ARTICLES

BANKRUPTCY TRUSTEE LIABILITY: IS THERE A METHOD IN THE MADNESS?

by
Elizabeth H. McCullough[*]

Mosser v. Darrow*, decided over 50 years ago, was the Supreme Court's first and only opinion concerning the personal liability of a bankruptcy trustee. Unfortunately, its mandates in the area of bankruptcy trustee liability are anything but clear, and it has since created uncertainty in the common law about when a bankruptcy trustee should be personally liable or immune from suit. Many courts rely on faulty analysis and a misunderstanding of the doctrines and terminology involved with bankruptcy trustee liability. To help guide courts in making more uniform decisions, that trustees may rely upon to ascertain whether they will be subject to personal liability, this Article creates a comprehensive analytical framework of trustee immunity and liability, which has been woven together using the existing threads of analysis suggested by scholars and applied by courts. The Article discusses the four-step framework in detail, concluding by applying it to a recent case, and arguing that a more reliable result would have been reached by the court had it been equipped with a more uniform framework of analysis. While the use of a structured examination of trustee immunity and liability might not always result in the same conclusions, it will hopefully clarify and unify the analytical process which has been, and continues to be, a contributing factor to the confusion.*

[*] Elizabeth H. McCullough, Associate Professor of Law, Charleston School of Law. I would like to thank Ashton Daley, Megan Harrigan, and Philip Paradise for their research and citation assistance.

I. INTRODUCTION

It has been more than 50 years since the Supreme Court issued its first and only opinion on the personal liability of a bankruptcy trustee.[1] In the case of *Mosser v. Darrow,* the Supreme Court found a reorganization trustee personally liable for the "willful and deliberate setting up of an interest in employees adverse to that of the trust" even though the trustee's actions resulted in no loss to the trust.[2] The Court found "no room for the operation of the principles of negligence in a case in which conduct [had] been knowingly authorized."[3] In dictum, the Court observed that trustees are able to limit, if not avoid, liability by making candid periodic accountings to the court and parties in interest of their actions or by seeking instructions from the court "as to matters which involve difficult questions of judgment."[4] Unfortunately, the trustee in *Mosser* failed to pursue either option, which would have revealed, early on, the objectionable employee arrangement.[5] The ruling in *Mosser* spawned much confusion in the common law concerning when a bankruptcy trustee should be found immune from suit or subject to personal liability instead.[6]

[1] *See* Mosser v. Darrow, 341 U.S. 267 (1951).

[2] *Id.* at 272.

[3] *Id.*

[4] *Id.* at 274.

[5] *Id.* at 275.

[6] The Court in *Mosser* found trustee Darrow personally liable because he committed a willful and deliberate act even though his actions did not cause damage to the estate or third parties. *Id.* at 274–75. The Court, however, embarked on a brief discussion of the application of principles of negligence with respect to a trustee's conduct in response to the views of the Seventh Circuit Court of Appeals. The Court held that the principles of negligence were not applicable to trustee Darrow because he acted deliberately. *Id.* at 272. The Court noted, however, that negligence might be

It was not until 46 years later that the National Bankruptcy Review Commission (Commission) attempted to clarify and unify the then existing, and still quite confused, state of the law by proposing to the United States Congress recommendations on bankruptcy trustee immunity and liability.[7] The Commission's proposal recommended that trustees appointed in Chapter 7, 11, 12, or 13 cases be afforded personal immunity from suit for acts taken within the scope of their duties set forth in the United States Bankruptcy Code (Bankruptcy Code) or ordered by the court after proper notice and full disclosure.[8] The proposal then provided that in Chapter 7, 12, and 13 cases, trustees would not be entitled to immunity from suit for acts taken in their representative capacity or for acts taken in their personal capacity to the extent their conduct was found grossly negligent in the performance of fiduciary duties.[9] With respect to Chapter 11 trustees of corporate debtors, the proposal recommended that they be subject to suit in their representative capacity and subject to suit personally only when they violated the standard of care applicable to officers and directors of corporations in the states where their cases were pending.[10]

While the Commission's recommendations as to trustee immunity and liability did not result in an amendment to section 323 of the Bankruptcy Code,[11] they generated significant scholarship on both the controversial trustee standard of conduct[12] and the errors made by the

required to surcharge a trustee should the liability arise from a failure to detect a problem. *Id.* This remark by the Court as well as a brief remark that courts may avoid imposing heavy liability on trustees for mistakes in business judgment produced confusion resulting in (a) inconsistent opinions as to the level of misconduct warranting a finding of trustee personal liability and (b) at times, an inappropriate commingling of the doctrines of trustee immunity and personal liability. *See id.* at 272–73. For example, in *Sherr v. Winkler*, the Tenth Circuit held that *Mosser* established three distinct rules that a bankruptcy trustee was never liable for mistakes in business judgment, was personally liable only for willful and deliberate acts in violation of his duties, and also was personally liable for negligent acts committed in his official capacity. 552 F.2d 1367 (10th Cir. 1977). *Mosser* simply did not establish these exact rules and especially did not hold that a trustee acting in his official capacity would be surcharged for his negligent acts. Unfortunately, the Sixth Circuit in *Ford Motor Credit Co.* also adopted the *Sherr* interpretation of *Mosser* even though the court examined more closely the issue of trustee liability with respect to a trustee's varied roles. As case law evolved, the scope and extent of a trustee's liability remained at issue. *See* Ford Motor Credit Co. v. Weaver, 680 F.2d 451 (6th Cir. 1982).

[7] NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 842 (1997).

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] David W. Allard, *Personal Liability of Trustees and Debtors in Possession: Review of the Varying Standards of Care in the United States*, 106 COM. L.J. 415, 415–16 (2001); NAT'L BANKR. REVIEW COMM'N, *supra* note 7, at 842.

[12] *See generally* Allard, *supra* note 11; David P. Primack, *Confusion and Solution: Chapter 11 Bankruptcy Trustee's Standard of Care for Personal Liability*, 43 WM. & MARY L.

Commission and courts in their "sloppy use of trust law terminology" and even more destructive mingling of the doctrines of trustee immunity and fiduciary obligations.[13] Daniel B. Bogart observed in the *Dickinson Law Review* that it was not just a misunderstanding and misapplication of *Mosser* that created the confusion in the law of trustee liability but a failure of the courts and the Commission to follow a "[c]areful doctrinal analysis" when examining personal liability claims.[14]

Presently, the Bankruptcy Code still fails to provide any guidance on the immunity or personal liability of a trustee. Guidance from the common law also remains inconsistent. While Louis M. Phillips and Ashley S. Green, in their recent musings on the common law in this area, recognized key "threads of analysis" being applied by courts when examining trustee immunity or liability, they concluded that even with this guidance, courts have continued to make basic mistakes in doctrinal analysis, resulting in awkward and sometimes confusing comments and conclusions.[15]

Such confusion breeds uncertainty for trustees who need guidance not only on the expected standards of conduct against which their actions towards constituents of the estates will be measured, but also on the appropriate application of the doctrines of immunity and fiduciary obligations when determining their personal exposure to both beneficiaries and non-beneficiaries of the estates. This uncertainty adds yet another stress to their already challenging environment. For the fiscal year ending March 31, 2010, bankruptcy filings totaled 1,531,997, which represents a 27% increase over the same period for the prior year.[16] This avalanche of filings, 72% of which were Chapter 7 filings, came on the heels of two prior years of record filings and at a time when total trustee compensation was decreasing.[17] Combining these challenges with the

REV. 1297 (2002); Theresa J. Pulley Radwan, *Trustees in Trouble: Holding Bankruptcy Trustees Personally Liable for Professional Negligence*, 35 CONN. L. REV. 525 (2003).

[13] *See* Daniel B. Bogart, *Finding the Still Small Voice: The Liability of Bankruptcy Trustees and the Work of the National Bankruptcy Commission*, 102 DICK. L. REV. 703, 711 (1998).

[14] *Id.* at 716.

[15] Louis M. Phillips & Ashley S. Green, *Musings on the Standard of Care Governing the Question of Trustee Immunity and Trustee Liability: Part 1*, J. NAT'L ASS'N BANKR. TRUSTEES, Fall 2008, at 8, 9; Louis M. Phillips & Ashley S. Green, *Musings on the Standard of Care Governing the Question of Trustee Immunity and Trustee Liability: Part 2*, J. NAT'L ASS'N BANKR. TRUSTEES, Winter 2008, at 10, 18–20.

[16] U.S. Courts, *Bankruptcy Statistics*, at *Table F: U.S. Bankruptcy Courts—Bankruptcy Cases Commenced, Terminated and Pending During the 12-Month Periods Ending March 31, 2009 and 2010*, *available at* http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2010/0310_f.pdf.

[17] Clifford J. White, III, *Report from the EOUST*, J. NAT'L ASS'N BANKR. TRUSTEES, Winter 2009, at 35; U.S. Courts, *Bankruptcy Statistics*, at *Table F-2: U.S. Bankruptcy Courts: Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the 12-Month Period Ending March 31, 2010*, *available at* http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2010/0310_f2.pdf.

existing volatile economy creates a perfect opportunity for frustrated creditors and debtors, especially in Chapter 7 and 11 cases, to consider asserting claims against trustees personally rather than being limited to possible fractional distributions from the bankruptcy estates.

Whether trustees and courts will be faced with an increase in trustee liability claims is uncertain. What is certain, however, is the need for a reliable method of analysis available to trustees and the courts as they find themselves, in their respective positions, faced with the daunting task of assessing an allegation of a trustee's personal liability within the confused state of the common law. The purpose of this Article, therefore, is to create a framework of analysis of trustee immunity and liability woven from existing threads of analysis suggested by scholars and occasionally applied by courts. While the use of a structured examination of trustee immunity and liability might not always result in the same conclusions, it will hopefully clarify and unify the analytical process which has been, and continues to be, a contributing factor to the confusion.

Part II provides a review of the roles and responsibilities of a bankruptcy trustee in the current bankruptcy system. Understanding what is expected of a trustee is the first step in any analysis of a trustee's immunity or personal liability. It provides guidelines against which the trustee's alleged misconduct in a personal liability suit can be compared and measured.

Part III examines the need to classify, early on, the claimant or alleged injured party who has sued the trustee in his or her individual capacity. Classifying whether the claimant is a third party unconnected to the administration of the bankruptcy estate or a beneficiary of the estate owed a fiduciary duty will assist the court in recognizing the appropriate doctrine to apply in resolving the dispute.

Part IV addresses the doctrine of immunity and its application to claims made against the trustee personally. A trustee's initial defense to a personal liability claim is that he or she is immune from suit. This third step in the analysis, when appropriately applied, will relieve the trustee personally from suit regardless of the class of the claimant while preserving certain third party claims against the bankruptcy estate. If the application of the immunity doctrine does not relieve the trustee personally from suit, then the trustee's alleged misconduct must be examined to determine whether he or she is personally liable within the context of one of two exceptions to the immunity doctrine.

Part V, therefore, analyzes the two exceptions to the immunity doctrine to determine whether the trustee is personally liable for misconduct that either (a) falls outside the scope of his or her authority as to a third party to the bankruptcy estate or (b) constitutes a breach of his or her fiduciary duty to the estate or a beneficiary. If the trustee is found liable in his or her individual capacity, then he or she may be held personally liable for any losses incurred by the claimant.

Part VI applies this four-step method of analysis to a recent case where both the bankruptcy and district courts were confused when analyzing the personal liability claims against the trustee. Using this case as an example, this Part argues for courts to use a structured method of analysis when examining trustee personal liability claims to avoid making errors in analysis and to produce more reliable opinions.

II. UNDERSTANDING THE ROLES AND RESPONSIBILITIES OF THE MODERN BANKRUPTCY TRUSTEE

The issue of trustee personal liability finds its genesis in a claim made by an allegedly injured party for some failure in a bankruptcy trustee's performance. Typical claims might include a trustee's failure to collect and reduce to money property of the estate as expeditiously and reasonably as possible, to protect assets of the estate, to properly invest funds held by the estate, to bring and defend lawsuits in a timely manner, to protect the environment and pay claims according to the law, or to notice properly those matters which must be brought to the attention of parties in interest to the estate.

Other claims against the trustee might include a breach of contract, selling property that is not property of the estate, defaming individuals through the act of making referrals of possible crimes, hiring employees whose interests are adverse to the estate or spending estate funds in a careless or reckless manner. A critical first step, therefore, in analyzing the immunity or potential personal liability of the bankruptcy trustee faced with a claim of malfeasance, is to examine the claim within the context of what is expected of a trustee in the current bankruptcy system.

The current bankruptcy system in the United States has its origin in the English bankruptcy system, which was a function of the Chancery.[18] "Upon the occurrence of an act of bankruptcy" and on the petition of creditors, the Lord Chancellor would "convene a bankruptcy proceeding" and appoint a commissioner to take charge of the bankruptcy process.[19] The functions of the "commissioners" were both ministerial and judicial.[20] They not only collected, liquidated and distributed assets of the debtor but, at times, assembled persons, conducted hearings, and committed persons to prison.[21] Over time, these ministerial or "trustee-like" functions were assigned to "assignees."[22]

The early bankruptcy system in the United States had a similar structure with the district court having original jurisdiction of bankruptcy matters. The courts appointed "registers in bankruptcy" to assist them

[18] Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 6–7 (1995).

[19] *Id.* at 8.

[20] *Id.*

[21] *Id.*

[22] *Id.* at 9.

with processing bankruptcy matters and delegated "assignees" to administer specifically the property of the debtors.[23]

As the bankruptcy system in the United States evolved, referees and finally bankruptcy judges succeeded to the positions of "registers in bankruptcy,"[24] and bankruptcy trustees succeeded to the positions of "assignees."[25] "Debtors, creditors, and third parties," however, began to question their ability to receive an impartial adjudication of their claims against bankruptcy trustees who were appointed and supervised by the same courts hearing their claims.[26]

To alleviate this concern and others, the "functions within the bankruptcy system were bifurcated" in order to remove bankruptcy judges from the responsibilities of appointing trustees and administering the cases.[27] These administrative and supervisory functions were placed, instead, within the Department of Justice through the creation of the United States Trustee program.[28]

Chapter 39 of Title 28 of the United States Code currently authorizes the Attorney General to appoint[29] and supervise United States trustees[30] who, in turn, serve as trustees when requested,[31] appoint bankruptcy trustees under Chapter 7 of Title 11,[32] appoint standing trustees in cases under Chapter 12 or 13 of Title 11,[33] and supervise the administration of cases and their trustees under Chapter 7, 11, 12, or 13 of Title 11.[34] While modern bankruptcy trustees are now creatures of statute rather than of the judiciary, their roles and responsibilities still retain, in part, the judicial-like functions of their predecessors.

Section 323 of the Bankruptcy Code defines a trustee's role in any case under Title 11 as "the representative of the estate" with the "capacity to sue and be sued."[35] Sections 704, 1106, 1202, and 1302 of the Bankruptcy Code enumerate the specific responsibilities of Chapter 7, 11, 12, and 13 trustees, respectively.[36] Pursuant to these sections, all trustees are obligated to be accountable for property they receive,[37] to

[23] *Id.* at 19.
[24] *Id.*
[25] *Id.* at 25.
[26] EXEC. OFFICE FOR U.S. TRS., U.S. DEP'T OF JUSTICE, HANDBOOK FOR CHAPTER 7 TRUSTEES 1–3 (2002), *available at* http://www.justice.gov/ust/eo/private_trustee/library/chapter07/docs/forms/ch7hb0702-2005_amended0306.pdf.
[27] *Id.* at 1–3.
[28] 28 U.S.C. § 586 (2006).
[29] *Id.* § 581.
[30] *Id.* § 586(c).
[31] *Id.* § 586(a)(2).
[32] *Id.* § 586(a)(1).
[33] *Id.* § 586(b).
[34] *Id.* § 586(a)(3).
[35] 11 U.S.C. § 323 (2006).
[36] *Id.* §§ 704, 1106, 1202(b), 1302.
[37] *Id.* § 704(a)(2).

examine and object to proofs of claims filed in their cases,[38] to furnish information concerning the estates and their administration to parties in interest,[39] and to make and file reports with the court and the United States trustee.[40] Trustees also assemble parties in interest to the bankruptcy estates and conduct meetings where testimony is given and the rights of parties with respect to estate property are resolved.

Chapter 7 trustees are charged specifically with the additional obligations of collecting and reducing to money property of the debtor's estates and closing the estates as expeditiously as possible.[41] Chapter 11 trustees, on the other hand, are charged specifically with the duties of investigating fully the debtors and their businesses,[42] filing plans of reorganization,[43] and unless courts order otherwise, operating the debtors' businesses.[44] Chapter 13 standing trustees must appear and be heard on each wage earner's encumbered property and plan of reorganization;[45] ensure that each debtor commences making timely payments under his or her plan of reorganization;[46] and receive, supervise, and control all or part of each debtor's future earnings in accordance with his or her plan of reorganization.[47] The duties of a Chapter 12 trustee are a composite of some, but not all, of the obligations of trustees in the other chapters.[48]

Other trustee duties include, but are not limited to, the institutional duties imposed by the Executive Office for United States Trustees as authorized by 28 U.S.C. § 586(a)(3)(A)(i)[49] and the reporting duty set forth in 18 U.S.C. § 3057(a), which obligates trustees to report to the

[38] *Id.* § 704(a)(5).
[39] *Id.* § 704(a)(7).
[40] *Id.* § 704(a)(9).
[41] *Id.* § 704(a)(1).
[42] *Id.* § 1106(a)(3).
[43] *Id.* § 1106(a)(5).
[44] *Id.* § 1108.
[45] *Id.* § 1302(b)(2).
[46] *Id.* § 1302(b)(5).
[47] *Id.* § 1322(a)(1).
[48] *Id.* § 1202.
[49] EXEC. OFFICE FOR U.S. TRS., U.S. DEP'T OF JUSTICE, HANDBOOK FOR CHAPTER 7 TRUSTEES 1–3 (2002), *available at* http://www.justice.gov/ust/eo/private_trustee/library/chapter07/docs/forms/ch7hb0702-2005_amended0306.pdf; EXEC. OFFICE FOR U.S. TRS., U.S. DEP'T OF JUSTICE, CHAPTER 11 TRUSTEE HANDBOOK 3 (2004), *available at* http://www.justice.gov/ust/eo/private_trustee/library/chapter11/docs/Ch11Handbook-200405.pdf; EXEC. OFFICE FOR U.S. TRS., U.S. DEP'T OF JUSTICE, CHAPTER 12 STANDING TRUSTEES HANDBOOK 106 (1992), *available at* http://www.justice.gov/ust/eo/private_trustee/library/chapter12/docs/ch12hdbk.pdf; EXEC. OFFICE FOR U.S. TRS., U.S. DEP'T OF JUSTICE, CHAPTER 13 STANDING TRUSTEES HANDBOOK 1–3 (1998), *available at* http://www.justice.gov/ust/eo/public_affairs/sig_guidance/docs/Chapter13_Trustee_Handbook.pdf.

United States Attorney any suspected crimes related to insolvent debtors, receiverships, or reorganization plans.[50]

Underlying these statutory duties are the trustee's fiduciary duties owed to beneficiaries of the bankruptcy estate as established by common law. Courts consistently have found that bankruptcy trustees are fiduciaries to beneficiaries of the estates[51] and, as such, are impressed with "the most rigorous responsibilities for fair dealing . . . ."[52] Chief Judge Cardozo in the case of *Meinhard v. Salmon* explained this rigor with respect to one fiduciary duty, the duty of loyalty:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate.[53]

These rigid and deep-rooted fiduciary obligations that a trustee must undertake in each bankruptcy case are many and varied,[54] however, the basic overriding fiduciary duties are "the duty of care (*i.e.*, the obligation not to act negligently), the duty of loyalty (*i.e.*, the obligation not to act in the fiduciary's own interests), and the duty of obedience (*i.e.*, the obligation not to act outside the fiduciary's permitted authority)."[55]

A trustee's duty of care is defined and measured by the care, diligence, and skill of an ordinarily prudent person in conducting his or

---

[50] 18 U.S.C. § 3057(a) (2006).

[51] Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) ("[T]he fiduciary duty of the trustee runs to shareholders as well as to creditors."). Dye v. Brown (*In re* AFI Holding, Inc.), 530 F.3d 832, 844 (9th Cir. 2008) ("A trustee is the 'legal representative' and 'fiduciary' of the estate."); *In re* United Healthcare Sys., Inc., 200 F.3d 170, 177 n.9, 177–78 (3d Cir. 1999) (finding that a debtor-in-possession is a fiduciary in a bankruptcy proceeding where the business is liquidating its affairs); United Pac. Ins. Co. v. McClelland (*In re* Troy Dodson Constr. Co.), 993 F.2d 1211, 1216 (5th Cir. 1993) ("The trustee owes a fiduciary duty to *all* the creditors, not just to the unsecured creditors."); Pereira v. Foong (*In re* Ngan Gung Rest.), 254 B.R. 566, 570 (Bankr. S.D.N.Y. 2000) ("A trustee also owes a fiduciary duty to each creditor of the estate."); *In re* Vebeliunas, 231 B.R. 181, 192 (Bankr. S.D.N.Y. 1999) ("These fiduciary duties are owed not only to the entire creditor body but to the debtor as well."); *In re* Jack Greenberg, Inc., 189 B.R. 906, 910 (Bankr. E.D. Pa. 1995) ("Section 323 provides that the trustee is the representative of the estate. In that capacity the trustee is a fiduciary and intended to be independent.").

[52] Young v. Higbee Co., 324 U.S. 204, 213 (1945).

[53] 164 N.E. 545, 546 (N.Y. 1928).

[54] Steven Rhodes, *The Fiduciary and Institutional Obligations of a Chapter 7 Bankruptcy Trustee*, 80 AM. BANKR. L.J. 147, 154 (2006) (noting "the duties of loyalty, distribution maximization, diligence, due care, accountability, competence, claims review, information disclosure, candor, civility, proper litigation preparation and conduct, impartiality and its appearance, enforcement, supervision, compliance, and good faith and fair dealing.").

[55] *In re Dalen*, 259 B.R. 586, 610 (Bankr. W.D. Mich. 2001).

her private affairs under similar circumstances.[56] A trustee's duty of loyalty is defined and measured by his or her personal disinterestedness[57] and "unstinted" devotion to the trust,[58] and a trustee's duty of obedience is defined and measured by the scope of his or her authority which subsumes that any actions taken are lawful.[59]

A bankruptcy trustee is, without a doubt, a "unique person," serving simultaneously as a "functionary" within a defined bankruptcy system and a "fiduciary" to a "discrete set of 'beneficiaries.'"[60] It is therefore important for courts and others, when reviewing a personal liability claim against a trustee, to recognize and distinguish these very different roles, their attendant responsibilities, and their intended recipients. Failure to do so may cause litigants and the court to venture down an incorrect path of analysis in assessing a trustee's immunity or personal liability. For example, courts mistakenly have applied a fiduciary analysis when a trustee was sued by a third party for tortious conduct[61] or have applied an immunity analysis when the trustee was sued by a beneficiary of the bankruptcy estate for an alleged breach of a fiduciary duty.[62] The task of correctly identifying the trustee's alleged misconduct in light of his or her duties and selecting the proper doctrinal analysis can be made even more difficult by the manner in which the aggrieved party frames his or her allegations in the complaint.

To avoid making an error in doctrinal analysis, it has been suggested that courts and others, when reviewing a trustee's potential liability, classify the claimants who allegedly have been injured by the trustee so as to determine their relationship to the estate as either beneficiaries or third parties.[63] Based upon this recommendation, therefore, this important thread of consideration must be woven into any framework of analysis of trustee liability as a critical second step, naturally following the identification and characterization of the trustee's alleged misconduct in administering the estate within the bankruptcy system.

III. CLASSIFYING THE CLAIMANT

In the daily administration of a bankruptcy case, a trustee typically interacts with his or her employees, debtors, creditors, shareholders,

---

[56] Estate of Reich v. Burke (*In re* Reich), 54 B.R. 995, 998 (Bankr. E.D. Mich. 1985).

[57] Dye v. Brown (*In re* AFI Holding, Inc.), 530 F.3d 832, 845 (9th Cir. 2008).

[58] Wootten v. Wootten, 151 F.2d 147, 150 (10th Cir. 1945).

[59] Olson v. Anderson (*In re* Anderson), 357 B.R. 452, 456 (Bankr. W.D. Mich. 2006).

[60] Bogart, *supra* note 13, at 708.

[61] *See, e.g.*, Sherr v. Winkler, 552 F.2d 1367 (10th Cir. 1977).

[62] *See, e.g.*, *In re* Cont'l Coin Corp., 380 B.R. 1 (Bankr. C.D. Cal. 2007); Dana Commercial Credit Corp. v. Nisselson (*In re* Center Teleproductions, Inc.), 112 B.R. 567 (Bankr. S.D.N.Y. 1990).

[63] Bogart, *supra* note 13, at 723.

certain invitees, and a variety of other third parties who find themselves or their property affected by the administration of the bankruptcy estate. Their respective interest in the estate and relationship with the trustee are important factors to consider when assessing their complaints against the trustee.

Creditors and shareholders of a bankruptcy estate are part of a very "discrete set"[64] of constituents whose interests must be safeguarded by the trustee. In addition, a Chapter 7 debtor may become a member of this group should the estate become solvent.[65] These particular parties are beneficiaries of the bankruptcy estate and are in a fiduciary relationship with the bankruptcy trustee. Accordingly, they are owed the common law fiduciary duties applicable to trustees as well as the statutory duties set forth in 11 U.S.C. §§ 704, 1106, 1202, or 1302.[66]

On the other hand, parties who have no interest in the administration of the estate but, instead, find themselves or their property somehow affected by the trustee's actions are non-beneficiaries of the bankruptcy estate to whom no fiduciary duties are owed by the trustee. They are considered third parties to the estate and its administration.[67]

A good example of this third party relationship is found in the case of *In re Bryan*, where a trustee, from unrelated deposition testimony, discovered that the debtor might have been receiving legal advice from an individual not licensed to practice law and submitted the individual's name to the bar.[68] As a result, the trustee was sued personally by the individual for libel and slander.[69] The plaintiff had no pecuniary or other interest in the estate, its property, or its administration; was a non-beneficiary of the estate; and would be classified as a third party.[70] The court in the case of *In re Bryan* appropriately recognized this relationship; applied an immunity rather than a fiduciary analysis to the personal liability claim against the trustee; found the trustee's actions to have been completed in his official capacity within the scope of his authority,

---

64 *Id.* at 708.

65 *See* Ebel v. King (*In re* Ebel), 338 B.R. 862, 874 (Bankr. D. Colo. 2005); *In re* Kazis, 257 B.R. 112, 114 (Bankr. D. Mass. 2001); *In re* Moon, 258 B.R. 828, 832 (Bankr. N.D. Fla. 2001); United States *ex rel.* George Schumann Tire & Battery Co. v. Grant (*In re* George Schumann Tire & Battery Co.), 145 B.R. 104, 107 (Bankr. M.D. Fla. 1992).

66 Hall v. Perry (*In re* Cochise College Park, Inc.), 703 F.2d 1339, 1357 (9th Cir. 1983); Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985); Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 461 (6th Cir. 1982). *See also* 11 U.S.C. §§ 704, 1106, 1202, and 1302 (2006).

67 Bogart, *supra* note 13, at 717–18.

68 Chambers v. Silliman (*In re* Bryan), 308 B.R. 583, 585 (Bankr. N.D. Georgia 2004).

69 *Id.* at 585.

70 *Id.*

entitling him to absolute immunity from suit; and granted the trustee's motion to dismiss the lawsuit.[71]

This same immunity analysis, however, would not be applicable to resolve a claim of a creditor of a bankrupt debtor against a trustee for his or her failure to preserve estate property in which the creditor's interest attached. In that case, a court would pursue, instead, a fiduciary analysis and examine whether the trustee breached a fiduciary duty injuring a beneficiary of the estate. Analyzing whether the trustee acted in his or her official capacity within the scope of his or her authority would be inappropriate since "[t]rustees are simply not 'immune' from suits brought by their beneficiaries," unless their acts or omissions are either authorized by the bankruptcy court or judicial in nature.[72]

Classifying a claimant as a beneficiary injured by a breach of a trustee's fiduciary duties or a third party non-beneficiary injured by a trustee acting within or outside the scope of his or her authority is an important second step in assisting courts when selecting the proper doctrine to apply when analyzing a personal liability claim against a trustee. Since the immunity doctrine may be applicable irrespective of the class of the claimant when a trustee's actions are either completed with explicit approval of a bankruptcy court[73] or closely associated with the judicial process,[74] courts should pause in their analysis after classifying the claimant, examine the immunity doctrine, and make sure that it is not applicable to relieve the trustee from suit in his or her individual capacity.

IV. UNDERSTANDING THE DOCTRINE OF DERIVED JUDICIAL IMMUNITY

A bankruptcy trustee's immunity from suit is derived, in part, from the immunity historically afforded judges. One of the early cases that dealt with the doctrine of judicial immunity as applicable to the personal liability of a bankruptcy trustee was the case of *Smallwood v. United States*, where several federal district judges, a United States Attorney and his assistant, a receiver, a bankruptcy referee, and a bankruptcy trustee were sued for conspiracy by the executive officer of a debtor.[75] The district court first recognized that "[t]he principle is well established that judicial officers are immune from suits for money damages for acts performed in the discharge of their official duties."[76] The court looked to the U.S.

[71] *Id.* at 586–88.

[72] Bogart, *supra* note 13, at 720.

[73] LeBlanc v. Salem (*In re* Mailman Steam Carpet Cleaning Corp.), 196 F.3d 1, 8 (1st Cir. 1999).

[74] Curry v. Castillo (*In re* Castillo), 297 F.3d 940, 947 (9th Cir. 2002).

[75] 358 F. Supp. 398, 401–02 (E.D. Mo. 1973).

[76] *Id.* at 402.

Supreme Court opinions of *Bradley v. Fisher*[77] and *Pierson v. Ray*[78] for guidance on the doctrine of judicial immunity.[79]

In *Bradley*, when addressing a claim by an attorney against a justice for ordering his name stricken from the roll of attorneys, the Supreme Court provided the following justification for judicial immunity:

> For it is a general principle of the highest importance to the proper administration of justice that a judicial officer, in exercising the authority vested in him, shall be free to act upon his own convictions, without apprehension of personal consequences to himself. Liability to answer to every one who might feel himself aggrieved by the action of the judge, would be inconsistent with the possession of this freedom, and would destroy that independence without which no judiciary can be either respectable or useful.[80]

Decades later, in *Pierson*, the Court, when examining a suit against a municipal police justice, provided the following discussion on the scope and purpose of the doctrine:

> This immunity applies even when the judge is accused of acting maliciously and corruptly, and it "is not for the protection or benefit of a malicious or corrupt judge, but for the benefit of the public, whose interest it is that the judges should be at liberty to exercise their functions with independence and without fear of consequences."[81]

The court in *Smallwood* then looked to the case of *Brictson v. Woodrough*, where the Eighth Circuit, also reviewing an allegation of conspiracy against several judges, noted as follows:

> Resting on considerations of public policy to the end that the administration of justice may be independent and based on the free and unbiased convictions of the judge, uninfluenced by apprehension of personal consequences, it is a general rule that, where a judge has jurisdiction over the subject matter and the person, he is not liable civilly for acts done in the exercise of his judicial function, even though he acts erroneously, illegally, or irregularly, or even corruptly.[82]

Relying on the carefully reasoned doctrine of judicial immunity, the court in *Smallwood* found the judges to be immune from suit because they "had no contact with plaintiff in any manner other than in their official capacity as United States District Judge."[83]

---

[77] 80 U.S. 335 (1871).

[78] 386 U.S. 547 (1967).

[79] *Smallwood*, 358 F. Supp. at 402–03.

[80] *Bradley*, 80 U.S. at 347.

[81] *Pierson*, 386 U.S. at 554 (quoting Scott v. Stansfield, (1868) 3 L.R. Exch. 220, at 223 (Eng.)).

[82] Brictson v. Woodrough, 164 F.2d 107, 109 (8th Cir. 1947) (citation omitted); *Smallwood*, 358 F. Supp. at 403.

[83] *Smallwood*, 358 F. Supp. at 404.

The court then looked to the claims against the bankruptcy referee and the trustee and found that they, too, were judicial officers entitled to immunity from suit.[84] With respect to the trustee specifically, the court explained that he "was elected, duly appointed and qualified" as trustee and also had had no contact with the plaintiff other than in his official capacity.[85]

Some years later, in the case of *Lonneker Farms, Inc. v. Klobucher*, the Ninth Circuit, when examining a bankruptcy trustee's liability for wrongful acts relating to the crops and farming operations of the debtor, found the trustee to be entitled to derived judicial immunity both as a "trustee in bankruptcy or an official acting under the authority of the bankruptcy judge" because he was "performing an integral part of the judicial process."[86] Around the same time, the Ninth Circuit, in addressing a civil rights claim brought by a debtor against four bankruptcy judges, court clerks, and a bankruptcy trustee, also found the judges absolutely immune from liability and the court clerks and the trustee entitled to "absolute quasi-judicial immunity."[87] The court explained that the judges "clearly had subject matter jurisdiction" over the debtor's bankruptcy petition and schedules and had not acted in error or in excess of jurisdiction.[88] With respect to the court clerks, the court reasoned that they were performing tasks that were "an integral part of the judicial process."[89] As to the trustee, the court found that his immunity was derived from the judge who appointed him, and he too had not acted "in the clear absence of all jurisdiction."[90] In awarding immunity to trustees, therefore, courts early on focused more on a trustee's official position and grant of authority rather than on the type of trustee function being challenged.

One year later, while examining the immunity of a judge for demoting and discharging a probation officer, the Supreme Court, in the case of *Forrester v. White,* had the opportunity to review the scope of absolute judicial immunity and the proper approach to be used in analyzing questions of immunity.[91] The Court first examined the following considerations that led to the creation of various forms of immunity from suit for certain government officials:

> Suits for monetary damages are meant to compensate the victims of wrongful actions and to discourage conduct that may result in liability. Special problems arise, however, when government officials are exposed to liability for damages. To the extent that the threat of

[84] *Id.*
[85] *Id.*
[86] 804 F.2d 1096, 1097 (9th Cir. 1986).
[87] Mullis v. U.S. Bankr. Ct., 828 F.2d 1385, 1390 (9th Cir. 1987).
[88] *Id.* at 1389.
[89] *Id.* at 1390.
[90] *Id.*
[91] 484 U.S. 219, 220 (1988).

> liability encourages these officials to carry out their duties in a lawful and appropriate manner, and to pay their victims when they do not, it accomplishes exactly what it should. By its nature, however, the threat of liability can create perverse incentives that operate to *inhibit* officials in the proper performance of their duties. In many contexts, government officials are expected to make decisions that are impartial or imaginative, and that above all are informed by considerations other than the personal interests of the decisionmaker. Because government officials are engaged by definition in governing, their decisions will often have adverse effects on other persons. When officials are threatened with personal liability for acts taken pursuant to their official duties, they may well be induced to act with an excess of caution or otherwise to skew their decisions in ways that result in less than full fidelity to the objective and independent criteria that ought to guide their conduct. In this way, exposing government officials to the same legal hazards faced by other citizens may detract from the rule of law instead of contributing to it.[92]

The Court then noted that except in cases decided by express constitutional or statutory enactment, a "functional approach" should be used in analyzing questions of immunity rather than simply identifying the official and his or her authority.[93] The Court explained that "[u]nder that approach, we examine the nature of the functions with which a particular official or class of officials has been lawfully entrusted, and we seek to evaluate the effect that exposure to particular forms of liability would likely have on the appropriate exercise of those functions."[94] The Court found that immunity was "justified and defined by the *functions* it protects and serves, not by the person to whom it attaches."[95]

The Court then reflected on the types of functions performed by a judge that historically had been protected by immunity, recognizing that cases had suggested "an intelligible distinction between judicial acts and the administrative, legislative, or executive functions that judges may on occasion be assigned by law to perform."[96] The Court held that the judge's actions at issue in the case, demoting and discharging a probation officer, were administrative acts not entitled to absolute immunity, which was justified only when there was a danger of the official being deflected from the performance of his duties.[97] The Court explained that it would constitute error and "lift form above substance" to conclude that the judge's employment decisions made "within the scope of his authority . . . [were] within the court's 'jurisdiction,' or

92 *Id.* at 223.
93 *Id.* at 224.
94 *Id.*
95 *Id.* at 227.
96 *Id.*
97 *Id.* at 230.

[could be] converted into 'judicial acts.'"[98] The Court noted, however, that qualified immunity may be available to judges for their discretionary employment decisions.[99]

In 1993, in *Antoine v. Byers & Anderson*, the Supreme Court examined the extent to which the doctrine of judicial immunity extended to a court reporter.[100] Instead of using the functional approach adopted in *Forrester*, the Court used a two-step process in reviewing the immunity of the court reporter. First, the Court examined whether the relevant official historically had been immune from suit at common law.[101] Finding to the contrary with respect to a court reporter, the Court then compared the court reporters' functions to those of judges.[102] Specifically, the Court held that "[w]hen judicial immunity is extended to officials other than judges, it is because their judgments are 'functional[ly] comparab[le]' to those of judges—that is, because they, too, 'exercise a discretionary judgment' as a part of their function."[103] The Court, however, found that "court reporters do not exercise the kind of judgment that is protected by the doctrine of judicial immunity," but instead perform ministerial and administrative duties lacking decisional characteristics.[104]

A decade later, the Ninth Circuit in the case of *In re Castillo*, applied the *Antoine* two-part test when assessing whether a Chapter 13 bankruptcy trustee was entitled to immunity after being sued by a debtor for the negligent miscalendaring and noticing of a plan confirmation hearing.[105] Upon examining whether bankruptcy trustees and their predecessors historically were afforded immunity, the court noted that "the common-law and nineteenth century antecedents of the modern bankruptcy trustee were entrusted with both administrative and adjudicatory functions,"[106] and "[t]o the extent the trustee performed the functions of a modern-day bankruptcy judge, immunity would have extended to the performance of these common-law adjudicatory functions."[107]

The court then addressed the modern trustee and his or her functions within the current United States trustee system and found that Congress had created a "hybrid official" who "performs some functions historically viewed as judicial in nature, and others that are not."[108] The court explained that while the modern trustee, like his or her predecessors, "is charged with many legal, adjudicative, clerical, financial,

[98] *Id.*
[99] *Id.*
[100] 508 U.S. 429, 430 (1993).
[101] *Id.* at 432–33.
[102] *Id.* at 434.
[103] *Id.* at 436 (quoting Imbler v. Pachtman, 424 U.S. 409, 423 n.20 (1976)).
[104] *Id.* at 436–37.
[105] 297 F.3d 940, 943, 949 (9th Cir. 2002).
[106] *Id.* at 950.
[107] *Id.*
[108] *Id.* at 951.

administrative, and business functions, quasi-judicial immunity attaches to only those functions essential to the authoritative adjudication of private rights to the bankruptcy estate."[109]

The court then examined the questionable conduct at issue, the scheduling and noticing of a confirmation hearing, and found that the duties constituted a single act that was judicial in nature.[110] The court held that "[a]t common law the bankruptcy trustee would have enjoyed immunity for the judicial function of controlling and managing her docket in the bankruptcy proceedings, and both the scheduling and noticing of the proceeding are a part of that discretionary function."[111] While the court compared the Chapter 13 trustee's scheduling and noticing of a confirmation hearing to the purely ministerial acts of court clerks, it still found the act to be part of a judicial process warranting protection from suit.[112] The court warned, however, that it was not holding that all trustee functions were protected by absolute quasi-judicial immunity.[113]

The doctrine of derived or quasi-judicial immunity, therefore, appears to be applicable to bankruptcy trustees and protects them from suit for acts or omissions associated with functions that have been afforded protection historically and are essential to the authoritative adjudication of private rights to the estates. This immunity, just like judicial immunity, is limited in its scope. It will be interesting to see just how far courts extend its reach with respect to the myriad of functions expected of a bankruptcy trustee.

This same immunity also has been afforded to bankruptcy trustees fulfilling their duties according to the express approval of the court. For example, in the case of *In re Mailman*, where a bankruptcy trustee was sued by a creditor for negligence and breach of fiduciary duty for abandoning certain rights to seek a revocation of a settlement, the First Circuit correctly completed an immunity analysis and explained "that a trustee acting with the explicit approval of a bankruptcy court is entitled to absolute immunity, as long as there has been full and frank disclosure to creditors and the court."[114] The court recognized that the trustee in the case had "wisely sought judicial approval" for the abandonment and, therefore, was entitled to immunity unless there was "reason to believe that he acted in bad faith or that the notice of disclosure he provided was deficient."[115] Finding nothing of the sort, the court found the trustee

[109] *Id.*

[110] *Id.* at 952.

[111] *Id.* at 952–53.

[112] *Id.* at 952.

[113] *Id.* at 953.

[114] LeBlanc v. Salem (*In re* Mailman Steam Carpet Cleaning Corp.), 196 F.3d 1, 8 (1st Cir. 1999).

[115] *Id.*

entitled to derived judicial immunity for those acts which had been expressly approved by the court.[116]

In both *In re Castillo* and *In re Mailman*, the award of immunity from suit to the trustees was made irrespective of the class of the claimants. What mattered to the courts was whether the trustees' acts or omissions in question were either judicial in nature or agreed to by the court.

Such is not the case, however, with respect to the final reason for providing a bankruptcy trustee with personal immunity from suit. Trustees also enjoy personal immunity from lawsuits brought by third parties for acts or omissions conducted in the trustees' official capacity within the scope of their authority. For example, "a trustee is not personally liable on contracts entered into on behalf of the estate, or for torts committed by employees of the estate."[117] A third party injured by some alleged tort or breach of contract committed by a trustee in his or her official capacity must pursue, instead, the bankruptcy estate by suing the trustee in his or her representative capacity.[118] This rule, coined the *McNulta* rule, was established by the Supreme Court in the case of *McNulta v. Lochridge*.[119] When addressing a claim by a court-appointed receiver that he should not be subject to suit for acts of his predecessor without leave of the appointing court, the Court held as follows: "Actions against the receiver are in law actions against the receivership, or the funds in the hands of the receiver, and his contracts, misfeasances, negligences and liabilities are official and not personal, and judgments against him as receiver are payable only from the funds in his hands."[120] The *McNulta* rule created a limited immunity, protecting only those alleged malfeasances committed by a receiver in his or her official capacity within the scope of specific authority.

In the early case of *Ziegler v. Pitney*, the Second Circuit adopted the *McNulta* rule and applied it when addressing a personal liability claim against bankruptcy trustees in a railroad reorganization proceeding.[121] The administratrix of the estate of a deceased infant sued the trustees personally for the negligent and reckless manner in which their employees operated a train that struck and killed the infant.[122] The court held that "receivers and trustees appointed under the Bankruptcy Act and authorized to conduct business on behalf of an estate in reorganization are by the weight of authority only liable as receivers or trustees, and not individually except in cases where they act outside their

[116] *Id.* at 9.

[117] Schechter v. Ill. Dep't of Revenue (*In re* Markos Gurnee P'ship), 182 B.R. 211, 217 (Bankr. N.D. Ill. 1995).

[118] *In re* Rollins, 175 B.R. 69, 77 n.7 (Bankr. E.D. Cal. 1994).

[119] 141 U.S. 327 (1891).

[120] *Id.* at 332.

[121] 139 F.2d 595, 595–96 (2d Cir. 1943).

[122] *Id.* at 595.

authority."[123] Finding that the trustees were appointed to run the railroad and that there were no allegations of misconduct on the part of the trustees, the court affirmed the lower court's dismissal of the complaint against the trustees individually.[124]

This same rule was applied with respect to a modern trustee in the case of *In re Heinsohn*, when a district court affirmed a bankruptcy court's dismissal of a malicious prosecution and defamation suit brought against a bankruptcy trustee personally by a third party who had been accused by the trustee of defrauding and conspiring to defraud the bankruptcy estate.[125] The court examined specifically the issue of "whether in a malicious prosecution action a bankruptcy trustee is entitled to absolute or qualified immunity for making a criminal referral."[126] The court found that the wrongdoing at issue in the case was an action taken by the trustee acting solely within his official capacity under the specific authority of 18 U.S.C. § 3057(a).[127] The court reasoned that "[s]ince the criminal referral concerned *bankruptcy* fraud and was made during and in relation to a *bankruptcy* proceeding by the trustee of the relevant estate, the logical inference is the trustee was acting pursuant to his statutory duty when making the criminal referral."[128] The court found no evidence that the trustee was acting "because of some personal vendetta" or "for some other reason unrelated to the bankruptcy."[129] The court affirmed the lower court's ruling that the trustee was entitled to absolute immunity from suit for fulfilling a duty in his official capacity.[130]

It appears, therefore, that based on the common law doctrine of immunity, bankruptcy trustees are afforded personal immunity from suits brought by beneficiaries of the bankruptcy estates if the acts or omissions in question are either (a) closely associated with a judicial process where private rights are being adjudicated or (b) expressly approved by a court. With respect to claims brought by third parties to the estates, however, trustees are afforded personal immunity from suits not only for acts or omissions deemed judicial in nature or approved by the court but also for alleged malfeasances completed in their official capacity pursuant to statutory authority.

In the very limited circumstances where a trustee is found personally immune from a suit brought by a beneficiary of the estate, the asserted claims against the trustee should be dismissed. In those circumstances where a trustee is found personally immune from a suit brought by a third party, however, the asserted claims should be dismissed against the

123 *Id.* at 596.
124 *Id.*
125 Kirk v. Hendon (*In re* Heinsohn), 247 B.R. 237, 240 (E.D. Tenn. 2000).
126 *Id.* at 244.
127 *Id.*
128 *Id.* at 246.
129 *Id.*
130 *Id.*

trustee personally but may remain actionable against the estate if they were also brought against the trustee in his or her representative capacity for acts or omissions completed in his or her official capacity pursuant to statutory authority.

Should a trustee not be found personally immune from suit, the court must then examine the trustee's alleged personal liability under one of two exceptions to the immunity doctrine. This fourth and final step in the framework of analysis is claimant-specific, and the earlier classification of the alleged injured party will also be relevant at this fork in the analytical path.

V. ANALYZING THE EXCEPTIONS TO THE DOCTRINE OF DERIVED JUDICIAL IMMUNITY

There are two basic exceptions to the doctrine of derived or quasi-judicial immunity. The first exception applies solely to claims brought by third parties to the bankruptcy estates against trustees for wrongdoings committed *outside* the scope of their authority. The second exception applies to claims brought by beneficiaries of the bankruptcy estates against trustees for acts or omissions neither ordered by the court nor judicial in nature. With respect to both types of claims, trustees are not protected by the immunity doctrine, and an analysis of the claims must focus, instead, on whether the trustees are personally liable to the claimants for the alleged misconduct.

A. Claims Brought by a Third Party for a Trustee's Misconduct Committed Outside the Scope of Authority

As previously noted, trustees in bankruptcy enjoy a limited immunity from personal liability with respect to third parties to the bankruptcy estate. The immunity is limited, pursuant to *McNulta* and its progeny, to those alleged malfeasances committed by the trustee in his or her official capacity within the scope of his or her authority.[131] If the trustee's wrongdoing, however, is found to be committed outside the scope of his or her authority, he or she may be found personally liable to the claimant whether the alleged wrongdoing by the trustee is tortious or constitutes a breach of contract.[132]

For example, in the early case of *In re United Engineering & Contracting Co.*, a bankruptcy trustee, with no authority to run the debtor's construction business, continued the business for some fourteen months, during which time he failed to prevent the debtor's horses and mules used in the construction business from escaping and grazing on

[131] McNulta v. Lochridge, 141 U.S. 327, 332 (1891). *See also* McRanie v. Palmer, 2 F.R.D. 479, 481 (D. Mass. 1942).

[132] E. Allan Tiller, *Personal Liability of Trustees and Receivers in Bankruptcy*, 53 AM. BANKR. L.J. 75, 82, 88 (1979).

the plaintiff's land.[133] The court found the trustee personally liable to the owner of the land for the negligent acts of his employees in failing to keep the animals off of the plaintiff's property.[134]

Another tortious act clearly outside the scope of a trustee's authority is the wrongful possession or disposition by the trustee of property that is not part of the bankruptcy estate. As noted by E. Allan Tiller in his article on trustee liability, "[c]onversion, then, is an example of an affirmative wrongful act which, in the terms of the *McNulta* rule, is an act outside the scope of the representative's authority, and so he must be personally liable."[135] He explained that since the bankruptcy representative "is only personally liable, the assets of the bankrupt estate are not threatened, and so a plenary action may be brought against the representative freely in a state court, under the *Barton* rule."[136]

The issue of a trustee's personal liability to parties not connected to the bankruptcy estate is often intertwined with jurisdictional issues due to the fact that third parties often bring their personal liability suits not in the courts that appointed the trustees but in more convenient local courts. The Supreme Court, in *Barton v. Barbour*, examined whether a receiver of a railroad company could be sued in a court that had not appointed him by a third party passenger injured in an accident "occasioned by the negligence and carelessness" of the receiver.[137] The Court held that a suit brought against a receiver in his or her representative capacity could not be brought in a court other than the appointing court unless that appointing court granted permission.[138] As the Court explained:

> A suit therefore, brought without leave to recover judgment against a receiver for a money demand, is virtually a suit the purpose of which is, and effect of which may be, to take the property of the trust from his hands and apply it to the payment of the plaintiff's claim, without regard to the rights of other creditors or the orders of the court which is administering the trust property.[139]

The Court then found that:

> The claim of the plaintiff, which is against the receiver for a personal injury sustained by her while travelling on the railroad managed by him, stands on precisely the same footing as any of the expenses incurred in the execution of the trust, and must be adjusted and satisfied in the same way.[140]

[133] McCauley v. Jackson (*In re* United Eng'g & Contracting Co.), 151 N.Y.S. 120, 121 (N.Y. App. Div. 1915).

[134] *Id.*

[135] Tiller, *supra* note 132, at 85.

[136] *Id.*

[137] 104 U.S. 126, 127 (1881).

[138] *Id.* at 129.

[139] *Id.*

[140] *Id.* at 131.

The plaintiff, therefore, would require permission from the appointing court to bring a claim against the trustee in his official capacity.[141]

The Court, however, held that its decision was limited to the facts of the case,[142] and should a receiver, instead, wrongfully or by mistake take possession of property belonging to another, the injured party "may bring suit therefor [sic] against [the receiver] personally as a matter of right; for in such case the receiver would be acting *ultra vires*."[143] If found liable, the receiver, not the trust, would be responsible for compensating the injured party for any losses.

Such ultra vires acts of bankruptcy trustees are not limited to tortious acts. Trustees have also been sued and found personally liable in contract to third parties. For example, in the early case of *Clark v. Baen*, a court found a bankruptcy receiver personally liable on a contract for the failure to disclose to the plaintiff the fact that he was a receiver acting in his official capacity in purchasing lumber for the debtor entity.[144] Years later, in the case of *Noyes v. Gold*, a court found the trustee's failure to deliver certificates to the estate's brokers beyond the scope of his authority and held him personally liable for any losses incurred by the brokers.[145]

Courts, however, in addressing suits against bankruptcy trustees by third parties, have been cautious when finding a trustee's conduct truly outside the scope of his or her authority or ultra vires.[146] As explained by the court in the case of *In re Markos Gurnee Partnership*, "[j]ust as a trustee's conduct does not become ultra vires because it is negligent, so it does not become ultra vires because it violates an obligation imposed by state law."[147] Additionally, as noted by the *In re Weisser Eyecare, Inc.* court, a trustee's failure to notice a sharing agreement that he entered into with a third party did not constitute an ultra vires action.[148] If, however, a court does find a trustee's act or omission ultra vires, the trustee generally will be held liable to the third party in his or her individual capacity.

Should the alleged misconduct of the trustee, instead, injure the bankruptcy estate or a beneficiary of the estate, the analysis of a trustee's personal liability is quite different. Whether the trustee acted within or outside the scope of his or her authority is irrelevant. What is relevant is whether the trustee breached a fiduciary duty owed to the estate or a beneficiary, and whether the misconduct associated with the breach reached a level sufficient to warrant a finding of personal liability.

---

[141] *Id.*

[142] *Id.*

[143] *Id.* at 134.

[144] 242 P. 872, 872–74 (Cal. Ct. App. 1926).

[145] 34 N.E.2d 1, 7 (Ill. App. Ct. 1941).

[146] *See, e.g.*, *In re* Weisser Eyecare, Inc., 245 B.R. 844, 851 (Bankr. N.D. Ill. 2000); Schechter v. Ill. Dep't of Revenue (*In re* Markos Gurnee P'ship), 182 B.R. 211, 224 (Bankr. N.D. Ill. 1995).

[147] *In re Markos Gurnee P'ship*, 182 B.R. at 224.

[148] *In re Weisser Eyecare, Inc.*, 245 B.R. at 851.

B. Claims Brought by a Beneficiary for a Trustee's Breach of Fiduciary Duties

Historically, in determining the standards of conduct applicable to a bankruptcy trustee in fulfilling his or her duties, courts have looked to the standards of conduct expected of receivers, executors, and administrators of non-bankrupt estates or trusts.[149] In the case of *In re Reinboth*, the Second Circuit explained that:

> Trustees in bankruptcy, like executors and administrators, are bound to use due diligence to get in the assets of the estate—to secure possession of the tangible property and collect the debts. If they fail in their duty, they may be charged in their accounts with the value of the assets thereby lost. If they take no steps to secure property or collect debts, of which they have knowledge, they are presumptively negligent.[150]

Decades later, in the case of *Leonard v. Vrooman*, the Ninth Circuit also recognized that "the receiver-trustee is charged by the Bankruptcy Act with gathering assets of the bankrupt, and that his failure to act diligently in this respect could result in a claim against him."[151] In the early Supreme Court case of *United States ex rel. Willoughby v. Howard*, the Court noted that "every trustee or receiver of an estate has the duty of exercising reasonable care in the custody of the fiduciary estate unless relieved of such duty by agreement, statute, or order of court."[152] These same standards of reasonable care and due diligence were found applicable to a bankruptcy trustee in the more recent case of *In re Cochise College Park, Inc.*, where the Ninth Circuit held that a bankruptcy trustee "has a duty to treat all creditors fairly and to exercise that measure of care and diligence that an ordinarily prudent person under similar circumstances would exercise."[153]

Since a breach of these very basic standards, by definition, constitutes negligence, it would have been simple for courts to find trustees personally liable when their acts or omissions toward the estate or its beneficiaries were found to be negligent. Such has not been the case, however, with courts taking divergent positions on the degree of misconduct warranting a finding of trustee personal liability, which has been due, in part, to a misreading of the Supreme Court's holding in *Mosser*.

While the holding in *Mosser* did spawn a consistently followed position that "[c]ourts are quite likely to protect trustees against heavy liabilities for disinterested mistakes in business judgment,"[154] it created

149 *See, e.g.*, Leonard v. Vrooman, 383 F.2d 556, 560 (9th Cir. 1967); *In re* Reinboth, 157 F. 672, 674 (2d Cir. 1907).

150 *In re Reinboth*, 157 F. at 674.

151 *Leonard*, 383 F.2d at 560.

152 302 U.S. 445, 450 (1938).

153 Hall v. Perry (*In re* Cochise College Park, Inc.), 703 F.2d 1339, 1357 (9th Cir. 1983).

154 Mosser v. Darrow, 341 U.S. 267, 274 (1951).

uncertainty as to the exact degree of wrongdoing that subjects trustees to personal liability should the misconduct exceed in severity a mere mistake in judgment. The mistake made by the trustee in *Mosser* was found by the Court to be a willful and deliberate act, and the Court disagreed with the Court of Appeals' position that principles of negligence governed the trustee's acts.[155] The Court explained that:

> We see no room for the operation of the principles of negligence in a case in which conduct has been knowingly authorized. This is not a case of a trustee betrayed by those he had grounds to believe were trustworthy, for these employees did exactly what it was agreed by the trustee that they should do.[156]

The Court then held that "[t]he liability here is not created by a failure to detect defalcations, in which case negligence might be required to surcharge the trustee, but is a case of a willful and deliberate setting up of an interest in employees adverse to that of the trust."[157]

What the Court meant when it opined that "negligence might be required to surcharge the trustee"[158] remains unknown. The Court has not had the opportunity since *Mosser* to determine whether a trustee's negligent breach of a fiduciary duty also subjects him or her to personal liability. Based on this statement and other considerations, however, courts have adopted three distinct levels of misconduct to subject trustees to personal liability for a breach of their fiduciary duties.[159] Some courts have followed *Mosser* and required a finding of intentional misconduct before imposing personal liability and a surcharge on a trustee.[160] Other courts have recognized that either negligent or willful misconduct may subject a trustee to personal liability.[161] Still other courts have adopted an intermediate level of misconduct, subjecting trustees to personal liability when the conduct was found to be grossly negligent.[162]

---

[155] *Id.* at 272–75.

[156] *Id.* at 272.

[157] *Id.*

[158] *Id.*

[159] *See generally* Dodson v. Huff (*In re* Smyth), 207 F.3d 758, 761 (5th Cir. 2000); LeBlanc v. Salem (*In re* Mailman Steam Carpet Cleaning Corp.), 196 F.3d 1 (1st Cir. 1999); *In re* Gorski 766 F.2d 723 (2d Cir. 1985); *In re* Chicago Pac. Corp., 773 F.2d 909 (7th Cir. 1985); Hall v. Perry (*In re* Cochise College Park, Inc.) 703 F.2d 1339 (9th Cir. 1983); Ford Motor Credit Co. v. Weaver, 680 F.2d 451 (6th Cir. 1982); Sherr v. Winkler, 552 F.2d 1367 (10th Cir. 1977); DiStefano v. Stern (*In re* J.F.D. Enters.), 223 B.R. 610 (Bankr. D. Mass. 1998); United States v. Lasich (*In re* Kinross Mfg. Corp.), 174 B.R. 702 (Bankr. W.D. Mich. 1994); *In re* Chicago Art Glass, Inc., 155 B.R. 180 (Bankr. N.D. Ill. 1993).

[160] *In re Chicago Pac. Corp.*, 773 F.2d at 915; *Weaver*, 680 F.2d at 461; *Sherr*, 552 F.2d at 1375.

[161] *In re Mailman*, 196 F.3d at 7; *In re Gorski*, 766 F.2d at 727; *In re Cochise College Park, Inc.*, 703 F.2d at 1357–58 n.26; *In re Kinross Mfg. Corp.*, 174 B.R at 706; *In re Chicago Art Glass*, 155 B.R. at 187.

[162] *In re Smyth*, 207 F.2d at 761; *In re J.F.D. Enters*, 223 B.R. at 628.

1. Intentional Breach of a Trustee's Fiduciary Duties

In the frequently cited but highly criticized case of *Sherr v. Winkler*, the Tenth Circuit examined a trial court's denial of the plaintiffs' claims for damages caused by a bankruptcy trustee's allegedly negligent and wrongful collection and use of their funds.[163] Instead of applying an immunity analysis to determine whether the trustee's actions with respect to the third parties were within or outside the scope of his authority, the court embarked on a fiduciary analysis, finding that the trustee had not "committed any willful or deliberate act or acts violative of his fiduciary duties which would render him *personally* liable."[164] The court also found that the trustee had not committed any "acts of negligence in his official capacity which would render him liable to the plaintiffs as trustee."[165]

The court looked to *Mosser* for guidance but, in so doing, both misread *Mosser* and confused basic terminology. Early in the opinion, the court found that pursuant to *Mosser*, "[t]he standard applicable to the surcharge of a bankruptcy trustee [was] negligence."[166] Later in the opinion, however, the court noted that *Mosser*

> established the rules that a trustee or receiver in bankruptcy is (a) not liable, in any manner, for mistake in judgment where discretion is allowed, (b) liable *personally* only for acts determined to be willful and deliberate in violation of his duties and (c) liable, in his official capacity, for acts of negligence.[167]

The court then explained that a bankruptcy trustee should not be held liable personally "unless he acts willfully and deliberately in violation of his fiduciary duties" but "may be held liable in his official capacity and thus surcharged if he fails to exercise that degree of care required of an ordinarily prudent person serving in such capacity, taking into consideration the discretion allowed."[168]

As explained by E. Allan Tiller in his critique of the *Sherr* opinion, *Mosser* never proposed that a trustee should be held personally liable and surcharged for negligent acts made in his official capacity.[169]

> On the contrary, that case shows just the opposite, for while the trustee in *Mosser* was found personally liable for a wilful and deliberate act, the result was a surcharge of the trustee. Surcharge, in other words, was and is merely the means of imposing personal liability upon a bankruptcy trustee or receiver for loss to the estate. It is certainly not, as the *Sherr* decision states, a means of imposing liability in his 'official capacity,' unless that phrase is to be given a meaning entirely opposite to its traditional definition, *i.e.*, where

[163] *Sherr*, 552 F.2d at 1369.
[164] *Id.* at 1376.
[165] *Id.*
[166] *Id.* at 1374.
[167] *Id.* at 1375.
[168] *Id.*
[169] Tiller, *supra* note 132, at 100.

> the estate rather than the fiduciary is required to bear loss to third persons . . . .[170]

The *Sherr* court first selected the wrong path of analysis, then misread *Mosser*, confused terminology, and made other misapplications of law.[171] The holding in *Sherr*, however, was relied upon by the Sixth Circuit in *Ford Motor Credit Co. v. Weaver*,[172] and the Seventh Circuit in the case of *In re Chicago Pacific Corp.*[173] where they too reviewed the personal liability of a bankruptcy trustee or equivalent debtor in possession.

In *Weaver*, the court examined whether the debtor in possession was personally liable to the creditors for a willful and deliberate breach of his fiduciary duty to safeguard the assets of the debtor, Weaver Farms.[174] After finding that the "principles governing the liability of a bankruptcy trustee" were applicable to a debtor in possession, the court adopted the holding in *Sherr*, and held that it could find the debtor in possession liable in his official capacity if he was negligent, and liable in his personal capacity only if he was willful and deliberate in violating his fiduciary duties.[175] With no findings of fact having been made by the lower courts as to the actions of the debtor in possession, the court remanded the case to the district court to determine if the debtor in possession either acted negligently as debtor in possession or "willfully and deliberately" as a fiduciary towards the creditors of the Weaver Farms' estate.[176]

While the Seventh Circuit in the case of *In re Chicago Pacific Corp.* agreed that "[a] trustee may be held personally liable only for a willful and deliberate violation of his fiduciary duties," it emphasized that an analysis of fiduciary liability was applicable to suits brought by creditors or shareholders, but not to suits brought by third parties who have no fiduciary relationship with the trustee.[177] The court made this very important distinction which was overlooked by the court in *Sherr*.

There appears to be disagreement within the Sixth and Seventh Circuits, however, as to whether trustees may be held personally liable only for willful and deliberate acts of misconduct. In the case of *In re Chicago Art Glass, Inc.*, a bankruptcy court in the Seventh Circuit recognized that negligent violations of duties imposed by law also warranted a finding of a breach of a fiduciary duty to the estate.[178] Similarly, a bankruptcy court in the Sixth Circuit, when addressing an action by a secured creditor against the trustee for an alleged breach of the trustee's duty for failing to protect and preserve property of the

---

[170] *Id.* at 100–01.
[171] *Id.* at 101.
[172] 680 F.2d 451, 461–62 (6th Cir. 1982).
[173] 773 F.2d 909, 915 (7th Cir. 1985).
[174] *Weaver*, 680 F.2d at 461.
[175] *Id.* at 462.
[176] *Id.*
[177] *In re Chicago Pac. Corp.*, 773 F.2d at 915.
[178] *In re* Chicago Art Glass, Inc., 155 B.R. 180, 187 (Bankr. N.D. Ill. 1993).

estate, found that a trustee who "negligently" performs his duties does not "faithfully" perform them under the standard set forth in the trustee's bond.[179] The court then explained that "any obligation whatsoever on the bond would be predicated upon negligent acts" by the trustee.[180] Finding trustees personally liable for negligent acts or omissions with respect to the bankruptcy estate and its beneficiaries is not foreign and has also been adopted by the First, Second, and Ninth Circuits.[181]

2. Negligent Breach of a Trustee's Fiduciary Duties

In the case of *In re Cochise College Park, Inc.*, the Ninth Circuit, in addressing a trustee's personal liability for breach of a fiduciary duty, held that a trustee "is subject to personal liability for not only intentional but also negligent violations of duties imposed upon him by law."[182] The court rejected the *Sherr* interpretation of *Mosser* that a reorganization trustee will not be personally liable unless his or her acts are willful and deliberate.[183] Instead, the court looked to the definition of the term "surcharge" and found it to mean the imposition of personal liability on a fiduciary for willful or negligent misconduct.[184] The court then held that:

> Properly construed, the language quoted from *Mosser* indicates merely that the sort of personal liability which may be imposed on a trustee for the acts of his employees is not strict liability but rather liability depending at least on a showing of the trustee's own negligence; *Mosser* does not "hold" in any sense that personal liability does not obtain if such a showing of negligence is made.[185]

Two years later, the Second Circuit in the case of *In re Gorski*, citing *Mosser* and *In re Cochise College Park, Inc.*, found that "a trustee in bankruptcy may be held personally liable for [a] breach of his fiduciary duties"[186] and that "[s]uch liability may attach as the result of negligent, as well as knowing or intentional, breaches."[187]

Around the same time, however, the First Circuit, in the case of *In re San Juan Hotel Corp*, followed *Mosser* and held that bankruptcy trustees are subject to personal liability for the willful and deliberate breach of their

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

180 *Id.*

181 Leblanc v. Salem (*In re* Mailman Steam Carpet Cleaning Corp.), 196 F.3d 1, 7 (1st Cir. 1999); *In re* Gorski, 766 F.2d 723, 727 (2d Cir. 1985); Hall v. Perry (*In re* Cochise College Park, Inc.), 703 F.2d 1339, 1357–58 (9th Cir. 1983).

182 *In re Cochise College Park, Inc.*, 703 F.2d at 1357.

183 *Id.* at 1357 n.26.

184 *Id.*

185 *Id.*

186 *In re Gorski*, 766 F.2d at 727 (citing Mosser v. Darrow, 341 U.S. 267 (1951)).

187 *Id.* (citing *In re Cochise College Park, Inc.*, 703 F.2d at 1357).

fiduciary obligations.[188] The court explained that because the trustee in the case acted intentionally, it "need not reach the issue of whether negligent acts also give rise to personal liability."[189] A decade later, however, the First Circuit did address the issue in the case of *In re Mailman*, and found that there was "simply no principled way after *Mosser* to avoid the conclusion that a bankruptcy trustee can be personally liable for negligent breach of fiduciary duty."[190] The court explained that:

> In our view, *Mosser*, properly construed, strongly indicates that parties interested in the administration of a bankruptcy estate can seek to surcharge the trustee for negligence. While *Mosser* itself involved "a willful and deliberate setting up of an interest in employees adverse to that of the trust," the Court took pains to clarify that "[t]he liability here is not created by a failure to detect defalcations, in which case negligence might be required to surcharge the trustee . . . ." The unmistakable implication of this observation is that, in the absence of deliberate misconduct, negligence suffices for surcharge.[191]

The court also found support for its decision in the definition of surcharge, which it claimed, "most fittingly," was defined as an imposition of personal liability on a fiduciary like the trustee for willful or negligent misconduct.[192]

One year before the First Circuit found trustees personally liable for negligent breaches of their duties, a bankruptcy court in the circuit took a different position when addressing a shareholder and creditor's complaint against a bankruptcy trustee personally for his alleged failure to preserve assets of the bankruptcy estate.[193] The court in the case of *In re J.F.D. Enterprises*, examined the ongoing dispute among the circuits with regard to the appropriate level of misconduct for imposing personal liability on a bankruptcy trustee for a breach of a fiduciary duty.[194] The court held that "*Mosser* cannot be extended any further than the proposition that trustees are personally liable for intentional violations of their fiduciary duties."[195] The court then embarked on its own analysis of the correct standard for imposing liability on a trustee for breach of a fiduciary duty.[196] After reviewing the Commission's 1997 Final Report,[197]

---

[188] Lopez-Stubbe v. Rodriguez-Estrada (*In re* San Juan Hotel Corp.), 847 F.2d 931, 936–37 (1st Cir. 1988).

[189] *Id.* at 937 n.5.

[190] LeBlanc v. Salem (*In re* Mailman Steam Carpet Cleaning Corp.), 196 F.3d 1, 7 (1st Cir. 1999).

[191] *Id.* (quoting *Mosser*, 341 U.S. at 272).

[192] *Id.*

[193] DiStefano v. Stern (*In re* J.F.D. Enters.), 223 B.R. 610, 618 (Bankr. D. Mass. 1998).

[194] *Id.* at 626.

[195] *Id.*

[196] *Id.* at 627.

[197] *See supra* notes 7–10 and accompanying text.

the court reasoned that "[i]mposing personal liability on trustees only for intentional harm" was unwarranted because it provided too much protection, discouraged responsible decision making, and jeopardized "the goal of expeditious and efficient administration of bankruptcy estates."[198] The court noted that more was expected of trustees in carrying out their duties.[199] The court also disagreed that trustees should be found liable for mere negligence because such an approach "underestimate[s] the role of a trustee under the Bankruptcy Code and the difficulties associated with a trustee's duties."[200] The court explained that:

> If the debtor is a business, the trustee will usually have little (or no) prior understanding of the industry in which the business operated. If further operation of the debtor's business is required, the trustee will be expected to make decisions presumably sounder than those of the principals who failed in that enterprise. If liquidation is the direction taken, the trustee will be expected to conduct that liquidation in a manner consistent with the industry in which the business operated. And the trustee is to accomplish these tasks without the unconditional confidence or assistance of any other actor in the case, except for that of her or his own agents. The court and the United States Trustee must remain disinterested. The debtor (or its principals, if the debtor is a corporation) certainly has no affection for the trustee. Secured creditors are the trustee's statutory adversaries. And unsecured creditors demand of the trustee the due performance of the trustee's duties, amid their underlying concern that the trustee may object to their claims, demand recovery of their prepetition gains as preferences or fraudulent transfers, and/or question their prepetition business activities with the debtor. Further, they often resent the dilution to their ultimate recovery that is caused by a trustee's involvement and resulting claim for compensation.[201]

Based on these considerations, the court concluded "that trustees should not be deemed to have violated their fiduciary duty and become subject to personal liability unless they are found to have acted with gross negligence."[202] The court additionally found that this standard should apply to trustees in both Chapter 7 and 11 cases because they "need the assurance of a more stable standard to which their actions will be held."[203]

While this third standard of misconduct was not adopted subsequently by the First Circuit in the case of *In re Mailman*, it was adopted by the Fifth Circuit as the appropriate level of trustee

[198] *Id.*
[199] *Id.*
[200] *Id.*
[201] *Id.* at 628.
[202] *Id.*
[203] *Id.* at 628 n.25.

misconduct to warrant a finding of personal liability for a breach of a fiduciary duty.[204]

3. *Grossly Negligent Breach of a Trustee's Fiduciary Duties*

The Fifth Circuit, in the case of *In re Smyth*, concluded that the proper level of misconduct to subject a bankruptcy trustee to personal liability "is gross negligence, an intermediate position."[205] The court relied on the "well-reasoned" opinion of *In re J.F.D. Enterprises*, agreeing that trustees need sufficient protection to persuade them to serve but not too much protection that might jeopardize the objective of efficient case management.[206] The court, quoting *In re J.F.D. Enterprises*, explained that "[t]his standard of care strikes the proper balance between the difficulties of the task assumed by trustees and the need to protect the interest of creditors and other parties in the bankruptcy case."[207]

Finding a trustee personally liable for conduct that is grossly negligent does provide a more balanced approach than subjecting trustees to potential personal liability for mere negligent conduct or solely for intentional acts or omissions. More courts should consider adopting this standard when addressing a personal liability claim against a bankruptcy trustee. This would bring uniformity to trustees as they attempt to fulfill their fiduciary duties to the estates and beneficiaries. Whatever standards courts ultimately adopt to find trustees personally liable, however, must be applied in the context of an analysis of a trustee's fiduciary liability and not in the context of his or her immunity from suit. This misapplication represents yet another area where courts have mingled the doctrines of immunity and fiduciary obligations and created an even more confused state of the law.

The final Part of this Article examines the very recent case of *In re Continental Coin Corp.* where the bankruptcy court[208] and the district court,[209] admittedly confused, improperly applied the levels of trustee misconduct associated with a fiduciary analysis to an immunity analysis. The Article closes with an application of the suggested four-step method of analysis to the facts of *In re Continental Coin Corp.*, arguing for its use to help courts avoid making mistakes in doctrinal analysis.

---

[204] *See* Dodson v. Huff (*In re* Smyth), 207 F.3d 758, 762 (5th Cir. 2000).

[205] *Id.* at 761.

[206] *Id.* at 761–62.

[207] *Id.* at 762 (quoting *DiStefano v. Stern* (*In re* J.F.D. Enters.), 223 B.R. 610, 628 (Bankr. D. Mass. 1998).

[208] *In re* Cont'l Coin Corp., 380 B.R. 1 (Bankr. C.D. Cal. 2007).

[209] Zamora v. Virtue (*In re* Cont'l Coin Corp.), No. CV 08-0093 (PA), 2009 WL 2589635 (C.D. Cal. Aug. 21, 2009).

VI. DOES AN APPLICATION OF THE METHOD HELP RELIEVE THE MADNESS?

In 2007, the United States Bankruptcy Court for the Central District of California received a request by the principal remaining creditor of Continental Coin Corporation to sue the Chapter 11 bankruptcy trustee and her law firm on behalf of the estate for the trustee's alleged failure

> to exercise her business judgment in a reasonable fashion when she initially refused to accept offers for sale of the ground leases and the personal property of the mint in 2002 (totaling about $1.1 million), failed to seek to set aside the order(s) allowing assumption of these leases on the ground that the orders were obtained without notice to creditors, did not employ a real estate broker to pursue offers, failed to undertake diligent marketing efforts, and further delayed sale because she alleged a $2.5 million offer for the Sepulveda Blvd. Property (which offer movant infers never existed or was not credible).[210]

The creditor sought recovery from the trustee and her law firm on the legal theories of negligence, gross negligence, breach of fiduciary duty, and breach of statutory duty.[211] The creditor's request to bring suit was made in accordance with the provisions of the debtor's confirmed Chapter 11 plan of reorganization.[212]

The impetus for the complaint appeared to be the fact that some two-and-a-half years after the trustee's appointment, upon approval of the court, the trustee concluded a sale of the same property for an amount less than expected, which may have contributed to a confirmed plan that provided for a "less than one hundred percent payout to creditors."[213] The court explained that based upon the creditor's request to sue the trustee, the court was required to determine whether the proposed complaint stated a claim for relief or, in other words, "whether the trustee and/or her counsel [were] entitled to immunity . . . or to an absolute defense (if the complaint [was] allowed to be filed) . . . ."[214]

The bankruptcy court initially embarked on a discussion of trustee fiduciary liability citing the aforementioned Commission's recommendations for subjecting trustees to suit personally in Chapter 7, 12, and 13 cases for gross misconduct, and in Chapter 11 corporate cases, only to the extent that the trustees failed to meet the standards of care of officers and directors of the corporations.[215] The court reasoned that since the Bankruptcy Code provided no guidance on exactly when a

---

210 *In re Cont'l Coin Corp.*, 380 B.R. at 3.
211 *Id.* at 3–4.
212 *Id.* at 1.
213 *Id.* at 3.
214 *Id.* at 4.
215 *Id.* at 4 (quoting NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 842 (1997)).

trustee is liable personally for his or her acts or omissions, courts have had to craft "the concept of quasi-judicial immunity or derived immunity, with certain courts conferring greater protection on the trustee than is given by other courts."[216] The court immediately examined the three levels of misconduct that might subject a trustee to personal liability but applied them in an immunity analysis, making the following recommendation, "[w]ere I in the position of crafting an appropriate policy for trustee liability, I would posit that a chapter 7, 12, or 13 trustee is entitled to immunity except for acts or omissions of 'gross negligence' or willful and intentional acts in violation of a trustee's fiduciary duty."[217]

Based on its position, the court then embarked on an immunity analysis determining first whether the doctrine applied to the trustee and then analyzing whether the specific acts complained of were of a type "to which immunity should attach."[218] The court used the *Antoine* and *Castillo* two-part test to assess the trustee's immunity and determined that the act of selling estate assets was a function adjudicatory in nature and protected.[219] The court found that "the trustee ha[d] complete immunity for all actions taken concerning the sale of estate property."[220] Following its policy, however, the court then found that this immunity did not release a trustee from personal liability when his or her acts are either "a breach of the duty of loyalty (such as self-dealing) or are due to gross negligence or a deliberate or willful breach of [a] duty of care."[221]

The court reviewed the cases of *In re Castillo*, an immunity case, and *In re Cochise*, a breach of fiduciary duty case, when it addressed the level of "quasi-judicial immunity" applicable to trustees in the Ninth Circuit.[222] As noted previously, the Ninth Circuit in the case of *In re Castillo* found the trustee immune from suit brought by the Chapter 13 debtor for the trustee's alleged negligence in miscalendaring and failing to notice a planned confirmation hearing.[223] The *In re Castillo* court found the act to be a judicial function entitling the trustee to quasi-judicial immunity.[224] As the court correctly noted, it did not have to reach the debtor's allegation that the trustee should be liable for negligence since it had found the trustee immune from suit.[225]

---

[216] *Id.* at 6.

[217] *Id.*

[218] *Id.* at 10.

[219] *Id.* at 10–11; *see* Antoine v. Byers & Anderson Inc., 508 U.S. 429, 432–33 (1993); Curry v. Castillo (*In re* Castillo), 297 F.3d 940, 949 (9th Cir. 2002).

[220] *In re Cont'l Coin Corp*, 380 B.R. at 11.

[221] *Id.*

[222] *Id.* at 11–12; *see* Curry v. Castillo (*In re* Castillo), 297 F.3d 940, 943 (9th Cir. 2002); Hall v. Perry (*In re* Cochise College Park, Inc.), 703 F.2d 1339, 1357 (9th Cir. 1983).

[223] *In re Castillo*, 297 F.3d at 953.

[224] *Id.* at 952.

[225] *Id.* at 953.

In the case of *In re Cochise*, however, the Ninth Circuit examined an act of the trustee that neither was approved by a court nor equivalent to a judicial function, but instead involved a possible breach by the trustee of a fiduciary duty owed to beneficiaries of the estate.[226] Therefore, an immunity analysis was not relevant, and the court analyzed the level of liability that would subject a trustee to personal liability, finding that both negligent and intentional misconduct was actionable.[227]

Unfortunately, the bankruptcy judge in the case of *In re Continental Coin Corp.* was admittedly confused as to these two doctrines and their proper application by the Ninth Circuit when he noted "that [he did] not understand the fine distinction made that allows the Ninth Circuit to rule that a trustee is entitled to quasi-judicial immunity for negligence (*Castillo*) and yet can be subject to personal liability for negligence (*Cochise*)."[228] In conclusion, the bankruptcy court found that the Ninth Circuit excuses a trustee from suit for mere negligence but "does not protect him from actions that are deemed to be gross negligence or for acts of intentional wrongdoing."[229] The court granted the creditor the right to bring a cause of action against the trustee personally for alleged acts of gross negligence or willful and deliberate violations of her fiduciary duties but denied the creditor the right to sue the trustee personally for both negligent acts and acts or omissions "which fall under the business judgment rule . . . ."[230]

The trustee appealed the ruling, asserting that she should be entitled "to absolute quasi-judicial immunity for any claim based on her decisions of how and when to sell the estate's assets," regardless of the level of any alleged misconduct.[231] The district court reviewed the bankruptcy court's conclusions of law on the issue of immunity de novo and, unfortunately, agreed with the bankruptcy court, making the same mistake of mingling the distinct doctrines of quasi-judicial immunity and fiduciary obligations.[232] The court found that quasi-judicial immunity extended to the trustee's actions of evaluating and selling assets of the estate but limited that immunity only to negligent mistakes and to acts or omissions that fall within the business judgment rule.[233] The court admitted additional confusion by noting that "[i]t is unclear what, if any, difference exists between the business judgment rule and quasi-judicial immunity."[234]

[226] *In re Cochise College Park, Inc.*, 703 F.2d at 1356–57.
[227] *Id.* at 1357.
[228] *In re* Cont'l Coin Corp., 380 B.R. 1, 14 (Bankr. C.D. Cal. 2007).
[229] *Id.* at 15.
[230] *Id.* at 17.
[231] Zamora v. Virtue (*In re* Cont'l Coin Corp.), No. CV 08-0093 (PA), 2009 WL 2589635, at *2 (C.D. Cal. Aug. 21, 2009).
[232] *Id.* at *2, *11.
[233] *Id.* at *7.
[234] *Id.*

If the courts addressing the creditor's claims in the cases of *In re Continental Coin Corp.* had applied, instead, the four-step method of analysis proposed by this Article, then they would have avoided making the destructive errors that led to their unreliable opinions. Pursuant to this method, an analysis of the request by the creditor to sue the trustee personally would have started with a careful examination of the allegations of the trustee's misconduct within the scope of her duties in the bankruptcy system. The alleged misconduct in the case, as recognized by the court, was the trustee's failure to exercise proper business judgment in liquidating certain property of the estate. Specifically, the creditor did not like the fact that the trustee (a) did not accept an earlier offer that was for an amount that was not much more than what the property appears to have been sold for years later, (b) did not market the property in a way that the creditor thought prudent, and (c) delayed a sale while allegedly waiting on a higher offer that did not materialize.[235] The fact that the creditor framed the allegation of misconduct as a negligent and grossly negligent breach of a fiduciary duty instead of a mere mistake in business judgment may have added to the courts' analytical confusion early on.

Based on the four-step method, however, after carefully identifying the creditor's claims against the trustee as mere mistakes in business judgment, and no more, the courts would have classified the claimant. The aggrieved party in the case of *In re Continental Coin Corp.* was a creditor of the bankrupt estate who was interested in the administration of the estate and hopefully a 100% payoff of its claim pursuant to a plan of reorganization.[236] He would be classified as a beneficiary of the estate owed the fiduciary duties imposed on the trustee by common law as well as the statutory duties provided by the Bankruptcy Code.[237]

Recognizing that a beneficiary of the bankruptcy estate was complaining about the business judgment of the trustee when marketing and selling estate property, the courts then would have determined whether the trustee, in her fiduciary role, might be immune from suit either (1) because she was acting pursuant to a court agreement, or (2) the acts or omissions complained of were adjudicatory in nature. At this juncture, the bankruptcy court simply could have denied the creditor's request to sue the trustee personally on the basis that the allegations made were typical complaints asserted in hindsight by a creditor who was disgruntled with a sale that had been previously ordered by the court. Instead, the court took the position that what was being contested by the creditor was a "non-sale," separate and apart from the previously ordered sale.[238] The court, however, continued its immunity analysis and found the trustee's acts or omissions in marketing

[235] *In re Cont'l Coin Corp.*, 380 B.R. at 3.
[236] *Id.* at 1.
[237] *See supra* notes 65–66 and accompanying text.
[238] *In re Cont'l Coin Corp.*, 380 B.R. at 11 n.28.

and selling estate property to be adjudicatory in nature, entitling the trustee to immunity for this alternate reason.[239] In making this finding, however, the court relied predominately on a case where the court had the benefit of a prior court order agreeing to the trustee's actions.[240]

Pursuant to the proposed four-step method of analysis, the *In re Continental Coin Corp.* courts, upon finding the trustee entitled to immunity from suit, would have ended their review and denied the creditor's request to sue the trustee personally. Instead, the courts continued their analysis, qualifying the immunity pursuant to the levels of misconduct applicable to a trustee's potential fiduciary liability and holding that the trustee was immune from suit for negligent misconduct but not immune from suit for grossly negligent or willful misconduct.[241] The courts' mingling of the doctrines of immunity and fiduciary obligations was improper. A trustee is either immune from suit or not, and the levels of misconduct associated with an analysis of a trustee's fiduciary liability to beneficiaries of an estate do not apply to an immunity analysis.

A more palatable result might have been a recognition by both courts that marketing and selling property is distinguishable from a truly adjudicatory act, such as noticing and calendaring a hearing as addressed in *In re Castillo*, and that as such, the doctrine of immunity was not applicable. At this juncture, the courts would have progressed to step four in the analysis and reviewed the trustee's potential personal liability under one of the two exceptions to the immunity doctrine. Having classified the claimant earlier as a beneficiary interested in the administration of the estate, the bankruptcy court, pursuant to step four, would have selected the second exception to the immunity doctrine and examined whether the trustee's misconduct subjected her to personal liability. At this stage in the analysis, the levels of misconduct normally would have been applicable. However, in this case, the trustee's acts or omissions were mere mistakes in business judgment for which she would not be held liable. Recognizing this universally accepted absolute defense to trustee liability, the courts would have dismissed the case.

If the *In re Continental Coin Corp.* courts had followed the proposed method of analysis, they would have segregated the applications of the doctrines of immunity and fiduciary obligations and would have understood why the Ninth Circuit was able to find a trustee's negligent conduct associated with calendaring and noticing a hearing to be protected from suit while a trustee's negligent breach of a fiduciary duty to be actionable. Additionally, the district court would have understood that the business judgment rule might protect trustees from "heavy

[239] *Id.* at 11.

[240] *Id.* at 10–11 (citing Harris v. Wittman (*In re* Harris), No. 06cv1939 WGH (RBB), 2007 WL 2456202 (S.D. Cal. Aug. 21, 2007)).

[241] *Id.* at 3.

liabilities" in accordance with *Mosser* but not from suit.[242] The courts also would have come to a more reliable conclusion that the trustee was entitled to immunity from suit personally or, if not, an absolute defense to liability based on the business judgment rule.

VII. CONCLUSION

While courts may continue to engage in a healthy dialogue of the exact level of misconduct that subjects a bankruptcy trustee to personal liability for a breach of his or her fiduciary duties, they need to avoid setting precedent based on a faulty analysis and a basic misunderstanding of applicable doctrines and terminology. Trustees in bankruptcy, with their unique challenges, need to be able to rely on the common law for guidance as they perform their statutory and fiduciary duties.

To alleviate making errors, courts should attempt to follow a more uniform method of analysis. The four-step method of analysis proposed in this Article and outlined in the following Addendum provides courts with a structured framework within which they may more consistently evaluate a trustee's immunity or potential personal liability in an effort to avoid destructive mistakes and to provide more reliable conclusions.

[242] *See* Mosser v. Darrow, 341 U.S. 267, 274 (1951).

ADDENDUM

FOUR-STEP METHOD OF ANALYSIS TO DETERMINE A BANKRUPTCY TRUSTEE'S PERSONAL IMMUNITY OR LIABILITY

STEP 1: *Carefully identify and understand the claimant's allegations* of trustee misconduct in light of the trustee's fiduciary and statutory duties.

STEP 2: *Classify the claimant* as either a beneficiary of, or third party to, the bankruptcy estate.

STEP 3: *Apply the doctrine of immunity* to determine whether the trustee is *personally immune from suit* brought by:

- A. A *beneficiary of the estate* because the alleged misconduct was either:
  1. Agreed to by the court after proper notice and disclosure; or
  2. Judicial in nature.
- B. A *third party to the estate* because the alleged misconduct was either:
  1. Agreed to by the court after proper notice and disclosure;
  2. Judicial in nature; or
  3. Committed in the trustee's official capacity within the scope of his or her authority.

If the trustee is immune from suit personally with respect to either class of claimant, then the suit should be dismissed. With respect to third parties, however, claims against trustees for misconduct committed in their official or *representative* capacity may remain actionable against the estate.

STEP 4: Should the trustee not be immune from suit personally, then apply one of the two exceptions to the immunity doctrine *to determine if the trustee is liable personally* to:

- A. A *beneficiary of the estate* because the alleged misconduct is more than a mere mistake in business judgment and is negligent, grossly negligent or intentional, as applicable;
- B. A *third party to the estate* because the alleged misconduct is *ultra vires* or outside the scope of the trustee's authority.