cir. 2012); *see also* Beck v. Fort James Corp. (In re Crown Vantage), 421 F.3d 963, 971 (9th Cir. 2005) ("[T]his limited exception [§ 959] applies only if the trustee or other officer is actually operating the business . . . .").
[107] Mullis v. U.S. Bankr. Ct., 828 F.2d 1385, 1390 (9th Cir. 1987).
[108] *See, e.g.*, Bradely v. Fisher, 80 U.S. 355 (1871); Gonzalez v. Musso, No. 08-CV-3026, 2008 WL 3194179, at *2 (D. E.D.N.Y. Aug. 6, 2008) ("[A] trustee 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.") (quoting Reisner v. Stoller, 51 F.Supp.2d 430, 446 (S.D.N.Y. 1999)).

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protects the free exercise of official discretion without fear of litigation risk.[109] 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.[110] But not all exercises of the trustee's authority trigger derivative immunity, only some. Which ones do depends upon classification along an "administrative/functional" to "judicial/discretionary" continuum, stemming from the Supreme Court's decision in *Forrester v. White*,[111] as refined with a more categorical historical two-part test in *Antoine v. Byers & Anderson*.[112] This stratification is a consequence of the derivative nature of the trustee's immunity from judicial immunity, as not all actions of judges enjoy absolute judicial immunity. (*Forrester* involved the judge demoting a probation officer, which was not an exercise of judicial power in need of protection.)[113] Bankruptcy trustees are "hybrid official[s]" who exercise some judicial-discretionary functions but also lots of administrative tasks, requiring a case-by-case immunity analysis for proper categorization.[114]

Moreover, even if the trustee's authority is on the non-judicial side of the *Forrester-Antoine* ledger and hence not entitled to derivative immunity, the trustee still enjoys alternative immunity from personal suit under something called the *McNulta* doctrine. Dating back to the Supreme Court case of *McNulta v. Lochridge*,[115] this additional immunity depends upon the identity of 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 his personal capacity, the trustee can assert *McNulta* immunity, which protects the trustee absolutely from suit for actions performed within the scope of his duties. The only exception to this is a claim of ultra vires conduct, i.e., that the trustee was acting outside the scope of his assigned responsibilities. Such cases are uncommon, but always interesting.[116]

Finally, even if the trustee's conduct is not immune under the foregoing analysis, there is still one final bite at the apple: derivative immunity by virtue of court approval.

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[109] *See* Forrester v. White, 484 U.S. 219, 223 (1988) ("[T]he threat of liability can create perverse incentives that operate to inhibit officials in the proper performance of their duties.").
[110] 18 U.S.C. § 3057(a); Kirk v. Hendon (In re Heinsohn), 247 B.R. 237, 245 (E.D. Tenn. 2000) (finding "analogy to the judicial immunity concept instructive" in holding trustee protected by absolute immunity when making criminal referral).
[111] 484 U.S. 219 (1988).
[112] 508 U.S. 429 (1993).
[113] 484 U.S. at 230 (noting judge might enjoy qualified immunity, however).
[114] In re Castillo, 297 F.3d 940, 951 (9th Cir. 2002).
[115] 141 U.S. 327 (1891).
[116] *See, e.g.*, McCauley v. Jackson (In re United Eng'g. & Contracting Co.), 151 N.Y.S. 120 (N.Y. App. Div. 1915) (finding trustee personally liable with no *McNulta* immunity for damages to third-party landowners caused by negligent supervision of horses and mules in debtor's business when trustee had not been authorized to run business).

This doctrine harks back to the seminal case of trustee liability, *Morris v. Darrow*, in which the Supreme Court noted in finding a trustee liable for breach of fiduciary duty that the trustee did not follow the "well established" practice 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."[117] Building on this rationale, modern courts have held trustees enjoy absolute immunity when they act "with the explicit approval of a bankruptcy court . . . as long as there has been full and frank disclosure to creditors and the court."[118]

So what is left for a trustee to be sued upon in his personal capacity? Breach of fiduciary duty. Note this is only available to "second party" plaintiffs, i.e., creditors or others to whom the bankruptcy trustee owes obligations as the beneficiaries of the duties. But, this being bankruptcy, even that is unclear due to convoluted case law. The cryptic foundational case of *Mosser* is to blame, and has led to three-way split of opinion. In *Mosser*, a receiver of a railroad reorganization case poorly supervised his employees, who ended up trading in securities they sold the estate. The case is interesting because the trustee appeared hapless: no personal gain was made by the trustee himself, just by the faithless agents, and, in fact, it's not clear the estate itself lost money (the faithless agents "merely" profited, although the Court acknowledged the foregone estate opportunity).[119]

In holding the trustee liable, the Court offered some 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."[120] 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 of buying and selling securities the trustee himself innocently but unwisely approved. But its reference to "no room for negligence" could be read to mean that negligence would 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 breach to transgress 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."[121] Or something else.

Fast-forward to subsequent appellate cases trying to divine the standard for trustee liability. A three-way circuit split has emerged—each claiming to draw support from *Mosser*'s terse opinion—with some courts requiring knowing/intentional wrongful conduct to predicate trustee personal liability for breach of fiduciary duty (as they have

[117] 341 U.S. 267, 274 (1951).
[118] LeBlanc v. Salem (In re Mailman Steam Carpet Clean'g Corp.), 196 F.3d 1, 8 (1st Cir. 1999).
[119] *See* 341 U.S. at 272.
[120] *Id.*
[121] *Id.* at 274.

interpreted *Mosser*);[122] some requiring mere negligence in the discharge of duties (making great hay out of the fiduciary-laden term "surcharge");[123] and still others staking out a middle ground of gross negligence (following the ignored recommendations of the National Bankruptcy Review Commission of 1997).[124] Some day, when it has smaller fish to fry, the Supreme Court will get around to clearing this up.

IV. Miscellaneous Issues with Fiduciary Duties in Insolvency.

Trustees may delegate operation of the estate to professionals by statute,[125] but must submit a resignation in writing to the United States Trustee in order to effectively resign.[126] Case law has generally held that they may not delegate the "essential decision-making responsibility" of administering a case.[127] Trustee obligations more generally tend to implicate the pragmatic considerations (paradoxically ignored by Congress) engrained in bankruptcy jurisprudence. For example, U.S. Trustees were given additional responsibilities under BAPCPA to conduct compulsory audits. As commentators have noted, it was nearly impossible to expect overworked civil servants to do this work, resulting in some passive-aggressive reports to Congress.[128] Notwithstanding Congress's blithe disengagement with reality, the courts, including the Supreme Court, take pragmatic considerations in bankruptcy seriously. Just this year, for example, the Court considered settlement incentives in deciding the scope of debt-buyer liability under the FDCPA (before holding in a subsequent case the FDCPA does not apply to debt buyers!).[129] And the dissent, too, doubled down on practical considerations in accusing the majority of not getting the full picture.[130] Even as far back as *Mosser*, the Court worried about the practical consequences of grumpy creditors seeking leverage in fashioning liability rules for trustees.[131] Thus, given that trustee obligations in

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[122] *See, e.g.*, In re Chicago Pac. Corp, 773 F.2d 909 (7th Cir. 1985). This line of cases has been criticized for conflating standards of the trustee's personal liability (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.*, *McCullough, supra* note 27, at 177–79 (citing E. Allan Tiller, *Personal Liability of Trustees and Receivers in Bankruptcy*, 53 AM. BANKR. L.J. 75, 100 (1979)).
[123] *See, e.g.*, McNulta v. Lochridge, 141 U.S. 327, 332 (1891).
[124] *See, e.g.*, Dodson v. Huff (In re Smyth), 207 F.3d 758 (5th Cir. 2000).
[125] 11 U.S.C. § 327.
[126] *See* HANDBOOK, *supra* note 33, at § 2.J, 6 (noting that procedures for suspension and termination, 28 C.F.R. § 58.6, do not apply).
[127] In re Computer Learning Ctrs. Inc., 285 B.R. 191, 207 (Bankr. E.D. Va. 2002).
[128] Jacqueline Palank, *Bankruptcy Watchdogs Resume Debtor Audits*, WALL ST. J. (Feb 26, 2014, 10:42 AM), https://blogs.wsj.com/bankruptcy/2014/02/26/bankruptcy-watchdogs-resume-debtor-audits/.
[129] Midland Funding, LLC v. Johnson, 137 S.Ct. 1407 (2017).
[130] *See id.* at 1420 (Sotomayor, J., dissenting) ("The problem with the majority's *ipse dixit* is that everyone with actual experience in the matter insists that it is false.").
[131] Mosser v. Darrow, 341 U.S. 267, 273–74 (1951).

bankruptcy are delineated by a federal common law of fiduciary duty, these pragmatic considerations seem likely to further shape the scope of the obligations of care and loyalty as case law develops.[132]

Finally, revisitation of the DIP fiduciary duty in the (common) context of a corporate debtor is in order before concluding. General corporate law has its own concerns of the agency challenges and temptations of corporate management exercising their fiduciary duties for shareholders.[133] Under influential Delaware law, however, this duty to shareholders shifts to encompassing creditors as well when the corporation enters the zone of insolvency.[134] Different systems saddle corporate fiduciaries with analogous responsibilities.[135] While this doctrine has undergone some revision (and retrenchment) in more recent cases, the proposition remains that shareholders lose their status as the exclusive beneficiaries of management's attention when this "zone" has been entered (which now appears to have been restricted to just straight "insolvency").[136]

Legions of commentators in the corporate field have attacked and defended this duty-shifting rule,[137] and the bankruptcy community has had its share of insights, too,[138] but one of the more poignant critiques has come from Texans Hu and Westbrook, who point out the poor fit of expanding fiduciary obligations to multiple stakeholders at state law, which is ill-equipped institutionally to handle the policing of duties to multiple and

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[132] See the pragmatic analysis of the Fifth Circuit in *In re Smyth*, 207 F.3d 758 (2000), in selecting the gross negligence standard for trustee personal liability for breach of fiduciary duty.

[133] *See, e.g.*, ADOLPH A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

[134] *See* Hu & Westbrook, *supra* note 79, at 1338 n.55. This doctrine apparently finds some historical pedigree in the trust fund doctrine that, prior to statutory regulation, policed improper corporate dividends from insolvent debtors. *Id.* at 1332–33.

[135] *See* Hu & Westbrook, *supra* note 79, at 1383 n.226, 1400 n.299.

[136] *See* Hu & Westbrook, *supra* note 79, at 1344 (explaining seminal *Giahwalla* case and nominal difference regarding derivative claims).

[137] *See, e.g.*, Carrieri v. Jobs.com, 393 F.3d 508, 534 n.24 (5th Cir. 2004) ("Officers and directors that are aware that the corporation is insolvent, or within the 'zone of insolvency' . . . have expanded fiduciary duties to include the creditors of the corporation."); Neil Ruben, Note, *Duty to Creditors in Insolvency and the Zone of Insolvency: Delaware and the Alternatives*, 7 N.Y.U. J.L. & BUS. 333 (2010) (canvassing arguments for and against creditor standing to allege derivative suits during insolvency).

[138] *See* Kelch, *supra* note 3, at 1350–63 (discussing the inherent conflict). Kelch proposes a taxonomy of theoretical proposals that includes "Group Favoritism" (pick one constituency); "Diffuse Loyalty" (help everyone, through the corporation); and even "Stakeholder-Mediation" (try to be neutral and transparent about fights). Kelch himself supports an Adversarial Model, openly acknowledging that discharge of a corporate fiduciary duty by the DIP is impossible, and thus advocates replacing any duty of care with the simple business judgement rule.

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antagonistic beneficiaries. Rather, say Professors Hu and Westbrook, expanding fiduciary duties to creditors when a corporation becomes insolvent (actually or just "zonally") should be abandoned at state law. No duty to creditors should obtain unless and until the debtor files a bankruptcy petition.[139] 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 above, such as the corporation-funded creditors committee, the ability to displace wayward fiduciaries with an external trustee, and, most importantly, the oversight of the bankruptcy judge, aided by an automatic stay that freezes all creditor conduct and corrals matters into her courtroom.[140] Thus, corporate directors saddled with new and unfamiliar duties to creditors would be best overseen by the bankruptcy court system, which has mechanisms for checking faithless corporate agents, but otherwise have their single focus outside bankruptcy remain on shareholders, both in good times and in bad.[141]

Conclusion.

Hu and Westbrook's article is a good place to conclude. It underscores the chaotic nature of swirling and conflicting fiduciary obligations to multiple stakeholders in insolvency. It argues that while bankruptcy courts are not perfect, they are at least used to shifting allegiances and disalignments of interest in their everyday dockets.[142] The Bankruptcy Code allows transparency of the process, committee watchdogs, and replacement of the DIP fiduciary with an external trustee all as an attempt to manage the challenging task of fiduciary obligation. Perhaps scholars of fiduciary duties could learn from bankruptcy's unruly practice.

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[139] *See* Hu & Westbrook, *supra* note 79, *passim*.
[140] 11 U.S.C. §§ 362, 554.
[141] As part of their critique, Hu and Westbrook question whether corporate duties provide any meaningful discipline at all. *See* Hu & Westbrook, *supra* note 79, at 1391 n.260.
[142] This is not to say trust law hasn't seen this problem before. The "duty of impartiality" implicates largely the same principles, mostly in the context of principal vs. income beneficiaries, *see* RESTATEMENT (SECOND) OF TRUSTS § 232 ("Impartiality Between Successive Beneficiaries"), but in my opinion (a) in a generally fewer-stakeholder environment, and (b) with the oft-present solution of explicit specification in a trust document itself of rules for resolving conflicting duties. *See also* UNIF. TRUST CODE § 803 (UNIF. LAW COMM'N 2010) ("Duty of Impartiality"); SCOTT AND ASHER ON TRUSTS § 17.15 (5th ed. 1995) ("Duty of Impartiality").