Personal Liability for Bankruptcy Trustees: Determining the Limits of the Doctrine of Quasi-Judicial Immunity

Jessica McCorvey, J.D. Candidate 2015


Introduction

It has been more than fifty years since the Supreme Court issued its first and only opinion on the personal liability of a bankruptcy trustee.¹ In Mosser v. Darrow, the Supreme Court found a reorganization trustee personally liable for willful and deliberate misconduct, despite the trustee’s actions resulting in no loss to the debtor’s trust.² Mosser’s ruling created confusion among courts when determining whether a trustee should be immune or subject to personal liability.³ Indeed, “[c]ase law governing personal liability for trustees has been described by several courts as confusing and sometimes contradictory.”⁴ Moreover, the Bankruptcy Code does not provide any guidance regarding the immunity or personal liability of a bankruptcy trustee.⁵

Currently, bankruptcy trustees may shield themselves from suit for money damages by invoking the doctrine of quasi-judicial immunity. A bankruptcy trustee’s immunity from suit is

³ See McCullough, supra note 1, at 154.
⁵ See McCullough, supra note 1, at 154.
derived from the immunity historically afforded to judges.\(^6\) When acting in their judicial
capacity, judges are entitled to absolute immunity from suit.\(^7\) The immunity enjoyed by judges
extends to officials performing quasi-judicial duties.\(^8\) The doctrine of quasi-judicial immunity
applies to “[t]hose persons performing tasks so integral or intertwined with the judicial process
that these persons are considered an arm of the judicial officer who is immune.”\(^9\)

Although a bankruptcy trustee enjoys the protections of quasi-judicial immunity, his
immunity is not absolute. The doctrine of quasi-judicial immunity will not shield bankruptcy
trustees in lawsuit for money damages arising from (1) an intentional, negligent, or grossly
negligent breach of the bankruptcy trustee’s fiduciary duties; and (2) an action taken *ultra vires*
(i.e., an action that was outside the scope of the bankruptcy trustee’s authority). However, even if
a bankruptcy trustee’s actions fall within either standard of quasi-judicial immunity, he may still
be immune if he obtained prior court approval for such actions.

This Article will discuss the standards of quasi-judicial immunity applied to a bankruptcy
trustee in an effort to help clarify conflicting case law addressing this issue. Part I will analyze
when a bankruptcy trustee can be personally liable for intentionally breaching his fiduciary
duties, acting negligently, or acting with gross negligence. Part II will analyze when a
bankruptcy trustee’s *ultra vires* acts will subject him to personal liability. Part III will analyze
how a bankruptcy trustee obtaining prior court approval may provide him the benefits of quasi-
judicial immunity, even if his actions fall within one of the standards. Finally, Part IV will
conclude by suggesting how a bankruptcy trustee can avoid personal liability.

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\(^6\) See *In re* McKenzie, 716 F.3d at 412.
\(^7\) See *Bush v. Rauch*, 38 F.3d 842, 847 (6th Cir. 1994).
\(^8\) Id.
\(^9\) Id.
I. The Intentional, Negligent or Gross Negligent Breach of Fiduciary Duties Standard of Quasi-Judicial Immunity

Currently courts follow three main approaches when determining whether a bankruptcy trustee should be personally liable for a breach of his fiduciary duties while representing the estate.\(^{10}\) Those approaches include finding a bankruptcy trustee personally liable for damages resulting from: (1) the bankruptcy trustee intentionally breaching his fiduciary duties while representing the estate; (2) the bankruptcy trustee breaching of his fiduciary duties as result of his negligence while representing the estate; and (3) the bankruptcy trustee breaching his fiduciary duties as a result of his gross negligence while representing the estate.\(^ {11}\) Depending on the jurisdiction, courts may apply one or more of these approaches when determining whether a bankruptcy trustee should be personally liable for damages resulting from the bankruptcy trustee breaching his fiduciary duties.\(^ {12}\) This Part will briefly discuss each approach.

A. Intentional Breach of Fiduciary Duties

Courts universally agree that bankruptcy trustees should be personally liable for willfully and deliberately violating their fiduciary duties.\(^ {13}\) For example, in *In re San Juan Hotel Corp*\(^ {14}\), the First Circuit held a bankruptcy trustee personally liable for damages resulting the bankruptcy trustee intentionally violating his fiduciary duties by mismanaging the financial affairs of the San Juan Hotel Corporation. On May 20, 1980, the San Juan Hotel Corporation faced $40 million in debts and filed for bankruptcy under chapter 11 of the Bankruptcy Code.\(^ {15}\) In that same year,

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\(^{10}\) See McCullough, *supra* note 1, at 177-182.

\(^{11}\) *Id.*

\(^{12}\) *Id.* (describing different approaches used by Tenth, Ninth, and Fifth Circuit courts).

\(^{13}\) See *In re San Juan Hotel Corp*, 847 F.2d 931, 937 (1st Cir. 1988) (citing *In re Gorski*, 76 F.2d 723, 727 (2nd Cir. 1985)).

\(^{14}\) *Id.* at 955.

\(^{15}\) *Id.* at 935.
Manuel Estrada Rodriguez ("Rodriguez") was appointed as operating trustee.\textsuperscript{16} Hans Lopez Stubbe ("Lopez"), who replaced Rodriguez as trustee, quickly realized that Rodriguez had grossly mismanaged the estate by failing to implement necessary cost-saving measures, keeping inadequate financial records, deliberately failing to pay taxes, and using hotel resources for his personal benefit.\textsuperscript{17} In Lopez’s place, the United States, a large creditor of the estate due to outstanding tax liability, filed suit against Rodriguez.\textsuperscript{18}

Relying on \textit{Mosser v. Darrow},\textsuperscript{19} the court held that Rodriguez was personally liable to the estate for the damages resulting from the willful and deliberate violation of his fiduciary duties.\textsuperscript{20} The court found that quasi-judicial immunity did not apply when a trustee breached his fiduciary duties and caused an estimated harm to the estate.\textsuperscript{21} Additionally, the court rejected the idea that a proven, quantifiable loss to the estate is a prerequisite to personal liability for trustees.\textsuperscript{22}

\textbf{B. Negligent Breach of Fiduciary Duties}

Although courts have accepted that a bankruptcy trustee is personally liable for intentionally breaching his fiduciary duties, courts have split when determining whether a bankruptcy trustee can be liable for negligently breaching his fiduciary duties. “[T]he Fifth, Sixth and Tenth Circuits have held that mere negligence is insufficient to impose personal liability on a bankruptcy trustee.”\textsuperscript{23} Courts reason that finding a trustee liable for mere negligence does not

\textsuperscript{16} \textit{Id.}  
\textsuperscript{17} \textit{Id.}  
\textsuperscript{18} \textit{Id.}  
\textsuperscript{19} \textit{341 U.S. 267} (1951).  
\textsuperscript{20} \textit{See In re} San Juan Hotel Corp, 847 F.2d at 937.  
\textsuperscript{21} \textit{Id.} at 938.  
\textsuperscript{22} \textit{Id.}  
\textsuperscript{23} \textit{See In re} Ngan Gung Restaurant, 254 B.R. 566, 570 n.8 (Bankr. S.D.N.Y. 2000) (citing Dodson v. Huff (\textit{In re} Smyth), 207 F.3d 758 (5th Cir.2000), \textit{reh’g. denied} (May 12, 2000) (bankruptcy trustees should not be subjected to personal liability for damages to the bankruptcy estate unless they are found to have acted with gross negligence); Ford Motor Credit Co. v.
strike the “proper balance between the difficulties of the tasks assumed by the trustees and the need to protect the interest of creditors and other parties in the bankruptcy case.”

However, the First and Ninth Circuit courts disagree with the majority rule and hold that a bankruptcy trustee may be liable for damages resulting from his negligent breaches of his fiduciary duties. For example, in In re Cochise College Park, Inc., the Ninth Circuit held that a trustee was subject to personal liability not only for intentional acts, but also for negligently violating his statutorily-imposed duties. In 1972, Cochise, an Arizona corporation, filed a voluntary petition for corporate reorganization and Wallace Perry (“Perry”) was appointed trustee. Perry repeatedly told the land sale vendees (“Vendees”) to continue making payments on their promissory notes to protect their rights and threatened to foreclose on the mortgaged lots if payments were not made. The vendees filed a claim against Perry for any payments made in reliance on Perry’s intentional or negligent misrepresentations. The court held that if Perry negligently violated his fiduciary duties by receiving payments on executory land sale contracts on or after the date of filing of an involuntary petition but prior to the trustee’s rejection of the contracts, then he is personally liable to the vendees.

Many courts, including the Mosser court, opine that imposing liability on a bankruptcy trustee for negligence encourages the bankruptcy trustee to exercise care in performing his...
duties. Generally, however, a bankruptcy trustee will not be liable for reasonable mistakes in judgment even in a jurisdiction that imposes liability for negligent breaches of the bankruptcy trustee’s fiduciary duties.

C. Grossly Negligent Breach of Fiduciary Duties

In an effort to find a balance between the conflicting case law regarding a bankruptcy trustee’s personal liability for negligence, the Fifth Circuit adopted the gross-negligence standard. For example, in In re Smyth, the Fifth Circuit concluded that the proper level of misconduct to subject a bankruptcy trustee to personal liability “is gross negligence, an intermediate position.” In 1991, a group of creditors filed for involuntary chapter 7 bankruptcy against an individual real estate developer. After the case was converted to a chapter 11 reorganization, the bankruptcy court appointed Ken Huff as trustee. One of the creditors objected to the trustee’s application for a final decree closing the case and the trustee’s motion for the final payment of his commission due to various alleged errors in the trustee’s handling of the estate’s federal income taxes.

The Fifth Circuit held that there was insufficient evidence in the record to support a finding that the trustee was negligent, much less grossly negligent. The court explained that a bankruptcy trustee needs enough protection to persuade him to serve, but not too much protection to jeopardize the objective of efficient case management.

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32 Id.
33 Id. at 545.
34 See In re Smyth, 207 F.3d 758, 762 (5th Cir. 2000).
35 Id. at 760.
36 Id.
37 Id. at 762.
38 Id. at 761-72.
II. The *Ultra Vires* Standard of Quasi-Judicial Immunity

In addition to the breach of fiduciary duties standard to quasi-judicial immunity, an exception to quasi-judicial immunity exists for actions taken *ultra vires*, or outside the scope of the bankruptcy trustee’s authority. Section 704 of the Bankruptcy Code establishes the duties and responsibilities of a bankruptcy trustee. Among those duties include, (1) liquidating property of the estate for which the trustee serves; (2) investigating the financial affairs of the debtor; (3) examining proofs of claims and object to the allowance of any claim that is proper; and (4) furnishing information concerning the estate and the estate’s administration as requested by a party in interest. Based on the duties and responsibilities of a bankruptcy trustee listed in the Bankruptcy Code, if a bankruptcy trustee takes an action that falls outside of section 704, such action may be considered *ultra vires*.

Although a bankruptcy trustee may violate his fiduciary duties or another obligation imposed by law, the presence of such a violation does not mean that the trustee acted *ultra vires*. In determining whether a bankruptcy trustee’s actions were within the scope of his authority, courts presume that actions taken by a trustee in his official capacity “were a part of the trustee’s duties” unless facts demonstrating otherwise were previously alleged. Additionally, when determining whether a trustee’s actions were *ultra vires*, courts review whether the acts were within the scope of the trustee’s official duties. The court, however, will not consider whether the actions were meritless, without foundation, or brought for ulterior motives.

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40 Id.
42 *In re* McKenzie, 716 F.3d 404, 416 (6th Cir. 2013).
43 Id.
In practice, courts have only found that a bankruptcy trustee acts *ultra vires* in limited circumstances.44 Thus far, courts have only applied the *ultra vires* standard to a bankruptcy trustee’s seizure of property that is not a part of the debtor’s estate.45 Since bankruptcy laws do not permit trustees, on their own authority to seize property of a non-debtor, trustees who do so are held personally liable.46

For example, in *In re Lunan*, the husband of a chapter 7 debtor sued the debtor’s chapter 7 trustee for illegally selling his property and the property of his adult children when the trustee sold the debtor’s property.47 Two and a half years after the debtor’s initial bankruptcy filing, the trustee filed a notice of intent to sell the debtor’s real property by public auction.48 The trustee advised the husband to remove his artwork from the debtor’s property before the planned auction.49 The debtor’s husband cited several cases that held that a trustee acts *ultra vires* where the trustee took possession of property he believed did not belong to the debtor.50 The court held that the doctrine of quasi-judicial immunity applied to the instant case because the trustee obtained a court order before selling the debtor’s property through a planned auction.51 Further, the husband received a sufficient amount of time to remove his artwork from the debtor’s property before the auction.52 Finally, the court found that the trustee did not act *ultra vires* because the debtor scheduled the sale of the property at issue.53

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44 See McCullough, *supra* note 1, at 174.
45 See *In re McKenzie*, 716 F.3d at 415.
48 *Id.* at 714.
49 *Id.*
50 *Id.* at 726.
51 *Id.*
52 *Id.*
53 *Id.* at 727 (distinguishing facts from *Leonard v. Vrooman*, 383 F.2d at 556, 561 (9th Cir.)).
III. The Exception to the Exception: Acting Pursuant to a Prior Court Order

Even if a bankruptcy trustee violates his fiduciary duties, or acts ultra vires, he may still be shielded from personal liability if he obtained prior court approval before acting. The Supreme Court stated that trustees might avoid personal liability for wrongful acts by obtaining court approval before engaging in the act. Moreover, in an effort to rectify a clear conflict between the concept of quasi-judicial immunity and the ability to sue trustees, some federal courts, including the Ninth Circuit, now apply certain requirements that allow trustees to protect themselves and gain judicial immunity. Those requirements include: (1) giving notice to the debtor and obtaining prior court approval of the proposed act, and (2) providing candid disclosure to the court in furtherance of the requested approval.

For example, in In re Mailman, a creditor sued a bankruptcy trustee for negligence and breach of fiduciary duties for abandoning specific rights to revoke a settlement. The court 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.” The court found that the trustee had “wisely sought judicial approval” for the abandonment and therefore, was entitled to quasi-judicial immunity.

However, some courts have reasoned that while a trustee may avoid personal liability by

54 See Theresa J. Pulley Radwan, Trustees in Trouble: Holding Bankruptcy Trustees Personally Liable for Professional Negligence, 35 Conn. L. Rev. 525, 554 (2003) (citing Mosser), 341 U.S. at 274 (“In order to enjoy this protection, the trustee must notify all interested parties such that they have an opportunity to argue their position before the court. This assumes, of course, that the trustee has sufficient time to ask for a hearing and notify all interested parties.”)).
55 See Kashani v. Fulton (In re Kashani), 190 B.R. 875, 883-84 (9th Cir. 1995).
56 Id.
57 See LeBlanc v. Salem (In re Mailman Steam Carpet Cleaning Corp.), 196 F.3d 1, 8 (1st Cir. 1999).
58 Id.
59 Id. at 9.
obtaining prior court approval, neither the Bankruptcy Code nor the Mosser holding require him to do so. For example, in In Re McKenzie, the court concluded that a trustee who acts on behalf of the estate and within the scope of his authority is not required to obtain prior court approval to invoke quasi-judicial immunity from suit.60 Kenneth Still (“Still”) was appointed as the chapter 7 Trustee for Steve A. McKenzie’s, the debtor in a bankruptcy case.61 Still initiated an adversary proceeding against Grant, Konvalinka & Harrison (“GKH”), seeking the turnover of documents and records alleged to be a part of the debtor’s estate.62 GKH then filed two adversary proceedings against Still and his attorneys alleging malicious prosecution.63 The Sixth Circuit held that Still’s actions were not ultra vires.64 The court found that if a trustee seeks a court order directing the third party to turn over property that is allegedly property of the estate, the trustee will enjoy the protections of quasi-judicial immunity, even if the turnover action is ultimately unsuccessful.65 However, the court found that a bankruptcy trustee was not required to obtain a prior court approval before acting on behalf of the debtor’s estate.66

IV. Analyzing the Limits of Qualified Immunity

Thus far, case law addressing the issue of quasi-judicial immunity for a bankruptcy trustee has not been applied uniformly.67 This split generates uncertainty for bankruptcy trustees who may need guidance on the standards of conduct that their actions will be reviewed under

60 See In re McKenzie, 716 F.3d 404, 414 (6th Cir. 2013).
61 Id. at 409.
62 Id.
63 Id. at 411.
64 Id. at 414 (referring to holding in Leonard v. Vrooman, 383 F.2d 556, 560 (9th Cir. 1967), where court explained proper course of action for chapter 7 trustee who wants to seize property is to go to court and obtain turnover order directing delivery of property not part of bankruptcy estate asset).
65 Id.
66 Id. at 414.
67 See McCullough, supra note 1 at 153.
when a court determines whether such conduct gives rise to personal liability. This uncertainty may affect how aggressively the bankruptcy trustee performs his duties, which could ultimately reduce creditors’ recoveries.

The following questions, derived from the case law determining the scope of a bankruptcy trustee's quasi-judicial immunity, may give bankruptcy trustees some guidance on their personal liability and help courts follow a uniform method of analysis:

1. Are the proposed plaintiffs seeking a judgment against the bankruptcy trustee personally? If yes, then the bankruptcy trustee may seek protection under the doctrine of quasi-judicial immunity. If no, then the doctrine of quasi-judicial immunity would not apply.

2. Do the claims pertain to actions of the bankruptcy trustee while administering the estate? If yes, then the bankruptcy trustee may seek protection under the doctrine of quasi-judicial immunity. If no, then the doctrine of quasi-judicial immunity would not apply.

3. Were the acts or transactions related to the carrying on of business connected with the property of the estate? If yes, then the bankruptcy trustee may seek protection under the doctrine of quasi-judicial immunity. However, if the bankruptcy trustee’s actions involved the seizure of property that is not part of the debtor’s estate, then he may find himself within the ultra vires standard to quasi-judicial immunity.

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68 Id. at 156.
69 See In re Kashani, 190 B.R. 875, 886-87 (B.A.P.. 9th Cir. 1995).
70 Id.
71 Id.
4. Do the claims involve the bankruptcy trustee breaching his fiduciary duties either through negligent or willful misconduct?\textsuperscript{72}

If yes, then depending on the jurisdiction where the claim is adjudicated, the bankruptcy trustee may not be protected under the doctrine of quasi-judicial immunity if he breached his fiduciary duties through negligent or willful misconduct. In contrast, mere mistakes in business judgment will not fall within this standard.

5. Was the bankruptcy trustee acting within the scope of his authority under statute, or orders of the bankruptcy court?\textsuperscript{73}

If yes, then the bankruptcy trustee will likely receive immunity from suit, even if his actions fall within one of the two standards to quasi-judicial immunity.

If a bankruptcy trustee actively follows the above questions before acting on behalf of the debtor and the debtor’s estate, then he will have a better understanding of whether his actions will fall under the doctrine of quasi-judicial immunity.

\textbf{Conclusion}

Currently, the doctrine of quasi-judicial immunity shields bankruptcy trustees from suit for money damages. However, a bankruptcy trustee will not be shielded from lawsuit for damages arising from (1) an intentional, negligent, or grossly negligent breach of the bankruptcy trustee’s fiduciary duties; and (2) an action taken \textit{ultra vires}. Although courts do not uniformly apply the negligence and gross negligence approaches to a bankruptcy trustee’s breach of his fiduciary duties, courts universally agree that a bankruptcy trustee is personally liable for willfully and deliberately breaching his fiduciary duties. Additionally, courts universally agree that a bankruptcy trustee acts \textit{ultra vires} when he seizes property that is not a part of the debtor’s

\textsuperscript{72} Id.

\textsuperscript{73} Id.
estate. However, even if a bankruptcy trustee’s actions fall within either standard of quasi-judicial immunity, he may still be immune if he obtained prior court approval for such actions.

If bankruptcy courts wish to alleviate errors when determining a bankruptcy trustee’s immunity, then judges should ask the above-mentioned questions to follow a more uniform analysis.\(^{74}\) Bankruptcy trustees maintain a unique and crucial position in bankruptcy proceedings that require the utmost diligence and commitment.\(^{75}\) Therefore, bankruptcy trustees deserve to know when their actions will afford them the protections of quasi-judicial immunity. If not, trustees may be less inclined to actively perform their duties on behalf of the debtor and the debtor’s estate.

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\(^{74}\) See McCullough, \textit{supra} note 1 at 153.