

Bankruptcy Trustee Liability

I. Background Perspective of Bankruptcy Trustee Liability

Bankruptcy trustees often step into storms of controversy with huge expectations placed on them by creditors, but little assistance from the debtor or its insiders, and no prior knowledge of the debtor or its industry. With regard to trustees, one bankruptcy court stated:

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 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.

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

To compound the trustees' dilemmas, they appear to owe conflicting duties to various parties whose own interests conflict with the bankruptcy estate and each other. Bankruptcy
DAL 76,636,079v3 3/13/2008

trustees also are frequently confronted by angry creditors who want to sue someone, even the trustees that are trying to help them. In fact, "[f]requently, a creditor's first reaction upon receiving notice of the debtor's bankruptcy case is anger. . . . The creditor wants to sue somebody. . . . [T]he trustee is a tempting target. A higher standard of liability [than simple negligence] will dissuade unfounded or petty suits while not eliminating possible legitimate claims."

Mark Ian Agee, *Personal Liability of Bankruptcy Trustees to the Estate and to Parties in Interest: A Comment*, Norton Bankruptcy Law Adviser, Annual Survey of Bankruptcy Law, 1987, Part I, p. 315, 326-27. Such creditors are unfairly armed with the benefit of hindsight, whereas the trustee must operate with only foresight.

Most courts are generally sympathetic to the dilemmas that trustees face. "Trustees are often obligated to make difficult business judgments and the best that disinterested judgment can accomplish with foresight may be open to serious criticism by obstreperous creditors aided by hindsight. Courts are quite likely to protect trustees against heavy liabilities for disinterested mistakes of business judgment." *Mosser v. Darrow*, 341 U.S. 267, 273-74 (1951). However, the law concerning bankruptcy trustee liability is confusing, at best. Rather, "[f]ew aspects of the bankruptcy law are as rife with confusion, misunderstanding and irreconcilable statements as the subject of the trustee's liability for his or her acts or omissions. There is no clear and well-settled body of law." Daniel R Cowans, *Bankruptcy Law and Practice*, 6th Ed., Vol. 1, § 2.6, p 161.

II. Chapter 7 Bankruptcy Trustee's Duties

A. Duties Imposed by Federal Statutes and Rules

Title 11 of the United States Code, 11 U.S.C. §§ 101, *et seq.* (the "Bankruptcy Code"), the Federal Rules of Bankruptcy Procedure, and other statutes and rules impose various duties and obligations on Chapter 7 bankruptcy trustees.

1. Duty to Maximize Value of Estate