St. John's University
SCHOOL OF LAW

St. John's Bankruptcy Research Library
A project of St. John's School of Law and the American Bankruptcy Institute Law Review

2009 Volume I No. 11

# Allowing Trustee Removal for Cause, *Sua Sponte*, After Notice and a Hearing

**Jonathan Grasso, J.D. Candidate 2010**

## Introduction

The issue of whether a bankruptcy judge can *sua sponte* remove a trustee has rarely been addressed; however, two courts have recently considered the issue. The Bankruptcy Appellate Panel in *Morgan v. Goldman (In re Morgan)*, 375 B.R. 838 (B.A.P. 8th Cir. 2007) and the U.S. Court of Appeals for the Eleventh Circuit in *Walden v. Walker (In re Walker)*, 515 F.3d 1204 (11th Cir. 2008) both concluded that a bankruptcy judge has the ability to remove a trustee "for cause," *sua sponte*, after "notice and a hearing."

*Morgan* was the first case to ever deal with the issue of *sua sponte* removal of a trustee. In *Morgan*, the lower court determined without any prior motion by a party that "cause" existed to remove the trustee due to her conflict of interest. *See* Morgan v. Goldman (*In re* Morgan), 375 B.R. 838, 848 (B.A.P. 8th Cir. 2007). The majority opinion of the appellate panel upheld the lower court judge's action, briefly stating that a bankruptcy judge has the power to remove a trustee *sua sponte*. The concurring in part and dissenting in part opinions in the *Morgan* case shed more light on the reasons for and against allowing *sua sponte* removal.

*Walker* was only the second, as well as the most recent court to deal with the issue of *sua sponte* removal of a trustee. In *Walker*, the lower court dealt with the issue of whether the debtor had standing because the debtor made a motion himself to have the trustee removed. Although *Walker* had a different procedural background than *Morgan*, the circuit court in *Walker*

Cite as: *Allowing Trustee Removal for Cause, Sua Sponte, After Notice and a Hearing*, 1 ST. JOHN'S BANKR. RESEARCH LIBR. No. 11, at 1 (2009), http://www.stjohns.edu/academics/graduate/law/journals/abi/sjbrl_main/volume/v1/grasso.stj (follow "View Full PDF").

ultimately concluded that a trustee could potentially be removed *sua sponte* as well. Since *Walker* held that the court could remove the trustee *sua sponte*, the standing issue became moot.

There are several implications that come from the holdings of *Morgan* and *Walker*. First, the courts within the Eighth and Eleventh Circuits are now empowered to remove a trustee whenever "notice and a hearing" are given and "cause" exists. Second, since courts can remove a trustee *sua sponte*, the issue of standing is no longer relevant within a trustee removal motion within the *Morgan* and *Walker* jurisdictions. Additionally, since *Morgan* and *Walker* are the only two courts that have dealt with the *sua sponte* issue, they will likely provide strong persuasive authority in other jurisdictions.

This paper regarding s*ua sponte* removal of a trustee will be divided into four sections. First, the statute governing the removal of a trustee will be described. Second, the *Morgan* case will be discussed by initially looking at the facts of the case, then turning to the holding of the court, and finally looking at the dissent of the court. Third, the *Walker* case will be discussed by initially looking at the facts of the case, which will be followed the holding of the court. Fourth, the implications of the *Morgan* and *Walker* case will be examined.

## Statute

Removal of a trustee is governed by Section 324 of the Bankruptcy Code, which provides that "[t]he court, after notice and a hearing, may remove a trustee. . . for cause." 11. U.S.C. § 324 (a) (2006). The two elements of this statute most frequently litigated are whether the "notice and a hearing" are adequate, and whether "cause" exists. The requirements of "notice and a hearing" are set out in Section 102, which provides for removal "after such notice as is appropriate in the particular circumstances and such opportunity for a hearing as is appropriate in

the particular circumstances." 11 U.S.C. § 102 (2006). When sufficient notice and an opportunity for a hearing are not provided, an order removing a trustee can be vacated. *See In re* Waller, 331 B.R. 489, 493 (Bankr. M.D. Ga. 2005). Because the Code does not explain what "cause" means, it is determined on a case-by-case analysis. The most common removal "for cause" is when a conflict of interest exists between the trustee and another party in the bankruptcy proceeding, *See In re* Baker, 38 B.R. 705, 707 (D. Md. 1983), such as when a trustee is discovered to have formally worked as an attorney and officer for the landlord of the debtor. *See In re Oliveri*, 45 F. Supp. 32, 32 (E.D.N.Y. 1933)

## Discussion

I. Recent cases deciding *sua sponte* issue

a) Morgan Case

i) Facts of the Case

In *Morgan*, the court dealt with the issue of whether a judge may remove a trustee *sua sponte*. *Morgan* involved a trustee, Ms. Jo-Ann Goldman, who was disbursing funds in violation of an agreement with the debtor. *See In re Morgan*, 375 B.R. at 844. On March 3, 2003, James and Linda Morgan filed for chapter 13, thereby creating an amended plan that stated all disposable income Ms. Goldman received during the first thirty six months of the amended plan would be paid to the unsecured creditors. *See In re Morgan*, 375 B.R. at 842 (citing 11 U.S.C. § 1325 (b) (1) (2006)).

A dispute arose over whether a personal injury settlement within the first thirty six months of the amended plan would be considered disposable income. *See id*. at 842. Ms. Goldman eventually made an informal agreement with the Morgans to use the settlement money

to pay the secured home mortgage lender. *See id.* Subsequent to the agreement, the court approved the motion to settle. In compliance with the court order, on May 5, 2005, Ms. Goldman received the $30,056.03 from the settlement. *See id.* at 844.

Ms. Goldman's office did not distribute the settlement funds in accordance with the agreement Ms. Goldman made with the Morgans. Even though Ms. Goldman agreed to use the settlement amount to pay the home mortgage lender, Ms. Goldman's office distributed $20,056.03 of the settlement to the unsecured creditors. (The remaining $10,000 was given to the Morgans to repair their roof and car). Ms. Goldman's office distributed the $20,000 to the unsecured creditors because that was the normal practices of her office. The Morgans filed an action against Ms. Goldman because she distributed the settlement funds in violation of the agreement that the money be used to pay off their home mortgage. *See id.*

Ms. Goldman gave conflicting testimony at two different hearings regarding the distribution of the settlement payments. During a hearing on May 10, 2006, Ms. Goldman admitted she broke her agreement with the Morgans to use the settlement money to pay off the Morgans' home mortgage. She further testified that she meant to make a note of this agreement but forgot. Since Ms. Goldman failed to make a note of her agreement with the Morgans, her office mistakenly released the funds to the unsecured creditors according to its customary practice. *See id.* at 852. However, at a later hearing in November 2006, Ms. Goldman stated that she did not have an agreement with the Morgans to use the remaining $20,000 from the settlement to pay off the Morgans' home mortgage. She further stated that she properly distributed the funds to the unsecured creditors. *See id.* at 854.

The lower court upon its own motion stated that a hearing would be held on January 19, 2007, where Ms. Goldman could attempt to justify why she should not be removed as trustee. At

the January 2007 hearing, the court determined that Ms. Goldman should be removed as trustee of the Morgans' estate. The "cause" for Ms. Goldman's removal was that she had given false testimony to the court at the November hearing. *See id.* at 846–47.

ii) Holding and Reasoning of Case

The majority opinion of *Morgan* found *sua sponte* removal in the lower court was appropriate based on statutory interpretation of Section 324 of the Bankruptcy Code. The court in *Morgan* noted Section 324 does not provide specifically that a "party in interest" must make a motion for removal of the trustee. The court held that because the statute does not restrict who needs to make a motion to remove a trustee, *sua sponte* removal should be allowed. *See In re Morgan*, 375 B.R. at 848.

Chief Judge Kressel's concurring in part and dissenting in part opinion for *Morgan* takes a more in-depth look at why *sua sponte* removal is appropriate under Section 324. Kressel bases his viewpoint that Congress deliberately wished to allow *sua sponte* removal of a trustee by breaking up the Bankruptcy Code in three different categories. First, there are many provisions that require a "party in interest" to make a motion as well as "notice and a hearing" to be given. Next, there are many statutes that require "notice and a hearing", but do not require a "party in interest" to make a motion. Last, there are some provisions that require neither "notice and a hearing" or a request by a "party in interest." Judge Kressel found that the use of the term "party in interest" in some provisions means that Congress did not wish for a "party in interest" requirement to be applied when it was not expressly provided for in the statute. *See In re Morgan*, 375 B.R. at 856.

iii) Dissent

Bankruptcy Judge Mahoney in his concurring in part and dissenting in part opinion of *Morgan* argues that Section 324 does not allow *sua sponte* removal of a trustee. Mahoney finds it problematic that the majority is unable to cite a single case where a trustee under Section 324 is removed without a motion by a third party. *See id.* at 857. Judge Mahoney also points to language quoted by the majority opinion in *Alexander v. Jensen-Carter (In re Alexander)*, 289 B.R. 711 (B.A.P. 8th Cir. 2003), which states that "the movant bears the burden of establishing cause by setting forth specific facts which support such removal." *In re Morgan*, 375 B.R. at 857 (quoting *In re Alexander*, 289 B.R. at 714). Since "movant" is defined as "one who makes a motion to the court," BLACK'S LAW DICTIONARY 1035 (7th ed. 1999), Mahoney argues that use of the word "movant" assumes that a third party is making a motion. However, Mahoney notes, *sua sponte* removal by definition does not have to be brought by a motion by a third party. *See In re Morgan*, 375 B.R. at 857. Mahoney further states that when a judge acts *sua sponte* he becomes both the "movant" in addition to being the trier of fact. Mahoney asserts this dual role is improper especially when other procedures could be followed to prevent its occurrence. For instance, judges could ask the Office of the United States trustee to look into the potential problem and make a suggestion to the court. *See id.* at 858.

b) Walker Case

i) Facts of Case

*Walker* was the second and most recent case to decide the issue of *sua sponte* removal of a trustee from a bankruptcy proceeding. Linda J. Walden was elected by creditors to be the trustee of James F. Walker's chapter 7 bankruptcy proceeding. Ms. Walden signed a Verified

Statement stating that she did not have any connections with the creditors in Mr. Walker's proceeding besides being the receiver in a connected matter. *See* Walden v. Walker (*In re* Walker), 515 F.3d 1204, 1206 (11th Cir. 2008). Later at the Ratification Hearing, Mr. Walker claimed that Ms. Walden had a connection to creditor Carl Shuhi, who had the second biggest claim in the proceeding. Ms. Walden denied Mr. Walker's claims, testifying that she never received any money from or worked for Mr. Shuhi. *See id.* at 1207.

On August 23, 2004 Mr. Walker filed a motion to have Ms. Walden removed as trustee. Mr. Walker alleged that Ms. Walden did accounting work for Mr. Shuhi, produced an expert report for Mr. Shuhi, and was the registered agent for two of Mr. Shuhi's businesses. To prove the relationship between Ms. Walden and Mr. Shuhi, Mr. Walker introduced numerous pieces of evidence. For example, during the 2000 case, Mr. Shuhi's attorney testified that Ms. Walden would be their expert and that he met with Ms. Walden several times in that context. *See id.* at 1207. Additionally, during two depositions for the 2000 case, Mr. Shuhi testified that Ms. Walden was his expert for the case. Mr. Shuhi further testified at these depositions that Ms. Walden was the CPA for his business and was also his personal CPA. *See id.* at 1208.

On November 17, 2004, the bankruptcy judge held that Ms. Walden did have connections to Mr. Shuhi prior to Mr. Walker's bankruptcy proceeding and gave false testimony to the court that these connections did not exist. Ms. Walden subsequently filed her appeal with the United States Court of Appeals for the Eleventh Circuit. *See id.* at 1209.

ii) Holding

The circuit court in *Walker* held that a bankruptcy judge could remove a trustee *sua sponte* if cause existed. *See id.* at 1212. However, this issue was not actually the issue presented before the court. As stated earlier, the debtor made a motion to have the trustee removed in the

lower court. *See id.* at 1207. The actual issue presented to the circuit court was whether the debtor had standing to make his motion. However, the court held that it did not need to determine the standing issue since *sua sponte* power to remove the trustee was granted under Section 324 of the Bankruptcy Code. *Walker* based its reasoning for *sua sponte* removal on the same statutory interpretation grounds as *Morgan*. *See id.* at 1212.[1]

II. Implications

There are two implications within the Eighth and Eleventh Circuits that come from the *Morgan* and *Walker* holdings. First, courts now have the power to remove a trustee *sua sponte*, even though some claim that Section 324 does not authorize *sua sponte* power. Second, now that bankruptcy courts can remove a trustee *sua sponte* there is no longer any benefit for the trustee to argue the point of standing because the court has the power to bring the issue regardless of an individual's standing. Since the standing issue has been removed, the trustee is only left with the ability to argue whether proper "notice and a hearing" were given and whether "cause" for the removal actually exists.

In addition to removing the requirement of standing within the Eighth and Eleventh Circuits, the *Morgan* and *Walker* holdings may also have an effect on courts in other circuits. Two circuits have now stated that there can be *sua sponte* removal of a trustee, while no court has affirmatively disallowed *sua sponte* removal, other circuits may follow suit in allowing *sua sponte* removal. Individuals may begin to argue in favor of *sua sponte* removal if a trustee opposes the motion on standing grounds. Even if an argument is not made in favor of *sua sponte* removal, as seen in *Walker*, a court may still find that *sua sponte* removal is allowed without a party ever presenting the issue to the court. Therefore, a trustee in opposition to a motion for

trustee removal may have to consider whether or not to address why *sua sponte* removal should not be allowed when standing is an issue, even if the party making the motion does not make a *sua sponte* argument.

[1] The circuit court also held that an additional reason to remove Ms. Goldman existed independent from her false testimony. Ms. Goldman had a conflict of interest in attempting to settle her own liability, while ignoring the interests of the unsecured creditors. *See id.* at 855.