ST. JOHN'S UNIVERSITY
SCHOOL OF LAW

Whose Claim is it Anyway?—Direct and Derivative Claims in the Context of Bankruptcy Litigation

2016 Volume VIII No. 14

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Cite as: *Whose Claim is it Anyway?—Direct and Derivative Claims in the Context of Bankruptcy Litigation*, 8 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 14 (2016)

Introduction

In bankruptcy litigation, the line between direct and derivative claims may be a thin one, and courts are often entrusted with the task of determining whether the claims creditors set forth are actually derivative of claims owned by the bankruptcy estate. Companies entering into bankruptcy proceedings have the option of creating litigation trusts, which are authorized to pursue any claims the bankruptcy estate may own. A release of claims is often part of any settlement agreement, and such an agreement combined with the ownership of claims by the bankruptcy estate, often controlled through a litigation trust, can leave defrauded investors out in the cold with no means to pursue their claims. With the growing use and power of litigation trusts, investors, especially those of the distressed variety, should be forewarned that they may be barred from bringing certain claims because those claims may belong to the bankruptcy estate and are properly brought by the estate or trustee.

Recent cases indicate that certain claims, which investors wish to bring, may be deemed derivative of those belonging to the bankruptcy estate. Particularly, in *In re SemCrude*, the U.S.

Court of Appeals for the Third Circuit found that the claims of breach of fiduciary duty, negligent misrepresentation, and fraud set forth by limited partners against the co-founder and former president and CEO of SemCrude L.P. were derivative of claims held by SemCrude's litigation trust because they could not demonstrate any additional loss they experienced as compared to that of the corporation.[1] Using Oklahoma state law, the Third Circuit determined that the plaintiffs would need to establish that they "sustained any loss *in addition to* the loss sustained by the corporation" in order for the court to hear their claims.[2] If an investor can demonstrate this sort of additional loss, that would indicate that he has his own direct claims that he may properly bring before the court. Without such a demonstration, an investor lacks standing to bring her claim.

Similarly, in *Marshall v. Picard*, the U.S. Court of Appeals for the Second Circuit enjoined state law tort actions brought by two of Bernie Madoff's defrauded investors against one of Madoff's alleged co-conspirators and related defendants.[3] Consequently, the recent tide of cases indicates that courts hold in great esteem the rights of the bankruptcy estate and require the demonstration of particularized injuries by individual investors before claims can be considered to be direct ones. Thus, in order for investors to bring their own lawsuits against officers, directors, or others whose wrongful actions may have caused the losses they experienced, within the context of bankruptcy litigation, they must be able to establish that they have an articulable, particularized injury that is not directly the result of the harm to the corporation or partnership. Crucially, some courts will find a claim to be direct where the investor can demonstrate that he

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[1] *See* 796 F.3d 310, 312–13, 322 (3d Cir. 2015).
[2] *Id.* at 316 (quoting *Dobry v. Yukon Elec. Co*., 290 P.2d 135, 138 (Okla. 1955) (internal quotation marks omitted) (emphasis in original)).
[3] *See* In re Bernard L. Madoff Inv. Secs., 740 F.3d 81, 84, 96 (2d Cir. 2014).

sustained any loss in addition to the loss sustained by the corporation, and consequently, then that creditor can properly bring the claim.

Part I of this article discusses the formation of litigation trusts in bankruptcy proceedings and the powers such trusts possess. Part II details the analysis of direct versus derivative claims to explain what rights investors may have in bankruptcy proceedings as they seek to pursue causes of action against the directors, officers, and others whose wrongful actions may have caused them to experience great losses. Recent cases are employed to illustrate the rules of law that the courts have developed to deal with the recent phenomenon of litigation trusts and how the classic direct or derivative claim conundrum takes on new meaning in the context of bankruptcy litigation. This article concludes that without a particularized injury, a court will likely deem a claim derivative of that belonging to the litigation trust and prevent the investor from bringing such a claim.[4]

I. The Formation and Powers of a Litigation Trust

[4] Though this article focuses on direct and derivative claims with special regard to litigation trusts, it is important to note that the rules discussed here are not the only ones governing the ability of creditors to bring claims against those whose wrongful actions contributed to the losses the creditors endured. For example, in *Shearson Lehman Hutton, Inc. v. Wagoner*, the Second Circuit determined that, under New York law, "when a bankrupt corporation has joined with a third party in defrauding its creditors, the trustee cannot recover against the third party for the damage to the creditors." 944 F.2d 114, 118 (2d Cir. 1991). There, the court found that the bankruptcy trustee lacked standing to pursue fraud claims against the debtor company's brokers where the company's sole shareholder was not only aware of, but also directed bad investments pursued by the brokers. *Id.* at 120. Under this rule, a claim against a third party for defrauding the corporation with the assistance of management belongs to the creditors rather than the guilty corporation. *Id.* The *Wagoner* rule is premised upon "the fundamental principle of agency that the misconduct of managers within the scope of the employment will normally be imputed to the corporation." Wight v. BankAmerica Corp. 219 F. 3d 79, 86 (2d Cir. 2003). A related doctrine is that of *in pari delicto*, short for *in pari delicto potior est conditio defendentis*, which translates to, " 'In a case of equal or mutual fault. . .the position of the [defending] party. . .is the better one.' " Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985) (quoting BLACK'S LAW DICTIONARY 711 (5th ed. 1979)). This potential defense is premised on the idea that courts should not use their resources to resolve disputes among wrongdoers, and that denying relief to a wrongdoer is an effective deterrent for illegality. *See id.*

In recent years, litigation trusts have come to play a progressively more important and noticeable role in chapter 11 bankruptcy proceedings.[5] As these trusts have become more common in bankruptcy proceedings, the courts have begun to develop rules for dealing with some of the issues that have arisen in response to the heightened prevalence of such trusts.[6] Litigation trusts are designed to pursue claims that belong to the debtor estate for the benefit of the creditors or that estate.[7] When a litigation trust is created, the power to prosecute causes of action belonging to the debtor is transferred to the trust so that it can pursue these claims and distribute the proceeds to creditors.[8] Consequently, litigation trusts are similar to class action litigation, in that the claims are consolidated and brought by a single party representing all others with a similar claim, and whereby, individuals wishing to bring their own claims individually are prevented from doing so.

Litigation trusts are created as part of the bankruptcy plan.[9] When a reorganization plan is confirmed, unless the plan provides otherwise, all property of the bankruptcy estate vests in the

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[5] *See* Paige Holden Montgomery & Casey A. Burton, *An Introduction to Litigation Trusts*, ABA SECTION OF LITIGATION: COMMERCIAL & BUSINESS (May 23, 2013) http://apps.americanbar.org/litigation/committees/commercial/articles/spring2013-0513-an-introduction-to-litigation-trusts.html (indicating that over the past decade, chapter 11 proceedings have given rise to a number of litigation trusts).

[6] *See id.* ("Courts have only just begun to address some of the important issues related to the existence of litigation trusts and their use to pursue claims on behalf of the creditors of an existing debtor.").

[7] *See id.* (providing that litigation trusts are entities whose "*raison d'etre* is solely the pursuit of certain litigation interests belonging to the debtor's estate at the time of the bankruptcy petition").

[8] *See id.* ("A litigation trust is a trust created for the benefit of creditors of a debtor to prosecute and distribute the proceeds of certain causes of action belonging to the debtor that are transferred the litigation trust as part of the bankruptcy plan.").

[9] *See* Andrew J. Morris, *Clarifying the Role of Litigation Trusts: Why Post-Confirmation Trustees Cannot Assert Creditors' Claims Against Third Parties*, 20 AM. BANKR. INST. L. REV. 589, 600–01 (2012) (indicating that often a reorganization plan creates a state-law trust to hold the estate's claims against third parties and appoints the bankruptcy trustee as the post-confirmation trustee that is in charge of litigating those claims) (internal citations omitted).

reorganized debtor.[10] This means that the bankruptcy estate ceases to exist and thus, loses its ability to pursue claims.[11] Indeed, the filing of a bankruptcy petition creates an estate that includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[12] Under title II of the United States Code ("the Bankruptcy Code"), "a plan may provide for the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest."[13] Through this provision, the Bankruptcy Code furnishes a means by which claims can continue to be prosecuted even after the debtor estate ceases to exist. The plan must, however, provide for this retention or else the claims will be forever lost. Notably, a litigation trust is permissible, but not required under the Bankruptcy Code.[14]

A litigation trust ultimately is the result of a contract between the debtor and its creditors during the reorganization proceedings aimed at attaining additional monetary recovery for the creditors.[15] Thus, the litigation trust is focused on maximizing the recovery for the creditors to narrow the gap between what was already recovered through the reorganization and liquidation

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[10] *See* 11 U.S.C. § 1141(b) (2012) ("Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.").

[11] *See* 11 U.S.C. § 541 (2012) (rendering the estate property to include causes of action that the debtor could have asserted).

[12] Highland Capital Mgmt. LP v. Chesapeake Energy Corp (*In re* Seven Seas Petroleum, Inc.) 522 F.3d 575, 584 (5th Cir. 2008) (quoting 11 U.S.C. § 541(a)(1) (internal quotation marks omitted)).

[13] 11 U.S.C. § 1123(b)(3)(B) (2012).

[14] *See id.* (stating that a plan "*may provide for*" the retention of claims) (emphasis added).

[15] *See* Montgomery & Burton, *supra* note 5 (positing that "[a] litigation trust is formed through the agreement between the debtor and its creditors. . .in the hope that those assets can be utilized to provide an additional cash recovery for the assets").

processes and what the allowed claims are.[16] Endowed by these powers, litigation trusts have become increasingly influential and popular in recent years, and creditors may find themselves locked out of litigating claims they wish to bring because the litigation trusts hold all the cards.

II. Direct and Derivative Claims in Bankruptcy Litigation

Often, when an investment becomes troublesome and depreciates in value due to misrepresentations or fraud on the part of the directors and officers, and the company is in bankruptcy, investors wish to pursue claims against the directors or others that caused the bankruptcy. Where a litigation trust has been formed, creditors are extremely limited in what claims they may pursue. Regardless of whether a litigation trust is formed, however, a creditor is constrained in her ability to bring claims. On the most basic level of analysis, a creditor may not bring claims unless they are direct claims against an officer, director, or other entity that caused that creditor to suffer losses outside of those to the debtor estate. Where a claim is deemed to be derivative of those belonging to the bankruptcy estate and assigned to the litigation trust, an investor will be unable to bring that lawsuit. This section divides the discussion of claims that may be brought by investors into (A) a background section on direct and derivative claims brought in bankruptcy litigation, and (B) an illustration of how investors' claims are likely to be treated in the context of bankruptcy litigation based on two relatively recent cases—*In re SemCrude L.P.* and *Marshall v. Picard*.

A. Claims in Bankruptcy Litigation

Both the formation of litigation trusts and the reorganization process are carefully delineated procedures governed by both the Bankruptcy Code and existing case law. It is well

[16] *See id.* ("Where those actions do not result in payment in full to all categories of creditors, the litigation trust has been used in recent years as an attempt to bridge the gap between what was recovered and what was owed.").

established that, "[t]he trustee stands in the shoes of the debtor, and may bring any suit that the debtor could have brought before bankruptcy."[17] Under section 544(a) of the Bankruptcy Code, the trustee also acts as agent for the creditors.[18] The trustee is not, however, able to "assert the personal, direct claims of creditors for the benefit of the estate or for a particular class of creditors."[19]

Commonly, the claims that a creditor wishes to bring as a result of the bankruptcy will be claims governed by state law.[20] Indeed, in bankruptcy litigation, a court often turns to state law to determine which claims are direct and belong to the investors, and which claims are derivative and belong to the estate.[21] Consequently, state law from the state of incorporation or where the partnership was formed "determines whether the right to sue belongs to the debtor or the individual creditors."[22] The distinction between direct and derivative claims is crucial to such

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[17] *In re* The 1031 Tax Group, LLC, 397 B.R. 670, 679 (Bankr. S.D.N.Y. 2008) (citing *In re* Granite Partners, L.P., 194 B.R. 318, 323–24 (Bankr. S.D.N.Y. 1996)).

[18] *See id.* (citing 11 U.S.C. 544(a)) (highlighting that "the trustee also stands in the shoes of creditors").

[19] *Id.* (quoting *In re Granite Partners, L.P.*, 194 B.R. at 324); *see also Hirsch v. Arthur Anderson & Co.*, 72 F.3d 1085, 1093 (2d Cir. 1995) ("Under the Bankruptcy Code, the bankruptcy trustee may bring claims founded, *inter alia*, on the rights of the debtor and on certain rights of the debtor's creditors.") (internal quotation marks omitted).

[20] Many of the lawsuits investors wish to bring involve state law tort claims, and thus, in a diversity action will be governed by state law. Also, such claims are sometimes brought in state court in which case state law will likewise govern the decision. It is important to note, however, that where there is a conflict of laws between state and federal law, the federal law will "preempt" the state law. *See* U.S. CONST. art. VI., cl.2; *see also* Altria Group, Inc. v. Good, 555 U.S. 70, 76 (2008) (quoting Maryland v. Louisiana, 451 U.S. 725, 746 (1981) ("[W]e have long recognized that state laws that conflict with federal law are 'without effect.' ")).

[21] *See In re The 1031 Tax Group, LLC*, 397 B.R. at 679 (citing *In re* Johns-Manville Corp., 517 F.3d 52, 63 (2d Cir. 2008)); *In re* Ionosphere Clubs, Inc., 17 F.3d 600, 604 (2d Cir. 1994); *In re Granite Partners*, 194 B.R. at 324; *In re* Keene Corp., 164 B.R. 844, 849 (Bankr. S.D.N.Y. 1994).

[22] *Wight*, 219 F.3d at 86 (quoting Mediators, Inc. v. Manney (*In re* Mediators, Inc.), 105 F.3d 822, 825 (2d Cir. 1997)) (internal quotation marks omitted).

litigation because it goes to the heart of standing.[23] If an individual tries to bring a claim that is determined by the court to be derivative of claims belonging to the bankruptcy estate, the court will determine that she has no standing.[24] Courts have held that when assessing standing, a court "must look to the underlying wrongs as pleaded in the complaint and whether the plaintiff alleges a particularized injury."[25] If a corporation suffers an injury, and the shareholders suffer only though the diminished value of their stock, the corporation owns the claim.[26] Conversely, where a third party's wrongful actions injure an investor's rights as opposed to the corporation, that investor may seek a direct action against the third party.[27] Such a direct action may be pursued where the alleged conduct breaches a separate duty owed to the shareholder, or where the conduct causes the investor to suffer an injury distinct to that suffered by the corporation.[28] Where an investor claims a particularized injury, that individual can pursue a separate action even if the corporation suffers an injury from the same alleged wrongful conduct.[29] For litigation involving limited partnerships, similar rules are followed.[30] Essentially, if creditors want to bring a claim in state or federal court against an alleged wrongful party, they must demonstrate that

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[23] *See In re Granite Partners, L.P.*, 194 B.R. at 324 ("If the cause of action belongs to the estate, the trustee has exclusive standing to assert it; conversely, if the cause of action belongs solely to the shareholders or creditors, the trustee has no standing to assert it." (citing Schertz-Cibolo-Universal City, Indep. Sch. Dist. v. Wright (*In re* Educators Group Health Trust), 25 F.3d 1281, 1284 (5th Cir. 1994))).

[24] *See id.*

[25] *In re Johns-Manville*, 517 F.3d at 63.

[26] *See In re Granite Partners, L.P.*, 194 B.R. at 325 (citing Vincel v. White Motor Corp., 521F.2d 1113, 1118 (2d. Cir. 1975) ("Where a corporation suffers an injury, and the shareholders suffer solely through the diminution in the value of their stock, the claim belongs to the corporation.")).

[27] *See id.* (citing *In re Ionosphere Clubs, Inc.*, 17 F.3d at 605).

[28] *See id.* (citing Cowin v. Bresler, 741 F.2d 410, 415 (D.D.Cir. 1984).

[29] *See id.* (citing Lipton v. News Int'l, Plc, 514 A.2d 1075, 1079 (Del. 1986)).

[30] *See* Lenz v. Associated Inns & Restaurants Co., 833 F. Supp 362, 380 n. 18 (S.D.N.Y. 1993); *see also* Strain v. Seven Hills Assocs., 75 A.D. 2d 360, 370 (1st Dept. 1980) ("In determining whether a cause of action is derivative in nature regarding limited partnership law, the case law relevant to corporation law may be looked for guidance.").

their claim is not derivative of that possessed by the bankruptcy estate by demonstrating either a separate breach of duty or a particularized injury, or else risk having no standing to bring the case.

B. Recent Decisions on Direct and Derivative Claims

The U.S. Courts of Appeal for the Third and Second Circuits have provided relatively recent decisions on direct and derivative claims in the context of bankruptcy litigation that are particularly illuminating of how a court is likely to rule when presented with an alleged direct claim. Those two decisions, as introduced above, are *In re SemCrude, L.P.* and *Marshall v. Picard*. Although only *In re SemCrude* involved a litigation trust, a discussion of each of these cases aids in understanding where the courts stand on causes of action asserted by investors rather than the bankruptcy estate or litigation trust and the likelihood that investors will be able to pursue such claims.

1. *In re SemCrude L.P.*

In *SemCrude*, the Third Circuit determined that the claims of breach of fiduciary duty, negligent misrepresentation, and fraud alleged by limited partners against the co-founder and former president and CEO of SemCrude L.P. were derivative of the claims held by SemCrude's litigation trust.[31] SemCrude L.P., an Oklahoma-based oil and gas company, was co-founded by Thomas Kivisto, who allegedly drove the company into bankruptcy due to self-dealing and speculative trading strategies.[32] In July 2008, SemCrude, along with its parent company and certain subsidiaries, filed petitions for relief under chapter 11 with the United States Bankruptcy Court for the District of Delaware.[33] In October 2009, the bankruptcy court issued an order

[31] *See* 796 F.3d at 312–13, 322
[32] *See id.* at 312.
[33] *See id.* at 314.

confirming SemCrude's plan of reorganization, which established a litigation trust.[34] The plan specifically transferred the claims belonging to SemCrude's bankruptcy estate to the litigation trust and authorized the trust to pursue SemCrude's claims and distribute any money attained to SemCrude's creditors.[35] The litigation trust asserted thirty claims, including breach of fiduciary duty, breach of contract, fraudulent transfer, and unjust enrichment, against Kivisto and certain SemCrude officers.[36] In November 2010, the bankruptcy court approved a $30 million settlement agreement, which also incorporated a mutual release of all claims.[37] Particularly, pursuant to the court-approved settlement agreement, the litigation trust released Kivisto and other officers from being accountable to any party for "contribution or indemnity to the released claims."[38]

On December 22, 2010, a group of limited partners, known to the court as the "Oklahoma Plaintiffs," filed a lawsuit against Kivisto and PricewaterhouseCoopers LLP, SemCrude's pre-bankruptcy auditor in Oklahoma state court.[39] The Oklahoma Plaintiffs alleged that Kivisto concealed his self-dealing and speculative trading, and vigorously misrepresented SemCrude's financial health to coax them into investing extra capital or retaining their investments in SemCrude.[40] Specifically, the Oklahoma Plaintiffs attempted to differentiate themselves from other limited partners by arguing that they were personally approached by Kivisto, and contrary to other limited partners, they did not hold board provisions, nor were they privy to "sweetheart

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[34] *See id.*
[35] *See id.*
[36] *See id.*
[37] *See id.*
[38] *See id.*
[39] *See id.*
[40] *See id.* at 313–14 (discussing how the Oklahoma Plaintiffs alleged they were personally induced into paying millions of dollars in capital contributions to SemCrude L.P. through their reliance on Kivisto's misrepresentations and omissions).

side deals."[41] Kivisto submitted an emergency motion to the bankruptcy court to enjoin the Oklahoma Plaintiffs' lawsuit from proceeding in state court and enforce the settlement agreement.[42] The bankruptcy court granted Kivisto's motion, but on appeal, the District Court reversed and remanded the matter to the bankruptcy court on all three claims.[43] On remand, the bankruptcy court denied Kivisto's motion to enjoin, and Kivisto appealed the denial of his motion to the Third Circuit.[44]

Under the derivative injury rule, a shareholder cannot sue for "personal injuries that result directly from injuries to the corporation."[45] The Third Circuit determined that, under Oklahoma law, the derivative injury rule is not applicable when a shareholder claims that he or she "sustained any loss *in addition to* the loss sustained by the corporation."[46] The court further noted that this standard applies equally to cases involving limited partnerships.[47] The court referred to *Dobry v. Yukon Electric Company*, which all the parties agreed provided the governing standard for determining whether a claim is direct or derivative under Oklahoma law.[48] In *Dobry*, the Oklahoma Supreme Court emphasized that where an alleged loss flows from management's wrong to the company that in turn affects the shareholder's stock and affects all shareholders alike, the claims are derivative.[49] Ultimately, the Third Circuit concluded that the Oklahoma Plaintiffs' claims for negligent misrepresentation, fraud, and breach of fiduciary duty

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[41] *See id.* at 314.
[42] *See id.*
[43] *See id.*
[44] *See id.*
[45] *Id.* at 316 (quoting Kaplan v. First Options (*In re* Kaplan), 143 F.3d 807, 811-12 (3d. Cir. 1998) (internal quotation marks omitted)).
[46] *Id.* (quoting *Dobry*, 290 P.2d at 138 (internal quotation marks omitted) (emphasis in original)).
[47] *See id.* (citing Okla. Stat. Ann. tit. 54, § 500–1001A(b)).
[48] *See id.* ("The parties agreed that *Dobry* creates the governing standard for determining the derivative status of claims in Oklahoma.").
[49] *See id.* at 317 (explaining a quote from *Dobry*, 290 P.2d at 137).

failed to demonstrate any additional loss compared to SemCrude's loss as a whole, and thus, their claims were derivative of those discharged by the litigation trust.[50] Having found the claims to be derivative, the court directed the bankruptcy court to enter a permanent injunction forbidding the Oklahoma Plaintiffs from proceeding in Oklahoma state court.[51]

2. *Marshall v. Picard*

In *Marshall*, the Second Circuit enjoined state law tort actions brought by two of Bernard Madoff's defrauded investors against one of Madoff's alleged co-conspirators and related defendants.[52] In this case, the Second Circuit followed a similar path to that of the Third Circuit in analyzing the derivative claims of investors, even though the proceeding did not involve a litigation trust. Prior to the Second Circuit proceedings, the investment enterprise Madoff created to effect his Ponzi scheme had entered into liquidation proceedings under the Securities Investment Protection Act ("SIPA"), with Irving Picard appointed as the trustee of the bankruptcy estate.[53] Under SIPA, the trustee is tasked with liquidating the failed broker-dealer and satisfying claims made by the failed enterprise's customers.[54] Pursuant to the liquidation proceedings, the trustee commenced an adversary proceeding against the defendants alleging that they had made improper withdrawals totaling $6.7 billion, which was ultimately increased to $7.2 billion to include further withdrawals.[55] While the trustee was in settlement talks with the defendants, certain investors attempted to file their own claims against the defendants in the United States District Court for the Southern District of Florida, and the United States

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[50] *See id.* at 316–17.
[51] *See id.* at 322.
[52] *See In re Bernard L. Madoff Inv. Secs.*, 740 F.3d at 84, 96.
[53] *See id.* at 84–85.
[54] *See id.* at 85 ("A trustee's primary duty under SIPA is to liquidate the broker-dealer and, in doing so, satisfy claims made on or behalf of the broker-dealer's customer for cash balances." (citing *In re* Bernard L. Madoff Inv. Sec. LLC, 654 F.3d 229, 233 (2d Cir. 2011)).
[55] *See id.*

Bankruptcy Court for the Southern District of New York promptly granted a preliminary injunction enjoining the Florida actions.[56] The liquidation trustee and the defendants ultimately entered into a settlement agreement, which included both a release of all potential claims by the trustee and a permanent injunction to enjoin any customers from suing the defendants for claims related to the Ponzi scheme.[57] The District Court approved the settlement, and the Florida plaintiffs appealed.[58]

On appeal, the Second Circuit determined that the Florida investors' claims were derivative of those asserted by the trustee for the estate against the defendant, and rejected the investors' argument that their claims were "particularized" to the defendants.[59] The Second Circuit noted that the "touchstone" for a bankruptcy court's jurisdiction over a non-debtor's claim is "whether its outcome may have any conceivable effect on the bankruptcy estate."[60] Thus, claims that are derived from those belonging to the bankruptcy estate may be released. Contrarily, the court acknowledged that non-debtors with a particularized injury retain the right to prosecute such a case, and the bankruptcy court has limited jurisdiction to approve the release of any such claims.[61] Indeed, where a creditor can demonstrate a particularized injury in addition to that belonging to the estate, that creditor may not be enjoined from bringing the case.

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[56] *See id.* at 85–86.
[57] *See id.* at 86.
[58] *See id.* at 87.
[59] *See id.* at 84, 96.
[60] *See id.* at 88 (quoting Quigley Co. v. Law Officers of Peter G. Angelos (*In re* Quigley Co.), 676 F.3d 45, 57 (2d Cir. 2012) (internal quotation marks omitted)).
[61] *See id.* (quoting *Hirsch*, 72 F.3d 1093 ("Put another way, 'when creditors. . . have a claim for an injury that is particularized as to them, they are exclusively entitled to pursue that claim, and the bankruptcy trustee is precluded from doing so.' ")).

The court ultimately found that the Florida lawsuits did not trace a particularized injury to the conduct of Madoff's alleged co-conspirators.[62] Instead, the lawsuits primarily sought to repair the harm caused by the same withdrawals that the liquidation trustee sought to redress.[63] As noted above, the liquidation trustee had pursued an adversary proceeding against the defendants, but had settled and released the rights to all the claims, just as the trust had done in *In re SemCrude, L.P.*[64] Moreover, the Second Circuit held that the injury was not particularized because it involved damages that all of Madoff's victims suffered.[65]

Taken together, these two cases demonstrate the potential limitations of investors' ability to bring claims. Distressed investors should be forewarned that they could be barred from bringing certain claims because those claims could be brought by the bankruptcy estate under its powers. A litigation trust is just one way that investors could be hindered from bringing their claims. The bankruptcy trustee could hold all the cards in a proceeding and give away the rights to bring such claims pursuant to a settlement agreement. The line between direct and derivative claims may be a thin one, and recent cases, including these two, indicate that the claims of investors are likely to be deemed to be derivative of claims owned by the bankruptcy estate. *Marshall v. Picard* bolsters the potential importance of the Third Circuit's decision in *In re SemCrude L.P.*, and both cases illustrate that courts view the rights of the bankruptcy estate in high regard and will be hesitant to view the claim of an individual investor as direct unless there is an explicit demonstration of a particularized injury.

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[62] *See id.* at 92–93.
[63] *See id.*
[64] *See id.* at 88.
[65] *See id.* at 93.

Conclusion

Recent decisions by the Third and Second Circuits illustrate how the courts hold in great esteem the rights of the bankruptcy estate and require the demonstration of particularized injuries by individual investors before claims can be considered direct, and thus, cognizable by the court. Without a particularized injury, a court will deem a claim derivative of that belonging to the litigation trust and prevent the investor from pursuing such a claim. The similar state and federal law requirements of a particularized injury for a claim to be direct signal that these recent decisions have important implications for the future of bankruptcy litigation in relation to the comparative rights of individual investors and a bankruptcy estate.