Concurrent Session

Keep Your License: Ethical Issues for Consumer Bankruptcy Attorneys, Debtor and Creditor

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2009 Educational Materials

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:	)	
GREEKTOWN HOLDINGS, LLC, *et al.*[1],	)	Case No. 08-53104 Chapter 11 Jointly Administered
Debtors.	)	
	)	Honorable Walter Shapero

MOTION OF THE UNSECURED CREDITORS' COMMITTEE PURSUANT TO 11 U.S.C. §§ 105(a), 107(b) AND 1102(b)(3)(A) FOR AN ORDER *NUNC PRO TUNC* CONFIRMING THAT THE COMMITTEE IS NOT REQUIRED TO PROVIDE ACCESS TO CONFIDENTIAL INFORMATION OF THE DEBTORS OR PRIVILEGED INFORMATION

For its Motion pursuant to 11 U.S.C. §§ 105(a), 107(b) and 1102(b)(3)(A) for an Order *Nunc Pro Tunc* Confirming that the Committee is Not Required to Provide Access to Confidential Information of the Debtors or Privileged Information (the "Motion"), the Official Committee of Unsecured Creditors (the "Committee") states:

Jurisdiction

1. This Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

2. The statutory predicates for the relief requested herein are 11 U.S.C. §§ 105(a), 107(b), and 1102.

[1] The Debtors in these jointly administered cases include Greektown Holdings, L.L.C. ("Holdings"); Greektown Casino, L.L.C. ("Greektown Casino"); Kewadin Greektown Casino, L.L.C. ("Kewadin"); Monroe Partners, L.L.C. ("Monroe"); Greektown Holdings II, Inc. ("Holdings II"); Contract Builders Corporation ("Builders"); Realty Equity Company Inc. ("Realty")' and Trappers GC Partner, LLC ("Trappers").

Background

3. On May 29, 2008 (the "Petition Date"), Greektown Holdings, LLC and certain of its affiliates (collectively, the "Debtors"), commenced these cases under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). The Debtors are continuing to operate their businesses and manage their assets as debtors in possession pursuant to §§ 1107(a) and 1108 of the Bankruptcy Code.

4. On June 6, 2008 (the "Committee Formation Date"), the Office of the United States Trustee appointed the Committee pursuant to § 1102 of the Bankruptcy Code.

5. Debtors own and operate the Greektown Casino gaming facility located in Detroit, Michigan, and are currently developing an expanded hotel and casino resort complex containing a live theater, a 400-room hotel, banquet and meeting rooms, restaurants, and additional gaming space.

6. Recently enacted Rule 2003-4 of the Local Rules of the Bankruptcy Court for the Eastern District of Michigan provides that: "[a]ny committee appointed under § 1102 shall serve a notice of the appointment of the committee on all creditors holding claims of the kind represented by that committee and file a certificate of service. The deadline to serve this notice is 45 days of appointment of the committee. This notice shall also provide for a procedure for creditors and their attorneys to be placed on a service list, maintained by the committee, of those who elect to receive information under § 1102(b)(3). This notice shall also provide for a procedure for creditors to provide comments to the committee."

7. On or about July 9, 2008, the Committee filed and served the Notice of (I) Appointment of Committee of Unsecured Creditors and (II) Procedures for Obtaining Access to Information and Providing Comments in Chapter 11 Bankruptcy Cases (the "Notice"), *attached*

as Exhibit B, upon Debtors' creditors as required by E.D. Mich. LBR 2003-4. The filing and service of the Notice was completed within 45 days of appointment of the Committee as required by E.D. Mich. LBR 2003-4.

Relief Requested

8. Pursuant to Bankruptcy Code § 1103(c), the Committee is authorized to, among other things, consult with Debtors, investigate the acts, conduct, assets, liabilities, and financial condition of Debtors, participate in the formulation of a plan and perform such other services as are in the interests of those represented. *See* 11 U.S.C. § 1103(c). In addition, as part of the Committee's duties under Bankruptcy Code § 1102(b)(3)(A), the Committee is required to provide the constituency it represents with access to certain information. *See* 11 U.S.C. § 1102(b)(3)(A).

9. By this Motion, the Committee seeks the entry of an order, *nunc pro tunc* to the Committee Formation Date, confirming that the Committee is not required, pursuant to the recently-enacted §1102(b)(3)(A) of the Bankruptcy Code, to provide access to Debtors' Confidential Information (defined below), or to Privileged Information (defined below), to any unsecured creditors who are not also Committee members.

10. The relief requested herein will aid the Committee in performing its statutory function by helping to ensure that confidential, privileged, proprietary, and/or material non-public information will not be disseminated to the detriment of Debtors' estates.

Basis for Relief Requested

11. On April 20, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") was enacted into law. The majority of the provisions in BAPCPA became effective on October 17, 2005, 180 days after the date of enactment.

12. Section 1102 of the Bankruptcy Code governs the appointment of statutory creditors' and equity security holders' committees. *See* 11 U.S.C. § 1102(a). Among the many amendments and additions made to the Bankruptcy Code, a new sub-section, § 1102(b)(3), was added to the Bankruptcy Code and that provides as follows:

> A committee appointed under subsection (a) shall –
>
> (A) provide access to information for creditors who –
>
> (i) hold claims of the kind represented by that committee; and
>
> (ii) are not appointed to the committee;
>
> (B) solicit and receive comments from the creditors described in subparagraph (A); and
>
> (C) be subject to a court order that compels any additional report or disclosure to be made to the creditors described in subparagraph (A).

13. The lack of specificity in new § 1102(b)(3)(A) creates significant issues for debtors and creditors' committees. *See* 7 COLLIER ON BANKRUPTCY ¶ 1103.05[2][a], p. 1103.05 (15th ed. rev. 2005). Typically, a debtor will provide committees, and in this case Debtors have indicated their willingness to provide the Committee, with confidential, material non-public information, including in draft form (the "Confidential Information").[2] Creditors' committees use this information to assess, among other things, a debtor's capital structure, asset values,

[2] For purposes of this Motion, the term "Confidential Information" means any nonpublic information of Debtors, including, without limitation, information concerning Debtors' assets, liabilities, business operations, projections, analyses, compilations, studies, and other documents prepared by Debtors or their advisors or other agents, which is furnished, disclosed, or made known to the Committee, whether intentionally or unintentionally and in any manner, including written form, orally, or through any electronic, facsimile, or computer-related communication. Confidential Information shall include (a) any notes, summaries, compilations, memoranda, or similar written materials disclosing or discussing Confidential Information; (b) any written Confidential Information that is discussed or presented orally; and (c) any other Confidential Information conveyed to the Committee orally that Debtors or their advisors or other agents advise the Committee should be treated as confidential. Notwithstanding the foregoing, Confidential Information shall not include any information or portions of information that: (i) is or becomes generally available to the public or is or becomes available to the Committee on a non-confidential basis, in each case to the extent that such information became so available other than by a violation of a contractual, legal, or fiduciary obligation to Debtors; or (ii) was in possession of the Committee prior to its disclosure by Debtors and is not subject to any other duty or obligation to maintain confidentiality.

opportunities for the restructuring of debtor's business in Chapter 11, the results of any revised operations of debtor in the bankruptcy case, and debtor's overall prospects for reorganization under a Chapter 11 plan. In that regard, debtors often condition the dissemination of such information on each committee member (and, in certain instances, committee professionals) agreeing to maintain such information in confidence.[3]

14. The enactment of new § 1102(b)(3)(A) raises the issue of whether a creditors' committee can be required to share Confidential Information with any non-member unsecured creditor. In the absence of appropriate protections for Confidential Information, the Debtors will be unwilling to readily share such information with the Committee, which will undoubtedly impede the Committee's ability to perform its duties and impair the working relationship between Debtors and the Committee.

15. The enactment of new § 1102(b)(3)(A) also raises the issue of whether a creditors' committee can be required to share information subject to the attorney-client or other state, federal, or other jurisdictional law privilege, whether such privilege is solely controlled by the committee or is a joint privilege with debtor or some other party ("Privileged Information"), with non-member unsecured creditors. Given the importance of this issue, the Committee seeks clarification that the Committee is not authorized or required to provide access to Privileged Information to creditors.

16. When a statute is clear and unambiguous, "the sole function of the courts is to enforce it according to its terms." *U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). However, in "rare cases [in which] the literal application of a statute will produce a result

[3] Typically, statutory committees have bylaws governing the conduct of their members, including the non-disclosure of confidential information concerning debtor. The Bylaws of the Committee in this case contain such confidentiality provisions.

demonstrably at odds with the intention of its drafters . . . the intention of the drafters, rather than the strict language, controls." *Id.* at 242.

17. The Committee respectfully submits that § 1102(b)(3)(A) is unclear and ambiguous. The statute simply requires a committee "to provide access to information," yet sets forth no guidelines as to the type, kind, and extent of such information. In its extreme, §1102(b)(3)(A) could be read as requiring a committee to provide access to ***all*** information provided to it by a debtor, or developed through exercise of its investigative function, regardless of whether such information is confidential, privileged, proprietary or material non-public information.

18. The legislative history to § 1102(b)(3) does not provide any further guidance on this point and merely reiterates the language of that section. *See* H.R. Rep. No. 109-31, 109th Cong., 1st Sess. 87 (2005) ("Section 405(b) requires the committee to give creditors having claims of the kind represented by the committee access to information. In addition, the committee must solicit and receive comments for these creditors and, pursuant to court order, make additional reports and disclosures available to them.").

19. Congress could not have intended for a committee to be required to provide unfettered access to every type and kind of information that a committee receives from a debtor. If this had been the intention, § 1102(b)(3) would frustrate numerous provisions of the Bankruptcy Code, including the plenary authority to obtain information and act in a fiduciary capacity pursuant to § 1103(c) of the Bankruptcy Code.

20. Absent clarification, a statutory committee's efforts may be frustrated because a debtor will be reluctant to share confidential, sensitive financial and strategic information with a committee – the exact information a committee needs and typically receives to assist it in the

discharge of its fiduciary obligations. In addition, committees will be reluctant to pursue an investigation of potential targets of litigation on behalf of a debtor's estate and to develop their own analyses of estate assets. Absent relief of the kind sought herein, debtors will undoubtedly be concerned that information shared with the statutory fiduciary may be shared with the public, including competitors and interested acquirers. Similarly, committees will be concerned that the fruits of their own investigation may be disseminated to inappropriate parties. In turn, these concerns will impede a statutory committee's own efforts to obtain information, which will undermine the committee's ability to maximize creditor recoveries. Certainly, the drafters could not have intended § 1102(b)(3) to hinder a committee's authority under § 1103(c) of the Bankruptcy Code. These statutes must be harmonized consistently with the overall purposes of Chapter 11.

21. Additionally, sharing Confidential Information would be detrimental to Debtors' businesses and ability to maximize value. Indeed, providing unfettered access to Confidential Information undoubtedly will allow competitors of Debtors to use such information, including any business plan of Debtors, trade secrets, or other proprietary information, to that competitor's advantage and, more importantly, to the disadvantage of Debtors and these estates.

22. Similarly unfettered access to Privileged Information will impact the attorney-client and work product privileges between the Committee and its counsel and other agents. *See In re Baldwin-United Corp., D.H.*, 38 B.R. 802, 805 (Bankr. S.D. Ohio 1984) (creditors' committee entitled to protection of attorney-client privilege). This is particularly relevant to the Committee's crucial investigative powers and the likelihood that the Committee will be investigating potential causes of action of the estates.

23. Courts that have had the opportunity to consider this issue since BAPCA's enactment have issued orders clarifying that creditors' committees are not authorized or required to provide access to confidential or privileged information. *See, e.g., In re Trans-Industries, Inc.*, Case No. 06-43993 (TJT) (Bankr. E.D. Mich. June 9, 2006); *In re Refco, Inc.*, Case No. 05-60006 (RDD) (Bankr. S.D.N.Y. Dec. 23, 2005); *In re FLYi, Inc.*, Case No. 05-20011 (MFW) (Bankr. D. Del. Nov. 17, 2005); *In re Calpine Corp.*, Case No. 05-60200 (BRL) (Bankr. S.D.N.Y. Feb. 15, 2006); *In re G+G Retail, Inc.*, Case No. 06-10152 (RDD) (Bankr. S.D.N.Y. Mar. 9, 2006); *In re Dana Corp.*, Case No. 06-10354 (BRL) (Bankr. S.D.N.Y. Mar. 29, 2006). Copies of the orders entered in these cases are available upon request.

24. Accordingly, the Committee respectfully requests that this Court clarify the requirements of § 1102(b)(3) consistent with the terms of this Motion.

Notice

25. Notice of this Motion has been provided to (i) the Office of the United States Trustee; (ii) counsel for the Debtors; (iii) counsel to Merrill Lynch Pierce Fenner and Smith as agent for itself, the Post-Petition Lenders, and the Pre-Petition Lenders; and, (iv) all parties who have filed a notice of appearance or request for service with the Court. Under the circumstances, the Committee believes that such notice is adequate and sufficient for all purposes.

WHEREFORE, the Committee requests that this Court enter an order, substantially in the form attached hereto as Exhibit A, granting the relief requested in this Motion, and granting such additional relief as the Court deems appropriate.

Respectfully submitted,

CLARK HILL PLC

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Date: July 9, 2008

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:	)	
GREEKTOWN HOLDINGS, LLC, *et al.*[1],	)	Case No. 08-53104 Chapter 11 Jointly Administered
Debtors.	)	Honorable Walter Shapero

ORDER CONFIRMING THAT THE UNSECURED CREDITORS' COMMITTEE IS NOT REQUIRED TO PROVIDE ACCESS TO CONFIDENTIAL INFORMATION OF THE DEBTORS OR PRIVILEGED INFORMATION

This matter having come before the Court on the Motion of the Official Committee of Unsecured Creditors (the "Committee"), pursuant to 11 U.S.C. §§ 105(a), 107(b) and 1102(b)(3)(A) for an Order *Nunc Pro Tunc* Confirming that the Committee is Not Authorized or Required to Provide Access to Confidential Information of the Debtors or Privileged Information (the "Motion")[2]; the Court having reviewed the Motion and being otherwise advised in the premises;

IT IS HEREBY ORDERED THAT:

1. The Motion is GRANTED *nunc pro tunc* to June 6, 2008.

2. The Committee is not required to provide access to Confidential Information and/or Privileged Information.

[1] The Debtors in these jointly administered cases include Greektown Holdings, L.L.C. ("Holdings"); Greektown Casino, L.L.C. ("Greektown Casino"); Kewadin Greektown Casino, L.L.C. ("Kewadin"); Monroe Partners, L.L.C. ("Monroe"); Greektown Holdings II, Inc. ("Holdings II"); Contract Builders Corporation ("Builders"); Realty Equity Company Inc. ("Realty")' and Trappers GC Partner, LLC ("Trappers").

[2] Capitalized terms used but not defined in this Order have the meanings given to them in the Motion.

3. Nothing in this Order shall expand, restrict, affirm, or deny the right or obligation, if any, of the Committee to provide or not provide access to any information of the Debtors to any party except as explicitly provided herein.

4. This Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation of this Order.

Signed on August 01, 2008

/s/ Walter Shapero
Walter Shapero
United States Bankruptcy Judge

ACCURACY OF SCHEDULES

Prepared by:
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I. Duties to Disclose and Provide Accurate Disclosure

A. To receive a fresh start under the Bankruptcy Code, debtors are required to present full and accurate information about themselves and their affairs. (See *Schechter v. Hansen, 325* B.R. 746 (Bankr N.D. Ill. 2005)*; In re Colvin*, 288 B.R. 477, 481 (Bankr. E.D.Mich.2003). A discharge is only for an honest debtor. *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991).

B. Information provided in schedules must allow the trustee and creditors to evaluate the case and administer the estate's property. *Schechter v. Hansen*, at *757, Clean Cut Tree Serve., Inc. v. Costello*, 299 B.R. 882, 899 (Bankr. N.D. Ill. 2003). "Complete and honest disclosure is therefore a condition precedent to the privilege of discharge." *Glucona Am., Inc. v. Ardesson*, *272 B.R. 346, 359 (Bankr. N.D. Ill. 2001)*

II. Penalty for Failure to Disclose and/or Inaccuracy

A. Denial of Discharge

1. § 727(a) (4)(A) denies a discharge to a debtor who has "knowingly and fraudulently in, or in connection with the case. . . made a false oath or account."

2. To prevail under § 727(a)(4)(A), the objecting party (usually the Trustee) must prove:

a. the debtor made a statement under oath;

i. Any information provided in a debtor's petition and schedules is a statement under oath since debtors must swear to their accuracy.

b. the statement was material to the debtor's case;

i. all statements in the petition and schedules relating to debtor's assets, property and financial affairs are material to the bankruptcy case

c. the statement was false; and

d. the debtor knew the statement was false, and the statement was made with an intent to deceive.

i. To possess the requisite intent, the debtor must either knowingly have intended to defraud or to have "engaged in such reckless behavior as to justify the finding of fraud." *In re Yonikus,* 974 F.2d 901, 905 (7th Cir. 1992). This concept is also known as "reckless indifference and consists of simply "not caring whether some representation is true or false." *In re Chavin*, 150 F.3d 726, 728 (7th Cir. 1998).

ii. Evidence to the indifference to the truth includes failure to correct through amendment errors on the fundamental matters in the schedules. *Hansen v. Schechter* 325 B.R. at 759. Intent can be inferred from circumstantial evidence.

3. Cases in which discharge was denied for failure to disclose or inaccuracy in schedules:

a. *Hansen v. Schechter*, 325 B.R. 746 (Bankr.N.D.Ill.2005) Misrepresentations and omissions made by a debtor in his petition and schedules constitute a false oath resulting in the denial of debtor's discharge. The debtor's efforts to blame his attorney and his insistence that he had nothing to gain by the filing of fraudulent schedules were unpersuasive.

b. *Structured Asset Services v. Self*, 325 B.R. 224 (Bankr.N.D.Ill.2005). Creditor sought denial of debtor's discharge based on his failure to disclose significant assets and for making false statement in his petition, schedules and in testimony at the §341 meeting. As part of the debtor's defense, he asserted that he failed to schedule a certain piece of property because he did not think he was required to do so since a judicial deed had been entered. In response to this argument, the Court stated:

> Unfortunately for the Debtor, this excuse has been rejected by the Seventh Circuit, which opined that "[d]ebtors have an absolute duty to report whatever interests they hold in property, even if they believe their assets are worthless or are unavailable to the bankruptcy estate. *In re Yonikus*, 974 F.2d 901, 904 (7th Cir.1992) (revocation of discharge action under 11 U.S.C. § 727(d)(2)). Thus, when a debtor is in doubt concerning disclosure, it is clear that the debtor is obligated to disclose. *See Richardson v. Von Behren (In re Von Behren),* 314 B.R. 169, 179 (Bankr.C.D.Ill.2004)

c. *Norton v. Cole*, 378 B.R. 215 (Bankr.N.D.Ill.2007). Creditor brought adversary proceeding to deny debtor/attorney a discharge based upon his failure to schedule ownership of a closely held corporation. In this case, the Court addressed the debtor's assertion that he was not aware of the duty to list his stock interests on his schedules by citing *Self* and *Yonikus* and further noted that the debtor's failure to amend his schedules to include the interest at any time since the filing of the petition was further proof of his reckless disregard for whether his bankruptcy Schedule B was false and therefore for purposes of § 727(a)(4)(A) he knew his representation was false.

d. Again, in the case of *Neary v. Happel,* 394 B.R. 915 (Bankr.N.D.Ill.2008) the Court found that the debtor's reckless disregard for the truth in the preparation of her schedules was grounds for the denial of her discharge.

The debtor had failed to disclose a business arrangement with a convicted felon in which she purchased residential properties located by her partner based upon false financial applications. Most of the properties eventually went into foreclosure or were returned to the mortgagees. The debtor claimed that the omitted information would not have aided in the recovery of assets in the case as there was no equity in any of the properties. However, the Court found that even if that assertion were true,

> …the value of the assets omitted is not the focus of the inquiry. Rather, it is the veracity of the debtor's statements which is paramount. *In re Milam*, 172 B.R. 371, 375 (Bankr.M.D.Fla.1994); *see also In re Chalik*, 748 F.2d 616, 618 (11th Cir.1984) (stating that the materiality of a false oath does not depend upon whether the falsehood is detrimental to creditors); *In re Calder*, 93 B.R. 734, 738 (Bankr.D.Utah 1988 (declaring that a debtor may not escape the denial of discharge by making a false oath merely by asserting that the business relationships or holdings omitted were worthless).

e. *Neary v. Leech*, 2009 WL 6244 (Bankr.E.D.Wis.). In this case the debtor failed to schedule jewelry purchased with a credit card, but in response to questions from the attorney for the credit card company at the § 341 meeting testified that he had purchased the jewelry, despite his earlier testimony that his schedules were correct. After the § 341 meeting, the debtor amended his Schedule B to include the omitted jewelry as well as his Schedule C to claim the jewelry as exempt. In its discussion of the proof required for a finding of fraudulent intent, the most difficult element necessary to establish a § 727(a)(4)(A) denial of discharge, the Court noted that:

> In *In re Saylor*, 339 B.R. 190, 191 (Bank.N.D.Ind.2006), the court declared that actual knowledge that a statement is false and a conscious intent to deceive are not always necessary for purposes of § 727(a)(4). *Saylor* declared that fraudulent intent under § 727(a)(4)(A) also exists where the debtor has demonstrated "a reckless disregard of the serious nature of the information sought and the necessary attention to detail and accuracy**.**" *Id. Saylor* further stated that a debtor's reckless disregard for the truth of information contained in the bankruptcy statements and schedules may be regarded as the equivalent of actual fraud on the part of the debtor who submits such false or inaccurate statements. *Id. See also In re Yonikus,* 974 F.2d 901, 905 (7th Cir.1992) ("[t]o

> find the requisite degree of fraudulent intent, the court must find the debtor knowingly intended to defraud the trustee, or engaged in such reckless behavior as to justify the finding of fraud").

f. *Warsco v. Saylor*, 339 B.R. 190 (Bankr.N.D.Ill.2006). The debtor once again blamed his attorney for nondisclosure of the sale of a business less than a month prior to his bankruptcy filing. In this oft-cited case the Court noted that:

> "[T]he law in this circuit is that an attorney's conduct must be imputed to his client in *any* context." *U.S. v. DiMucci,* 879 F.2d 1488, 1496 (7th Cir. 1989) (emphasis original).

The Court went on to find that:

> Ultimately, it is debtors who are responsible for the accuracy of the information contained in their bankruptcy schedules and statement of affairs, *Dawley,* 312 B.R. at 787; it is it they who have the duty to carefully consider all of the questions posed and to see that they are completely and correctly answered. *Citations omitted.*

B. Denial of Exemption

1. Although amendment may assist a debtor who failed to disclose assets to defeat the element of fraudulent intent in adversary proceedings to deny discharge, it may not be enough to allow an exemption based upon the amendment. In *In re Colvin*, 288 B.R. 477 (Bankr.E.D.Mich.2003), after the Chapter 7 Trustee elicited testimony at the Debtor's § 341 meeting regarding an unscheduled $10,000 tax refund, the debtors filed amended schedules disclosing the refund and claiming the majority of it as exempt. The Trustee filed a motion for turnover and objection to the exemption. After a review of the law relating to the debtor's duty to disclose, the Court in Colvin stated:

> Pursuant to FED.R.B.BANKR.P. 1009(a), a debtor may amend a voluntary petition as a matter of course any time before the case is closed. *Lucius v. McLemore*, 741 F.2d 125, 126 (6th Cir. 1984). However, the court may disallow amendments based on a finding of bad faith or when property has been concealed. *Citations omitted.*
>
> In the context of an amendment of exemptions, bad faith is determined by an examination of the totality of the circumstances. *Kaelin, 308 F.3d 885*. Mere allegations of bad faith will not suffice; the objecting party must demonstrate the bad faith of the debtor by specific evidence.

2. Based upon a series of seven facts elicited at trial, the *Covin* Court granted the motion for turnover and denied the claim of exemption as the tax refund.

C. Revocation of Discharge

1. *Tidwell v. Smith*, 379 B.R. 315 (Bankr.N.D.Ill.2007). The Court found that by failing to list as unsecured creditors on his schedules former patients with pre-petition medical malpractice actions against him, the debtor made the knowing and fraudulent false oath that might provide the basis for revocation of discharge pursuant to § 727(d)(1). The Court found unpersuasive the debtor's argument that he relied on his attorney to properly complete the schedules. The creditors' argument in support of revocation to discharge was bolstered by the fact that the debtor had schedule the patients as creditors in a previous bankruptcy that had been dismissed

III. Conclusion

In view of the current state of case law, it is recommended that debtors' attorneys err on the side of providing more disclosure than perceived as necessary to avoid denial of exemptions and discharge and possible revocation of discharge. Further, precautions should be taken to avoid inaccuracies in the disclosures in the schedules. Although courts may not accept a debtor's efforts to "blame the attorney" when it comes to the defense of failure to disclose or inaccuracy of disclosures, that may not insulate the debtor's attorney from malpractice claims by the debtors if their discharge is denied or revoked.

1120515

NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES

CHAPTER 7 TRUSTEE CANON OF ETHICS ANNOTATED*

PREAMBLE

A Chapter 7 Trustee is committed to excellence in the administration of bankruptcy cases and to carry out all duties with the utmost integrity, diligence, and professionalism. Parties are entitled to service that adheres to the highest standards of professional, moral, and ethical conduct. As a fiduciary, a Trustee occupies a significant position of trust and responsibility and is accountable to all in the bankruptcy system and the public at large.

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* Annotations by the 2007 NABT Ethics Committee:

- Hon. Steven W. Rhodes
- Paul G. Swanson
- Claire Ann Resop
- Eugene Crane
- Richard D. Nelson

References herein to the "Handbook" are to the Handbook for Chapter 7 Trustees published by the United States Department of Justice, July 1, 2002. References to the "1987 NABT Code" are to the NABT Code of Ethics and Standards of Personal Conduct, adopted September, 1987. References to the "2004 NABT Pledge" are to the Chapter 7 Trustees Pledge of Excellence, adopted by the NABT March, 2004.

NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES

CHAPTER 7 TRUSTEE CANON OF ETHICS ANNOTATED

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NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES

CHAPTER 7 TRUSTEE CANON OF ETHICS ANNOTATED

Integrity of the Bankruptcy System

1. A Trustee shall at all times promote and defend the integrity of the bankruptcy system.

Selected Statutes and Rules

"(a) The Trustee Shall – (6) if advisable, oppose the discharge of the debtor;" *11 U.S.C. § 704(6)*

A Trustee is required to make a report to the United States Attorney when the trustee has reasonable ground to believe that a bankruptcy crime has been committed or that an investigation should be undertaken. *18 U.S.C. § 3057(a)*

Such reports are to be coordinated through the United States trustee. *See 28 U.S.C. § 586(a)(3)(F).*

"The trustee, a creditor, or the United States trustee may object to the granting of a discharge under subsection (a) of this section." *11 U.S.C. § 727(c)(1)*

Selected Caselaw

"Trustees in bankruptcy are public officers and officers of a court. . . ." Callaghan v. Recon. Fin. Corp., 297 U.S. 464, 468 (1936).

"The underlying purpose of § 727 is to protect the integrity of the bankruptcy system[.]" Bankr. Receivables Mgmt. v. de Armond (*In re* de Armond), 240 B.R. 51, 55 (Bankr. C.D. Cal. 1999).

See also Austin Farm Ctr. v. Harrison (*In re* Harrison), 71 B.R. 457, 459 (Bankr. D. Minn. 1987) ("Section 727(a) is directed toward protecting the integrity of the bankruptcy system[.]"); *In re* Levine, 287 B.R. 683, 691 (Bankr. E.D. Mich. 2002).

That the responsibility to object to a debtor's discharge is shared with the United States trustee further demonstrates the institutional nature of the responsibility. *In re* Parker, 186 B.R. 208, 210 (Bankr. E.D. Va. 1995) ("[B]oth the United States Trustee and the chapter 7 trustee have a statutorily imposed duty to object to discharge if a discharge is unwarranted."

This duty to report bankruptcy crimes is considered so important and central to the integrity of the judicial process that the referring trustee is granted absolute immunity from a subsequent civil suit for malicious prosecution. Heinsohn, 231 B.R. at 59

The duty to report crime is also shared with the court. 18 U.S.C. § 3057(a). *See also* Stockbridge Funding, 153 B.R. at 656 ("The duties of a bankruptcy trustee under this statute are the same as those of a bankruptcy judge.").

See In re Heinsohn, 231 B.R. 48, 59 (Bankr. E.D. Tenn. 1999), *aff'd*, 247 B.R. 237 (E.D. Tenn. 2000) ("The directive in [18 U.S.C.] § 3057 is no less an obligation of the trustee than those that are specifically set forth in 11 U.S.C. § 704 which describe various duties of a trustee. Thus, a trustee who makes a criminal referral is simply carrying out his administrative duties[.]"). *See also In re Olympia Holding Corp.*, 305 B.R. 586, 591 (Bankr. M.D. Fla. 2004). *In re Stockbridge Funding Corp.*, 153 B.R. 654, 657 (Bankr. S.D.N.Y. 1993), *leave to appeal denied*, 1993 WL 205225 ("[T]he bankruptcy crimes investigation privilege shields from discovery Trustee Kittay's and his attorney's written and oral communications that were created or took place in connection with Kittay's investigating potential bankruptcy crimes or reporting such potential crimes to the United States attorney or other law enforcement agencies pursuant to 18 U.S.C. § 3057(a).").

Some courts conclude that due to institutional and policy considerations, the trustee cannot dismiss a discharge objection in exchange for a monetary settlement. State Bank of India v. Chalasani (*In re* Chalasani), 92 F.3d 1300, 1310 (2d Cir. 1996); *In re* Wilson, 196 B.R. 777 (Bankr. N.D. Ohio 1996); *In re* Moore, 50 B.R. 661, 664 (Bankr. E.D. Tenn. 1985) ("Discharge, the principal objective of a Chapter 7 debtor, is a statutory right involving public policy considerations. It is not a proper subject for contractual negotiation.").

In Moister v. Vickers (*In re* Vickers), 176 B.R. 287, 290 (Bankr. N.D. Ga. 1994), the court forcefully stated:

> Either the discharges ought to be granted or they ought to be denied. Nothing in the Bankruptcy Code authorizes a trustee to seek funds from a debtor or to release a non-debtor entity as a price for giving up on a discharge complaint. Discharges are not property of the estate and are not for sale. It is against public policy to sell discharges. *In re Moore,* 50 B.R. 661 (Bankr. E.D. Tenn. 1985). The reasons are obvious. Selling discharges would be a disease that would attack the heart of the bankruptcy process, its integrity. A trustee seeking to get paid may coerce an honest debtor into paying something to get rid of a complaint that has no merit. A dishonest debtor may cover up even greater sins than those that gave rise to the complaint in the first place.

The court further suggested, "The conduct described in these hypothetical situations may be criminal bankruptcy fraud. *See* 18 U.S.C. § 152(6); 9 COLLIER ON BANKRUPTCY, ¶ 7041.03 (15th ed. 1988)."

See also In re Wilson, 196 B.R. 777, 779 (Bankr. N.D. Ohio 1996); Russo v. Nicolosi (*In re* Nicolosi), 86 B.R. 882, 888 (Bankr. W.D. La. 1988).

Other courts reach this result on the grounds that the process of granting and denying a bankruptcy discharge is necessarily a bankruptcy court process and therefore the trustee

is without authority to compromise such a claim. In *Levine*, 287 B.R. at 693, the court held that compromising the objection in exchange for the payment of money to the estate is not an available option, stating:

> Once a party has filed a complaint objecting to discharge, it has only two options - the objecting party may either (a) participate in the process by prosecuting its objection to judgment (*i.e.*, an order barring the entry of the debtor's discharge), or (b) withdraw from the process by seeking the dismissal of its complaint.

Id. at 692.

A third group of courts, however, rejects a per se rule against judicial approval of a discharge objection compromise while recognizing the institutional considerations inherent in an objection to discharge. In Lindauer v. Traxler (*In re* Traxler), 277 B.R. 699, 704 (Bankr. E.D. Tex. 2002) (footnote omitted), the court reasoned:

> The issue at bar raises competing policies: certainly, there should be no "taint of compromise" involved in the dismissal of a § 727 action, yet the estate should be maximized to benefit its creditors. There is a "tension between vindication of the public interest in upholding the policies behind § 727, and the public interest in fostering the peaceful, just, speedy and inexpensive resolution of disputes . . . ." *In re* Margolin, 135 B.R. 671, 673 (Bankr. D. Colo. 1992).

These courts respond to the balance of competing considerations by viewing such settlements with "heightened skepticism" and by subjecting them to "close scrutiny." *Id.* at 705; *In re* Bates, 211 B.R. 338, 348 (Bankr. D. Minn. 1997); Note Buyers, Inc. v. Cooler (*In re* Cooler), No. Civ.A. 98-02856, 1999 WL 33486071, *3 (Bankr. D.S.C. June 1, 1999) ("If settlements are not allowed, the resolution of the cases and proceedings may be neither speedy nor inexpensive.").

Fulfilling the obligation to object to the discharge calls for a two step process. "A trustee's review of the debtor's compliance with the Code and Court orders is mandatory, but the trustee has some discretion to decide if and when an objection to discharge is 'advisable.'" *In re* Espinoza, No. 03-00093, 2003 WL 21981591, *6 (Bankr. D. Idaho Aug. 12, 2003); *In re* Parker 186 B.R. 208, 210 (Bankr. E.D. Va. 1995) ("The Chapter 7 trustee is obligated to object to discharge if a discharge is unwarranted."). *See also In re* Arnold, 162 B.R. 775, 778 (Bankr. E.D. Mich. 1993) ("Because denial of a discharge is so serious a matter, a trustee ought not lightly bring an action under § 727(a).").

Selected Administrative Decisions of the Director of EOUST

"[A] standing trustee occupies a significant position of trust and responsibility and is accountable for his actions not just to the United States Trustee, but also to the bankruptcy community and the public at large." Case No. 00-0001, Decision by Director Kevyn Orr, (April 28, 2001), at p. 15-16, available at: http://www.usdoj.gov/ust/eo/rules_regulations/admin_decisions/docs/case00-0001.htm

See also Case No. 98-0004 Decision by Director Joseph Patchen (October 2, 1998), available at http://www.usdoj.gov/ust/foia/admin-decisions/case98-0004.PDF. (Trustee removed for repeated failure to notify the United States Trustee of criminal activity.)

Handbook for Chapter 7 Trustees

See Chapter 8(W)

"The trustee is often in the best position to initially identify fraud or criminal activity in chapter 7 cases. When criminal activity is suspected, the trustee should notify the United States Trustee immediately." *Chapter 8(W)(1)*

"If the trustee has information that would support an objection to discharge but deems such an action inadvisable, the trustee should promptly bring such facts to the attention of the United States Trustee." *Chapter 6(B)(6)*

Other References

See also Mary Jo Heston, The United States Trustee: The Missing Link of Bankruptcy Crime Prosecutions, 6 Am. Bankr. Inst. L. Rev 359 (Winter 1998); Peter Ainsworth and Robert Calo, The U.S. Trustee Program's Criminal Enforcement Unit, 22 Am. Bankr. Inst. J. 30 (January 2004) (announcing the creation of the Criminal Enforcement Unit by EOUST.).

2. A Trustee shall exercise independent fiduciary judgment in the administration of any bankruptcy case.

Selected Statutes and Rules

The trustee is designated as the "representative of the estate." *11 U.S.C.§323(a)*

Selected Caselaw

While the trustee's obligation is to marshal assets for the benefits of creditors, that task is assumed as a fiduciary relationship to the estate itself and not as some sort of "hired gun." The trustee is not the employee or agent of the creditors; they do not have the right to direct how the trustee chooses to perform the statutory duties of the position. The trustee is in essence an independent third party charged with the responsibility of maximizing assets for the estate. *In re* Vasquez, 325 B.R. 30, 37-8 (Bankr. S.D. Fla. 2005)

The term "fiduciary" is not in the bankruptcy code. Nevertheless, the cases uniformly refer to a chapter 7 trustee as a fiduciary and to the trustee's obligations in a bankruptcy

case as fiduciary obligations. *See, e.g.*, Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 120 S. Ct. 1942, 1950 (2000); Weintraub, 471 U.S. at 349, 105 S. Ct. at 1994; Stalnaker v. DLC, Ltd., 376 F.3d 819, 825 (8th Cir. 2004); United States v. Schilling (*In re* Big Rivers Elec. Corp.), 355 F.3d 415, 430 (6th Cir. 2004); Dechert v. Cadle Co., 333 F.3d 801, 802 (7th Cir. 2003); Hoseman v. Weinschneider, 322 F.3d 468, 474 (7th Cir. 2003); Connolly v. Harris Trust Co of Cal. (*In re* Miniscribe Corp.), 309 F.3d 1234, 1242 (10th Cir. 2002); Fogel v. Zell, 221 F.3d 955, 966 (7th Cir. 2000); Mailman Steam Carpet Cleaning Corp., 196 F.3d at 6; Architechural Bldg. Components v. McClarty (*In re* Foremost Mfg. Co.), 137 F.3d 919, 924 (6th Cir. 1998); Petitioning Creditors of Melon Produce, Inc. v. Braunstein, 112 F.3d 1232, 1240 (1st Cir. 1997); Myers v. Martin (*In re* Martin), 91 F.3d 389, 394 (3d Cir. 1996); *In re* Salzer, 52 F.3d 708, 712 (7th Cir. 1995); United States v. Aldrich (*In re* Rigden), 795 F.2d 727, 730-1 (9th Cir. 1986); Ford Motor Credit Co v. Reynolds & Reynolds Co. (*In re* JKJ Chevrolet, Inc.), 26 F.3d 481, 485 (4th Cir. 1994); *In re* L & S Indus., Inc., 989 F.2d 929, 934 (7th Cir. 1993); Kowal v. Malkemus (*In re* Thompson), 965 F.2d 1136, 1143 (1st Cir. 1992); Grant v. George Schumann Tire & Battery Co., 908 F.2d 874, 883 (11th Cir. 1990); River Prod. Co., Inc v. Webb (*In re* Topco, Inc.), 894 F.2d 727, 739 (5th Cir. 1990); Con'tl Ill. State Bank v. Wooten (*In re* Evangeline Ref. Co.), 890 F.2d 1312 (5th Cir. 1989).

The cases interpret this designation to accomplish two distinct purposes - to demonstrate the trustee's fiduciary role. *See, e.g.*, United States v. Shadduck, 112 F.3d 523, 531 (1st Cir. 1997) ("[A]s the representative of the debtor estate . . . ., it is incumbent upon the trustee to collect and reduce to money all nonexempt assets of the estate . . . ." (citation omitted)); Martin-Trigona v. Ferrari (*In re* WHET, Inc.), 750 F.2d 149 (1st Cir. 1984) ("[A trustee] is a 'representative of the estate,' 11 U.S.C. § 323, and as such he owes a fiduciary duty to debtor and creditors alike to act fairly and protect their interests."). *See also* Edmonston v. Murphy (*In re* Edmonston), 107 F.3d 74, 76 (1st Cir. 1997); Richman v. First Woman's Bank (*In re* Richman), 104 F.3d 654, 657 n.1 (4th Cir. 1997); United States v. Hemmen, 51 F.3d 883, 890 n.6 (9th Cir. 1995). and to establish the trustee's capacity to sue or be sued on behalf of the estate. *See, e.g.*, Logan v. JKV Real Estate Serv. (*In re* Bogdan), 414 F.3d 507, 512 (4th Cir. 2005); Bezanson v. Thomas (*In re* R & R Ass'n of Hampton), 402 F.3d 257, 265 (1st Cir. 2005); *In re* Consol. Indus., 360 F.3d 712, 716 (7th Cir. 2004) ("But the estate itself is the true party harmed by any violation of the August 14 order, and the code charges the trustee to pursue the interests of the bankruptcy estate."); Vreugdenhil v. Hoekstra, 773 F.2d 213 (8th Cir. 1985); Detrick v. Panalpina, Inc., 108 F.3d 529, 536 (4th Cir. 1997); Richman, 104 F.3d at 657; *In re* El San Juan Hotel Corp., 841 F.2d 6, 8 (1st Cir. 1988). *See also* FED. R. BANKR. P. 6009, which provides, "With or without court approval, the trustee . . . . may prosecute or may enter an appearance and defend any pending action or proceeding by or against the debtor, or commence and prosecute any action or proceeding in behalf of the estate before any tribunal."

A bankruptcy trustee's duty of loyalty is the duty to forebear from "all opportunities to advance self-interest." Mosser v. Darrow, 341 U.S. 267, 271 (1951). The RESTATEMENT (THIRD) OF TRUSTS §170(1) is to the same effect: "The trustee is under a duty to

administer the trust solely in the interest of the beneficiaries." *See also* UNIFORM TRUST CODE, § 802(a) (National Conference of Commissioners on Uniform State Laws (July 2002)). *See also* G. BOGERT, LAW OF TRUSTS AND TRUSTEES § 543 (rev. 2d ed. 2003).

As Justice Jackson proclaimed in *Mosser v. Darrow*, "Equity tolerates in bankruptcy trustees no interest adverse to the trust." *Mosser,* 341 U.S. at 271.

The Tenth Circuit stated that a bankruptcy trustee "must completely efface self-interest. His loyalty and devotion to his trust must be unstinted. Its well-being must always be his first consideration. These principles are inveterate and unbending." Wootten v. Wootten, 151 F.2d 147, 149-50, n.1 (10th Cir. 1945) (citing Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y.1928); Johnston v. Loose, 167 N.W. 1021, 1023 (Mich. 1918); Ball v. Hopkins, 167 N.E. 338, 341 (Mass. 1929).

The Second Circuit agreed, stating, "[T]he law of trusts requires that the trustee, *in his role as trustee,* be disinterested and prohibits him from obtaining interests adverse to the estate. As with any trustee, a bankruptcy trustee owes a duty of loyalty to the beneficiaries of the trust." [1] *In re* Palm Coast, Matanza Shores Ltd. P'ship, 101 F.3d 253, 258 (2d Cir. 1996) (citing AUSTIN W. SCOTT, SCOTT ON TRUSTS § 170 (3rd ed. 1967).) *See also* Massaro v. Massaro (*In re* Massaro), 235 B.R. 757 (Bankr. D.N.J. 1999) (citing *Scott on Trusts* § 170 (4th ed. 1987)).

The duty of loyalty has been characterized as "the most fundamental duty owed." Rutanen v. Baylis (*In re* Baylis), 313 F.3d 9, 20 (1st Cir. 2002) (citing A A. SCOTT, THE LAW OF TRUSTS § 170 (W.F. Fratcher ed., 4th ed. 2001)).

11 U.S.C. § 701(a)(1) is explicit in its requirement that an *appointed* trustee must be disinterested. *In re* BH & P Inc., 949 F.2d 1300, 1307 (3d Cir. 1991) ("An interim trustee appointed by the United States Trustee must, under the terms of the Bankruptcy Code, be a 'disinterested person.'"). Section 702, relating to elected trustees, contains no such explicit requirement of disinterestedness; however, because of the importance of the duty of loyalty, the requirement is nonetheless imposed. *In re* Greenberg, 189 B.R. 906, 911 (Bankr. E.D. Pa. 1995) ("[A] Chapter 7 trustee, without regard to how he gained his office, cannot serve with a disabling conflict of interest." Nevertheless, after balancing the harms and benefits of the trustee's continued service, the court declined to find cause to remove the trustee.). *But see In re* Colony Press, Inc., 83 B.R. 862, 867 n.3 (Bankr. D. Mass. 1988) (dicta).

The obligation of loyalty exists throughout the tenure of the trustee and the trustee's professionals with the estate. *In re* Sauer, 191 B.R. 402 (Bankr. D. Neb. 1995); *In re* Diamond Mortgage of Ill., 135 B.R. 78, 93 (Bankr. N.D. Ill. 1990).

> To promote efficiency, however, the duty of loyalty has several exceptions. First, in limited circumstances, the Bankruptcy Code itself gives the trustee's duty to maximize the estate priority over the broad duty of loyalty. For example, § 327(d) of the Bankruptcy Code explicitly

> provides, "The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate." 11 U.S.C. § 327(d). *See Interamericas, Ltd.*, 321 B.R. at 833 ("Section 327(d) is an exception to the general rule that an estate professional must be 'a disinterested person' pursuant to § 327(a)").

The trustee may not, however, serve in any other professional position for the estate. *In re* Palm Coast, Matanza Shores Ltd. P'ship, 101 F.3d 253, 257 (2d Cir. 1996) ("A trustee who hires his own professional firm to assist him cannot be a 'disinterested person' who has no interest adverse to the estate. Once the trustee's firm is hired by the estate, the trustee's personal interests are implicated." Accordingly, trustee's appointment as a real estate broker was disapproved.); *In re* Mandell, 203 B.R. 345 (Bankr. S.D. Fla. 1996); *In re* Blue, 146 B.R. 856, 858 (Bankr. W.D. Okla. 1992); *Alexander*, 129 B.R. at 185; *In re* Cont'l Nut Co., 44 B.R. 48, 49 (Bankr. E.D. Cal. 1984); Assistant United States Trustee v. John Galt, Ltd. (*In re* John Galt, Ltd.), 130 B.R. 464, 465-66 (S.D. W. Va. 1989). *But see In re* Wilkinson Distrib. Co., 106 B.R. 658, 660 (Bankr. D. Haw. 1989) (stating that "[t]he Code does not prohibit the Trustee from serving in one of the other professional capacities enumerated in 11 U.S.C. § 327(a) and being compensated independently for those professional services" and allowing the trustee to receive a commission for acting as a real estate broker).

In re BH & P, Inc., 949 F.2d 1300, 1310 (3d Cir. 1991). The court also held that a trustee whose estate holds a claim against another estate is not a "creditor" of the second estate under § 101(14)(A) because the trustee holds the claim in a representative capacity, not in a personal capacity. Therefore, the trustee is not disqualified on that basis from serving as trustee of both estates. *Id.* at 1308. *See also* Katz v Kilsheimer, 327 F.2d 633 (2d Cir. 1964); Chrysler Credit Corp. v. B.J.M., Jr., Inc., 834 F. Supp. 813, 840 (E.D. Pa. 1993); White v. Tendler (*In re* Lyons Transp. Lines, Inc.), 144 B.R. 32, 34 (Bankr W.D. Pa. 1992); *In re* Smartt, 132 B.R. 765 (Bankr. D. Colo. 1990); Hassett v. McColley (*In re* O. P. M. Leasing Servs., Inc.), 16 B.R. 932, 938 (Bankr. S.D.N.Y. 1982) ("[I]t is 'personal interests' that are forbidden."). *See also In re* Jack Greenberg, Inc., 189 B.R. 906, 913 (Bankr. E.D. Pa. 1995):

> Given the benefits to creditors as perceived by the Court and as expressed by the creditors that appeared at the hearing to urge retention of [the elected trustee], and having weighed the potential of harm arising from [the trustee's and his employer's] service to [a debtor of the debtor], we believe his disqualification is not required.

But see Gill v. Sierra Pac. Constr., Inc. (*In re* Parkway Calabas Ltd.), 89 B.R. 832, 835 n.2 (Bankr. C.D. Cal. 1988).

Selected Administrative Decisions of the Director of EOUST

Case No. 03-0004 (Decision by Director Lawrence A. Friedman, January 21, 2004), at p. 3. ("The vigorous pursuit of assets is not discretionary; it is a fiduciary and statutory obligation of a chapter 7 trustee. To adequately perform his or her duties, it is imperative

that a trustee be willing to pursue assets aggressively and possess the ability to do so effectively.").

Handbook for Chapter 7 Trustees

"A trustee should have in place a procedure to screen new cases for possible conflicts of interest or lack of disinterestedness upon being appointed. If a trustee discovers a conflict of interest or a lack of disinterestedness after accepting the appointment, the trustee should immediately file a notice of resignation in the case." *Chapter 5(C)*

"The trustee must advise the United States Trustee upon the discovery of any potential conflict or lack of disinterestedness so that a determination can be made as to whether the appointment of a successor trustee is necessary. In addition, the trustee must disclose any potential conflicts on the court record or at the § 341(a) meeting, or both on the court record and at the § 341(a) meeting. The trustee should also advise the United States Trustee upon discovery of any circumstances which might give rise to the appearance of impropriety." Chapter 5 (C)

"Routine matters may be handled quickly and economically by this kind of representation. However, a trustee should be sensitive to the best interest of each individual estate and any conflict of interest problems that may be posed by acting as an attorney or accountant for the estate." *Chapter 8(M)(5)*

"[D]etailed time records of the tasks performed as a trustee and as an attorney or accountant . . . . The importance of distinguishing trustee duties from attorney or accountant for trustee functions cannot be overemphasized. The demarcation of the roles of the trustee and the professional is made to ensure that an estate incurs only appropriate costs for administration." *Chapter 8(M)(5)*

Other References

"The trustee is under a duty to administer the trust solely in the interest of the beneficiaries." The RESTATEMENT (THIRD) OF TRUSTS §170(1)

See also UNIFORM TRUST CODE, § 802(a) (National Conference of Commissioners on Uniform State Laws (July 2002)); G. BOGERT, LAW OF TRUSTS AND TRUSTEES § 543 (rev. 2d ed. 2003).

"The trust law concept of the duty of loyalty acknowledges that human nature will cause any person to favor his or her personal interests over the interests of another, and it is this assumption of disloyalty that gives rise to the strict prohibitions of trustee conflicts of interest required under the label of 'duty of loyalty.'" Karen E. Boxx, *Of Punctilios and Paybacks: The Duty of Loyalty Under the Uniform Trust Code*, 67 MO. L. REV. 279 (Spring 2002).

See GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 543, at 227 (2d ed. 1993) ("It is not possible for any person to act fairly in the same transaction on behalf of himself and in the interest of the trust beneficiary. It is only human that he will tend to favor his individual interest, whether consciously or unconsciously, over that of the beneficiary."); Robert W. Hallgring, *The Uniform Trustees' Powers Act and the Basic Principles of Fiduciary Responsibility*, 41 WASH. L. REV. 801, 803 (1966) ("Given human frailty, we cannot expect the fiduciary to put his personal advantage in second place. That 'no man can serve two masters' is a commonplace, and the difficulty is compounded where one of the masters is his own self-interest.").

If an appointment would result in a breach of this important duty of loyalty, the trustee has an obligation promptly to decline or resign the appointment. FED. R. BANKR. P. 2008 provides that a trustee who has a blanket bond and who "does not notify the court and the United States Trustee in writing of rejection of the office within five days after receipt of notice of selection shall be deemed to have accepted the office." This rule further states, "Any other person selected as trustee shall notify the court and the United States Trustee in writing of acceptance of the office within five days after receipt of notice of selection or shall be deemed to have rejected the office." *Id. See In re* Schultz Mfg. Fab. Co., 956 F.2d 686, 691 (7th Cir. 1992). *See also In re* S. Diversified Prop., Inc., 110 B.R. 992 (Bankr. N.D. Ga. 1990) (holding that a five day delay from appointment until resignation was too long).

3. A Trustee shall comply with the United States Bankruptcy Code, the Federal Rules of Bankruptcy Procedure, the local rules and orders of the districts in which they practice, the Handbook for Chapter 7 Trustees published by the Executive Office for United States Trustees, and state law as required.

Selected Statutes and Rules

"Except as provided in section 1166 of title 11, a trustee . . . appointed in any cause pending in any court of the United States . . . shall manage and operate the property in his possession as such trustee . . . according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof." *28 U.S.C. § 959(b)*

"Whoever, being a receiver, trustee, or manager in possession of any property in any cause pending in any court of the United States, willfully fails to manage and operate such property according to the requirements of the valid laws of the State in which such property shall be situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof, shall be fined not more than $3,000 or imprisoned not more than one year, or both." *18 U.S.C. § 1911*

Selected Caselaw

The case law is in conflict on whether 28 U.S.C. § 959(b) requires a Chapter 7 trustee to comply with state law. The Third, Fifth, Sixth and Eighth Circuits have concluded that this language is broad enough to obligate Chapter 7 trustees to comply with state law when liquidating estate property. Texas v. Lowe (*In re* H.L.S. Energy Co.), 151 F.3d 434, 438 (5th Cir. 1998) ("Under federal law, bankruptcy trustees must comply with state law."); Robinson v. Mich. Consol. Gas Co., 918 F.2d 579, 585 (6th Cir. 1990); Lancaster v. Tenn. (*In re* Wall Tube & Metal Prods. Co.), 831 F.2d 118 (6th Cir. 1987); New York v. Quanta Res. Corp (*In re* Quanta Res. Corp.), 739 F.2d 912, 919 (3d Cir. 1984) ("[T]here is no reason to suppose Section 959(b) inapplicable in Chapter 7."); Missouri. v. United States Bankr. Ct. for E. Dist. of Ark., 647 F.2d 768, 778 (8th Cir. 1981) ("[B]y requiring the trustee to obtain state licenses to operate the [grain] warehouses, the bankruptcy court has recognized that the trustee must act consistent with the dictates of 28 U.S.C. § 959(b)"). *See also In re* Stevens, 68 B.R. 774 (D. Me. 1987); *In re* Chaffee Aggregates, Inc., 300 B.R. 170 (Bankr. W.D.N.Y. 2003); Guterl Special Steel Corp v. Economic Dev. Admin. (*In re* Guterl Special Steel Corp.), 198 B.R. 128 (Bankr. W.D. Pa. 1996); *In re* Vel Rey Prop., Inc., 174 B.R. 859 (Bankr. D.D.C. 1994); *In re* Thurman, 163 B.R. 95 (Bankr. W.D. Tex. 1994); First Va. Bank of Tidewater v. Va. Builders, Inc. (*In re* Va. Builders, Inc.), 153 B.R. 729 (Bankr. E.D. Va. 1993); Leavell v. Karnes, 143 B.R. 212, (S.D. Ill. 1990).

A few older cases recognize the trustee's duty to comply with state law but excuse compliance when the estate has no assets with which to comply. *In re* A & T Trailer Park, Inc., 53 B.R. 144, 148 (Bankr. D. Wyo. 1985):

> It would be unfair, to say the least, if [the trustee] were forced to retain responsibility for the property until liability for the environmental violations comes to rest with him when no funds exist in the estate from which he could effectuate compliance with state environmental laws. This is not a liability to which the court will subject Chapter 7 trustees.

See also In re Better-Brite Plating, Inc., 105 B.R. 912 (Bankr. E.D. Wis. 1989); *In re* Oklahoma Ref. Co., 63 B.R. 562 (Bankr. W.D. Okl. 1986); *In re* Catamount Dyers, Inc., 50 B.R. 790 (Bankr. D. Vt. 1985); *In re* Charles George Land Reclamation Trust, 30 B.R. 918 (Bankr. D. Mass. 1983) (dismissing the case because trustee had no assets with which to comply with applicable state environmental laws).

However, there is a line of bankruptcy court decisions that have concluded that because this section only addresses trustees that "manage" or "operate" estate property, it does not apply to trustees that are liquidating estate property. Mo. Dep't of Natural. Res. v. Valley Steel Prods. Co. (*In re* Valley Steel Prods. Co.), 157 B.R. 442 (Bankr. E.D. Mo. 1993); *In re* St. Lawrence Corp., 239 B.R. 720 (Bankr. D.N.J. 1999); *In re* Heldor Indus., Inc., 131 B.R. 578 (Bankr. D.N.J. 1991); *In re* Corona Plastics, Inc., 99 B.R. 231 (Bankr. D.N.J. 1989); Walker v. Maury County (*In re* Scott Housing Sys. Inc.), 91 B.R. 190 (Bankr. S.D. Ga. 1988); Walsh v. West Virginia. (*In re* Sec. Gas & Oil, Inc.), 70 B.R.

786 (Bankr. N.D. Cal. 1987); *In re* Bourne Chem. Co., 54 B.R. 126 (Bankr. D.N.J. 1984); Catamount Dyers, Inc., 50 B.R. 790. *See also* Great Am. Bank of Broward Cty v. McCracken (*In re* Cusato Bros. Int'l, Inc.), 750 F.2d 887, 891 (5th Cir. 1985) (holding that the trustee is not obligated under § 959(b) to pay a state liquor tax when liquidating liquor inventory because the trustee was not "conducting any business" within the contemplation of 28 U.S.C. § 960."); Alabama Surface Mining Comm'n v. N.P. Mining Co. (*In re* N.P. Mining Co.), 963 F.2d 1449 (11th Cir. 1992) (holding that environmental fines incurred by a Chapter 11 trustee after determining to liquidate are not incurred through managing or operating estate property under § 959(b)).

Wisconsin v. Better Brite Plating, Inc., 483 N.W.2d 574, 582 (1992).

> Thus, where a trustee violates state law while performing acts that constitute 'carrying on business' connected with the property in trust, such trustee may be sued in his or her official capacity in state court without leave of the appointing court. And, where the trustee violates state law performing acts that do not constitute 'carrying on business' connected with the property in trust, such trustee may be sued in his or her official capacity in state court only if leave of the appointing court is granted.

Without addressing this issue directly, the Supreme Court in *Midlantic National Bank v. New Jersey Department of Environmental Protection* stated that § 959(b) "provides additional evidence that Congress did not intend for the Bankruptcy Code to pre-empt all state laws." Midlantic Nat. Bank v. N.J. Dept. of Envtl. Prot., 474 U.S. 494, 505 (1986). Previously, in *Ohio v. Kovacs*, the Supreme Court had stated that it did "not question that anyone in possession of the site — whether it is [the debtor] or another in the event the receivership is liquidated and the trustee abandons the property, or a vendee from the receiver or the bankruptcy trustee — must comply with the environmental laws of the State . . . ." Ohio v. Kovacs, 469 U.S. 274, 285 (1985).

Clearer, however, is the trustee's duty to comply with applicable federal laws, such as:

Environmental Laws

Midlantic, 474 U.S. 494; *In re* HLS Energy Co., Inc., 151 F.3d 434 (5th Cir. 1998); *Wall Tube & Metal Prods. Co.*, 831 F.2d 118;

Tax Laws

Holywell Corp. v. Smith (*In re* Holywell Corp.), 503 U.S. 47 (1992); Otte v. United States, 419 U.S. 43 (1974); Al Copeland Enters. v. Tex. (*In re* Al Copeland Enters.), 991 F.2d 233 (5th Cir. 1993); Tambay Tr. v. Pizza Pronto, Inc. (*In re* Pizza Pronto, Inc.), 970 F.2d 783, 784 (11th Cir. 1992); United States v. State Farm Fire & Cas. Co. (*In re* Joplin), 882 F.2d 1507, 1511 (10th Cir. 1989); Williams v. United States, 667 F.2d 1108 (4th Cir. 1981); *In re* Moon, 258 B.R. 828, 838 (Bankr. N.D. Fla. 2001) (reducing the trustee's fees for failing to file timely tax returns); *In re* ABA Recovery Serv., Inc., 110 B.R. 484 (Bankr. S.D. Cal. 1990); *In re* Flaherty, 169 B.R. 267 (Bankr. D.N.H. 1994); *In re* Pflug, 146 B.R. 687 (Bankr. E.D. Va. 1992). In United States v. Hemmen (*In re* Hemmen), 51 F.3d 883 (9th Cir. 1995), the court held that the trustee was obligated to

comply with a notice of levy that the Internal Revenue Service served upon him as a result of tax debt of an administrative claimant. Because the trustee paid the administrative claimant instead of the IRS, the court held the trustee personally liable. *See also* United States v. Ruff, 99 F.3d 1559 (11th Cir. 1996).

Pension Plan Termination Requirements
PBGC v. Pritchard (*In re* Esco Mfg. Co.), 33 F.3d 509 (5th Cir. 1994).

Federal Arbitration Act
Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 885 F.2d 1149, 1154-62 (3rd Cir. 1989).

Nevertheless, in some circumstances, courts have concluded that the Bankruptcy Code explicitly relieves the trustee of complying with such statutory obligations. *In re* Quanta Resources Corp., 739 F.2d 912, 918 (3d Cir. 1984) ("Thus, whether the trustee's power to abandon is limited depends in part on whether there is express federal law that either grants superseding power or subjugates the abandonment power to state law even if that law would otherwise be inconsistent."); United States v. Sims (*In re* Feiler), 218 F.3d 948 (9th Cir. 2000) (finding that 11 U.S.C. § 548 permits a trustee to avoid an otherwise irrevocable net operating loss election under 26 U.S.C. § 172(b)(3)).

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"When appropriate, the trustee should take the necessary steps to abate or prevent environmental contamination by or to estate property. If property of the estate has no value and may be hazardous to the health or safety of the general public, the trustee should give immediate consideration to abandoning property under § 554(a). Before abandoning the property, however, the trustee should take all precautions possible in light of the available assets of the estate and consult with appropriate federal, state and local authorities. Consultation is advised to ensure adequate notice and appropriate consideration of public policy issues. A notation of the consultation in the estate file is recommended." *Chapter 6(B)(2)*

Other References

In the section captioned "Compliance," the 1987 NABT Code states, "All members (Trustees) of the National Association of Bankruptcy Trustees (NABT) shall perform their duties as defined in the United States Bankruptcy Code, the Bankruptcy Rules, and

Local Rules of the districts in which they practice and shall at all times promote and defend the integrity of the bankruptcy system itself."

The 2004 NABT Pledge, paragraph 2, states that trustees should "Diligently perform his or her responsibilities according to the Bankruptcy Code and Rules, and Handbook for Chapter 7 Trustees."

Tax Laws

See generally John W. Ames, Richardo I. Kilpatrick, Thomas J. Salerno, and Patrick Casey Coston, *Trustee Liability in Environmental Cases - Has* Better-Brite Plating *Lost its Luster?*, 15 AM. BANKR. INST. J. 7 (February 1996); Joseph S. Maniscalco, *At the Crossroads of Environmental Laws and the Bankruptcy Code: Abandonment and Trustee Personal Liability*, 23 HOFSTRA L. REV. 879 (Summer 1995); W. Carter Santos, *Trustee Liability in CERCLA: Confronting the Problems and Proposing Solutions*, 19 WM. & MARY ENVTL. L. & POL'Y REV. 69 (Fall 1994); John W. Ames, Richardo I. Kilpatrick & Thomas J. Salerno, *The Struggle Between the State and the Trustee: Environmental Laws And the Right to Abandon Contaminated Estate Property*, 13 AM. BANKR. INST. J. 8 (March 1994); Kevin C. Murphy & Elizabeth C. Yen, *Trustee Liability for the Cost of Site Environmental Cleanup*, 110 BANKING L.J. 467 (September-October 1993); D. Ethan Jeffery, *Personal Liability of a Bankruptcy Trustee Since* Midlantic National Bank v. New Jersey Department of Environmental Protection*: The Environmental Law and Bankruptcy Code Conflict Threatens to Engulf Bankruptcy Trustees*, 2 VILL. ENVTL. L.J. 403 (1991).

Environmental Laws

Jennifer R. Moran, *Holywell Corp. v. Smith: Partially Clarified Tax-Paying Duties for Bankruptcy Trustees*, 46 TAX LAW 567 (Winter 1993); Todd Johnson, *Two Codes Collide: Is Abandoning Property by a Chapter 7 Trustee a Tax Recognition Event for the Bankruptcy Estate?*, 14 J. CORP. L. 687 (Spring 1989); James I. Shepard & Jack F. Williams, *The Duty of a Bankruptcy Trustee to File Federal Information Returns on Behalf of a Debtor-Partnership*, 3 AM. BANKR. INST. L. REV. 295 (Winter 1995); Richard Finkel, *Bankruptcy Trustee's Guide to Income Tax Return Filing Requirements*, 14 NABTalk No. 2 (1998).

4. A Trustee shall exercise due care to preserve and protect the interests of all parties.

Selected Statutes and Rules

"A trustee in a case under this title may make such deposit or investment of the money of the estate for which such trustee serves as will yield the maximum reasonable net return on such money, taking into account the safety of such deposit or investment." *11 U.S.C. §345*

A trustee is required to distribute to the debtor any assets remaining after full distribution to other interested parties. *11 U.S.C. § 726(a)(6)*

A duty is created to provide certain notices to domestic support claimants. *11 U.S.C. § 704(10)*

An obligation is created to perform the debtor's obligations as a plan administrator under the Employee Retirement Income Security Act. *11 U.S.C. § 704(11)*

An obligation exists to patients of a health care business. *11 U.S.C. § 704(12)*

A fourth new duty exists in a health care business case to notify patients and preserve patient records for one year to give patients an opportunity to claim them. *11 U.S.C. § 351*

The trustee has standing to file a motion to dismiss for abuse when the income of the debtor and the debtor's spouse exceeds the applicable state median. *11 U.S.C. §707(b)(1) and (6)*

Selected Caselaw

"A trustee also acts as a custodian of estate property in which a debtor claims an interest and, as such, has a duty to exercise reasonable diligence to preserve and protect such property." *In re Hutchinson*, 132 B.R. 827, 832 (Bankr. M.D.N.C. 1991).

A trustee owes a specific duty to account to the debtor for any estate assets to which the debtor is entitled because of the debtor's exemptions. *In re Fetner*, 218 B.R. 262, 264 -5 (Bankr. D.D.C. 1997) ("It is the trustee who has the capacity to prosecute a lawsuit on behalf of the estate. While the debtor has an interest in the potential proceeds of the lawsuit, 'the trustee, as representative of the estate, nevertheless has an interest over and above the debtor's exemption.' *Wissman v. Pittsburgh Nat'l Bank,* 942 F.2d 867, 872 (4th Cir. 1991). Of course, the trustee does have a duty to reduce any recovery to cash so that the debtor may collect on his exemption.").

However, before distribution assets to a debtor, a trustee also has a duty to investigate whether exempt assets are subject to creditors' claims under 11 U.S.C. § 522(c). *In re Kaufman*, 68 B.R. 391 (Bankr. S.D.N.Y 1986) ("[A] trustee has a duty to ascertain if an allowed exemption must be turned over to a federal or state agency which may have a superior nondischargeable tax claim under 11 U.S.C. § 523(a)(1), or turned over to a spouse or former spouse who might have a nondischargeable alimony, maintenance or support claim under 11 U.S.C. § 523(a)(5). The trustee must also ascertain if any exempt assets are subject to unavoidable liens as stated in 11 U.S.C. § 522(c)(2)."). In addition, the trustee may also set off the debtor's exemption against the value of any claims that the estate has against the debtor. *In re Ward*, 210 B.R. 531, 538 (Bankr. E.D. Va. 1997).

The same duty arises from the estate's solvency. 11 U.S.C. § 726(a)(6) requires the trustee to distribute to the debtor any assets remaining after full distribution to other interested parties. See *In re Moon*, 258 B.R. 828 (Bankr. N.D. Fla. 2001). In appropriate circumstances, this duty may also include the obligation to consider the debtor's interest when selling estate property or when settling the estate's claims against others. *In re Central Ice Cream Co.*, 836 F.2d 1068, 1072-73 (7th Cir. 1987).

When the debtor is a corporation, this duty is owed to shareholders. *Commodity Futures Trading Com'n v. Weintraub*, 471 U.S. 343, 352, 105 S.Ct. 1986, 1992 (1985) ("[T]he fiduciary duty of the trustee runs to shareholders as well as to creditors."); *In re Central Ice Cream Co.*, 836 F.2d 1068, 1072-73 (7th Cir. 1987).

In addition and more generally, a trustee must recognize and respect the humanitarian purpose and spirit of bankruptcy law when administering all estate business. *See Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934); *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915). *See generally*, Veryl Victoria Miles, Assessing Modern Bankruptcy Law: an Example of Justice, 36 Santa Clara L. Rev. 1025 (1996); Richard E. Flint, Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor, 48 Wash. & Lee L. Rev. 515 (Spring 1991).

Similarly, when an estate is solvent and the debtor or its owners do not object to a claim, the trustee has no duty to do so. *In re* Choquette, 290 B.R. 183, 189 (Bankr. D. Mass. 2003) ("[B]ecause the value of the assets to be liquidated were more than sufficient to pay all filed claims, the Trustee became indifferent to the allowance of any individual claim."); *In re* I & F Corp., 219 B.R. 483, 484 (Bankr. S.D. Ohio 1998) ("Unless the estate is solvent and there will be a distribution to the debtor, the debtor has no pecuniary interest in the reduction of a filed claim.").

"The trustee owes a fiduciary duty to *all* the creditors, not just to the unsecured creditors." [1]United Pac. Ins. Co. v. McClelland (*In re* Troy Dodson Constr. Co.), 993 F.2d 1211, 1216 (5th Cir. 1993). *See also* Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 462 n.8 (6th Cir. 1982) ("A trustee in bankruptcy or a debtor in possession, as a fiduciary, represents both the secured and unsecured creditors of the debtor."); United States v. Vickers (*In re* Fortier), 315 B.R. 829, 832 (W.D. Mich. 2004) ("The Trustee acts as a fiduciary for unsecured and secured creditors representing their interests . . . .").

One court phrased a trustee's duty to a secured creditor in these circumstances as follows:

> A trustee's only duty to a secured creditor is to exercise reasonable care in acting as a custodian of estate property that serves as collateral for the holder of a secured claim. As a custodian, a trustee must exercise reasonable diligence to protect and preserve any property in which a secured creditor has an interest.

Hutchinson, 132 B.R. at 832 (citations omitted).

The great weight of the case law discourages trustees from selling fully encumbered property. *See, e.g., In re* Feinstein Family P'ship, 247 B.R. 502, 507 (Bankr. M.D. Fla. 2000) ("It is now almost universally recognized that where the estate has no equity in a property, abandonment is virtually always appropriate because no unsecured creditor could benefit from the administration."); United States Trustee v. Messer (*In re* Pink Cadillac Assoc.), No. 96 CIV. 4571(LLS), 1997 WL 164282 (S.D.N.Y. Apr. 8, 1997) (summarizing the case law recognizing that "selling property subject to a lien worth more than the property may be no better for the estate than abandoning or turning over the property to the lienholder . . . ."); Noland v. Williamson (*In re* Williamson), 94 B.R. 958 (Bankr. S.D. Ohio 1988). *See also In re* Riverside Inv. P'ship 674 F.2d 634, 640 (7th Cir. 1982) ("As a general rule, the bankruptcy court should not order property sold "free and clear of" liens unless the court is satisfied that the sale proceeds will fully compensate secured lienholders and produce some equity for the benefit of the bankrupt's estate.").

One court asserted unequivocally, "Clearly, the Code never contemplated that a Chapter 7 trustee should act as a liquidating agent for secured creditors who should liquidate their own collateral." *Feinstein Family P'ship*, 247 B.R. at 507.

One court identified three additional circumstances in which a trustee should sell fully encumbered property:

> First, the secured claim may be cross-collateralized. While the sale of one piece of the collateral package might produce no equity for the estate, ultimately, the sale of all the collateral would. . . .
> Second, overencumbered property might be subject to a senior lien subject to avoidance, e.g., as a preference pursuant to section 547. . . .
> Third, generally speaking, a voluntary sale by the estate will bring a higher price than a foreclosure sale by a senior lienholder. The foreclosed out junior may have a deficiency claim against the estate that would compete with other unsecured claims for any other assets of value in the estate. The trustee would have a legitimate interest in maximizing the sale price for the overencumbered property so as to minimize any such deficiency claim.

In re Canonigo, 276 B.R. 257, 262 (Bankr. N.D. Cal. 2002).

See also In re Laredo, 334 B.R. 401 (N.D. Ill. 2005) (approving as sale of fully encumbered property because a tax lien was subject to subordination for administrative expenses under 11 U.S.C. § 724(b)); *In re* Buchanan, 270 B.R. 689 (Bankr. N.D. Ohio 2001) (allowing a sale of encumbered property even though it would result in no meaningful dividend to unsecured creditors because it would allow full payment to secured and priority creditors); *In re* WPRV-TV, 143 B.R. 315 (D.P.R. 1991) (approving a sale of fully encumbered assets because the sale aided in the sale of other estate assets to the benefit of the estate.).

Conversely, it might be clear that the property has equity for the estate. In that event, the trustee's duties are to sell the property for the maximum benefit of the secured creditor and the estate and to pay the debtor's exemption and the secured creditor's allowed claim

from the proceeds of the sale. 11 U.S.C. §§ 506(a) and 363(e). *See also* United States v. Darnell (*In re* Darnell), 834 F.2d 1263, 1265 (6th. Cir. 1987) ("[I]f a lien is perfected, it must be satisfied out of the asset(s) it encumbers before any proceeds of the asset(s) are available to unsecured claimants . . . ."); Grochocinski v. Laredo (*In re* Laredo), 334 B.R. 401 (Bankr. N.D. Ill. 2005) (holding that the proceeds of a sale had to be paid to a tax lien before the debtor's exemption); Mather v. Northfield Freezing Sys, Inc. (*In re* S. Star Foods, Inc.), 202 B.R. 784, 790 (Bankr. E.D. Okla. 1996) ("[C]reditor with a perfected security interest in the equipment, was entitled to receive the proceeds from the sale of its collateral . . . ."); *In re* Bevis Co., 201 B.R. 923 (Bankr. S.D. Ohio 1996); *In re* Collins, 180 B.R. 447, 452-53 (Bankr. E.D. Va. 1995) ("So to protect the interests of [the secured creditors], their liens must attach to proceeds of this sale under § 363(f).").

In re Double LL Inv., Inc., No. 90-03877-HS-7, 1995 WL 736463, *3 (Bankr. S.D. Tex. Dec. 7, 1995):

> The primary role of the trustee is to administer the estate, turning over to the secured creditors by appropriate action the property to which they are entitled and in which there is no equity for the estate, and to marshal for the benefit of the general creditors the maximum funds available for distribution. It is only where the secured property has a potential equity for general creditors or to protect that secured property that the trustee should become involved therein.
> Secured creditors by consent and the trustee by acquiescence cannot impose upon the Court the duty to serve as a foreclosure or collection forum.

Often, however, it is not immediately clear whether the property has value for unsecured creditors. In that case, the trustee's duty is to diligently investigate whether there is equity for the estate. In Heidleberg Harris, Inc. v. Grogan (*In re* Estate Design & Forms, Inc.), 200 B.R. 138, 142 (E.D. Mich. 1996), the court observed, "The Trustee retains possession of the property in order to determine its value. This allows the Trustee to fulfill his duty to determine if the estate could be benefited by the asset — i.e., does its value exceed the debt it serves? Abandonment cannot take place during this period."

A trustee owes a specific duty to account to the debtor for any estate assets to which the debtor is entitled, whether because of the debtor's exemptions. In *In re* Fetner, 218 B.R. 262, 264-65 (Bankr. D.D.C. 1997), the court stated:

> It is the trustee who has the capacity to prosecute a lawsuit on behalf of the estate. While the debtor has an interest in the potential proceeds of the lawsuit, 'the trustee, as representative of the estate, nevertheless has an interest over and above the debtor's exemption.' Wissman v. Pittsburgh Nat'l Bank, 942 F.2d 867, 872 (4th Cir. 1991). Of course, the trustee does have a duty to reduce any recovery to cash so that the debtor may collect on his exemption.

However, before distributing assets to a debtor, a trustee also has a duty to investigate whether exempt assets are subject to creditors' claims under 11 U.S.C. § 522(c).

Kaufman v. Balber-Strauss (*In re* Kaufman), 68 B.R. 391, 393 (Bankr. S.D.N.Y. 1986):

> [A] trustee has a duty to ascertain if an allowed exemption must be turned over to a federal or state agency which may have a superior nondischargeable tax claim under 11 U.S.C. § 523(a)(1), or turned over to a spouse or former spouse who might have a nondischargeable alimony, maintenance or support claim under 11 U.S.C. § 523(a)(5). The trustee must also ascertain if any exempt assets are subject to unavoidable liens as stated in 11 U.S.C. § 522(c)(2).

In addition, the trustee may also set off the debtor's exemption against the value of any claims that the estate has against the debtor. *In re* Ward, 210 B.R. 531, 538 (Bankr. E.D. Va. 1997).

Regarding the trustee's duties when the estate is solvent, see *In re* Moon, 258 B.R. 828 (Bankr. N.D. Fla. 2001); *In re* Kazis, 257 B.R. 112, 114 (Bankr. D. Mass. 2001).

In reality if not in law, the debtor becomes a creditor of the estate for those limited purposes. In appropriate circumstances, this duty may also include the obligation to consider the debtor's interest when selling estate property or when settling the estate's claims against others. *In re* Central Ice Cream Co., 836 F.2d 1068, 1072-73 (7th Cir. 1987). *See also In re* Mercury, 280 B.R. 35 (Bankr. S.D.N.Y. 2002) (holding that trustee's counsel in a personal injury suit was not disinterested because counsel previously represented the debtors and still owed them duties). When the debtor is a corporation, this duty is owed to shareholders. Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 352 (1985) ("[T]he fiduciary duty of the trustee runs to shareholders as well as to creditors."); *Central Ice Cream Co.*, 836 F.2d at 1072-73.

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"In certain limited circumstances, however, a trustee may properly sell secured property that would generate no proceeds for the benefit of unsecured creditors ("fully secured property"). For example, a trustee may be able to satisfy in full a blanket security interest on multiple units of property by selling only one unit. Similarly, a trustee may be able to obtain a higher price from an aggregate sale of assets than from selling the assets individually. In a case with funds otherwise available for unsecured creditors, a trustee also may sell fully secured property to eliminate a deficiency, if the secured creditor agrees to waive any unsecured claim for a deficiency in the event the sale does not fully satisfy the security interest." *Chapter 8(K)(4)*

"The trustee is a fiduciary charged with protecting the interests of all estate beneficiaries – namely, all classes of creditors, including those holding secured, administrative,

priority, and non-priority unsecured claims, as well as the debtor's interest in exemptions and in any possible surplus property." *Chapter 6(B)*

Other References

5. A Trustee shall encourage debtors, creditors, attorneys, other professionals, petition preparers, and other participants in the bankruptcy process to diligently perform their bankruptcy and professional obligations.

Selected Statutes and Rules

A trustee is required to ensure that the debtor is aware of certain rights in and consequences of bankruptcy. *11 U.S.C. §341(d)*

The trustee is required to ensure that the debtor performs the intention disclosed under § 521(2) regarding the surrender, reaffirmation or redemption of secured property. *11 U.S.C. §704(3)*

Selected Caselaw

"Further, in a Chapter 7 case, the meeting of creditors also serves to ensure that the debtor has a basic understanding of the consequences of filing bankruptcy." *In re* Brown, 221 B.R. 902, 904 (Bankr. M.D. Fla. 1998).

One court detailed the specific responsibilities of § 704(3):

> (1) a determination that the debtor has filed the statement of intention required by § 521(2)(A), (2) if the debtor has not completed such a filing, to demand that the debtor comply immediately, (3) to examine the debtor with regard to any requests received prior to or at the time of the 341(a) meeting from creditors concerning § 521(2)(A) or (B), and (4) to respond to appropriate creditor inquiries following the 341(a) meeting. In the absence of any secured creditor's appearance at the § 341(a) meeting, or any written request from a secured creditor seeking the trustee's involvement within the period provided under § 521(2)(B), the trustee may assume that the debtor has performed the stated intention.

In re Bayless, 78 B.R. 506, 510 (Bankr. S.D. Ohio 1987).

See also In re Rathbun, 275 B.R. 434, 441 (Bankr. D.R.I. 2001) (holding that § 704(3) "require[s] the trustee to at least monitor the debtor's performance of his or her intentions and to assist a secured creditor in communicating with a debtor, if necessary."). The HANDBOOK states at 6-5, "The trustee must ensure the performance of such intentions and should examine the statement of intention early in the case and seek the debtor's verification at the § 341(a) meeting that the intentions have been performed." *But see*

Lowry Fed. Credit Union v. West, 882 F.2d 1543, 1546 (10th Cir. 1989) ("That responsibility, however, is not coupled with any power of enforcement. In short, there is a gap between the trustee's duty to obtain compliance and the trustee's power to enforce that duty because Congress provided [no] penalty for a debtor's failure to comply with § 521(2) . . . ." (footnote omitted)).

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"The trustee has a duty under § 704 to object to the debtor's discharge if advisable. Whenever appropriate, the trustee should examine the acts and conduct of the debtor to determine whether grounds exist for denial of discharge." *Chapter 6(B)(6)*

"The trustee is responsible for reviewing the sufficiency of the petition, matrix (list of creditors' names and addresses) and statements and schedules." *Chapter 6(C)*

"The trustee should review this disclosure of compensation and make an independent determination whether the fee paid or agreed to be paid is excessive. If the fee is questionable, the trustee or the United States Trustee should move, pursuant to § 329(b) and FRBP 2017(a), to have the court review the fee for reasonableness." *Chapter 6(D)*

"The trustee should report potential violations of § 110 to the United States Trustee." *Chapter 6(E)*

"The trustee must review the schedules, statements of financial affairs, and statements of current income and expenses in each case, for any evidence of substantial abuse that may provide the basis for a motion to dismiss pursuant to § 707(b)." *See also* HANDBOOK, at 6-13, which states, "The trustee should notify the United States Trustee of any reasonable basis for a motion to dismiss pursuant to § 707(b) as soon as possible." *Chapter 6(F)*

Regarding the potential for creditor abuse in seeking reaffirmation agreements, the *Handbook* requires trustees to "[p]rohibit creditors from soliciting reaffirmations, redemptions or the surrender of property 'off the record' in the § 341(a) meeting room." *Chapter 8(R)*

Other References

The 2004 NABT Pledge, paragraph 2, states that trustees should "Encourage debtors, creditors, attorneys, and other participants in the bankruptcy process to diligently perform their respective responsibilities according to the highest standards of professional, moral and ethical conduct."

The 2004 NABT Pledge, paragraph 7, states that trustees should "Work to ensure that debtors comply with their obligations under the Bankruptcy Code and Rules."

6. A Trustee who observes conduct by debtors, creditors, attorneys, other professionals, petition preparers, or parties in interest that is fraudulent, abusive, or criminal, shall report any such conduct to the appropriate authorities.

Selected Statutes and Rules

A trustee is required to make a report to the United States Attorney when the trustee has reasonable ground to believe that a bankruptcy crime has been committed or that an investigation should be undertaken. Such reports are to be coordinated through the United States trustee. See 28 U.S.C. § 586(a)(3)(F). *18 U.S.C. § 3057(a)*

Selected Caselaw

This duty to report bankruptcy crimes is considered so important and central to the integrity of the judicial process that the referring trustee is granted absolute immunity from a subsequent civil suit for malicious prosecution. Heinsohn, 231 B.R. at 59

The duty to report crime is also shared - in this context, with the court. 18 U.S.C. § 3057(a). *See also* Stockbridge Funding, 153 B.R. at 656 ("The duties of a bankruptcy trustee under this statute are the same as those of a bankruptcy judge.").

See In re Heinsohn, 231 B.R. 48, 59 (Bankr. E.D. Tenn. 1999), *aff'd*, 247 B.R. 237 (E.D. Tenn. 2000) ("The directive in [18 U.S.C.] § 3057 is no less an obligation of the trustee than those that are specifically set forth in 11 U.S.C. § 704 which describe various duties of a trustee. Thus, a trustee who makes a criminal referral is simply carrying out his administrative duties[.]"). *See also In re Olympia Holding Corp.*, 305 B.R. 586, 591 (Bankr. M.D. Fla. 2004). *In re Stockbridge Funding Corp.*, 153 B.R. 654, 657 (Bankr. S.D.N.Y. 1993), *leave to appeal denied*, 1993 WL 205225 ("[T]he bankruptcy crimes investigation privilege shields from discovery Trustee Kittay's and his attorney's written and oral communications that were created or took place in connection with Kittay's investigating potential bankruptcy crimes or reporting such potential crimes to the United States attorney or other law enforcement agencies pursuant to 18 U.S.C. § 3057(a).").

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

" In all cases where the trustee suspects criminal activity after questioning at the § 341(a) meeting, the trustee should immediately notify the United States Trustee so that the recording of the § 341(a) meeting may be properly secured and stored to preserve its later use in a criminal proceeding." *Chapter 8(W)(1)*

Other References

The 2004 NABT Pledge, paragraph 8, states that trustees should "Promote and preserve the integrity of the bankruptcy system by helping to detect fraudulent or abusive conduct."

Professional Conduct as Trustee

7. A Trustee shall not accept or continue an appointment in a case if the Trustee is not competent to perform the required duties.

Selected Statutes and Rules

"A person may serve as trustee in a case under this title only if such person is – (1) an individual that is competent to perform the duties of trustee..." *11 U.S.C. § 321(a)(1).*

Selected Caselaw

Competence is "expertise and experience in the matter for which the person has been appointed or elected." *In re Jack Greenberg, Inc.*, 189 B.R. 906, 909 n.6 (Bankr. E.D. Pa. 1995).

"A person who is not competent to perform *all* of these duties is not eligible to be appointed trustee." *In re McKenna*, 93 B.R. 238, 241 (Bankr. E.D. Cal. 1988).

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"A trustee is expected to accept all cases assigned, unless there is a conflict of interest or other extraordinary circumstance." *Chapter 5(B)*

"A trustee must be knowledgeable of § 701(a)(1), § 101(14), and § 101(31), as well as any other applicable law or rules, and must decline any appointment in which the trustee has a conflict of interest or lacks disinterestedness. A trustee should have in place a procedure to screen new cases for possible conflicts of interest or lack of disinterestedness upon being appointed." *Chapter 5(C)*

"If a trustee discovers a conflict of interest or lack of disinterestedness after accepting the appointment, the trustee should immediately file a notice of resignation in the case. Conflict waivers by either the debtor or creditor are not effective to obviate the trustee's duty to resign." *Chapter 5(C)*

Other References

8. A Trustee shall act with full candor to the court and shall not make any knowingly false statement.

Selected Statutes and Rules

Selected Caselaw

A trustee is "an officer of the court." *King v. United States*, 379 U.S. 329, 336, n.7, (1964).

"The Court must determine whether the former Chapter 7 Trustee in this case, [Trustee], and his attorneys committed fraud on the Court, by failing to properly disclose a fee agreement that [Trustee] made with a secured creditor, Comerica Bank ("Comerica"), and then obtaining several orders from the Court that benefited Comerica. The Court is unable to find, on the present record, that [Trustee] and his attorneys *intended* to deceived the Court or to commit a fraud on the Court. But such intent is not required to find a fraud on the Court, as that concept is defined in the case law. The Court concludes that [Trustee] and his attorneys did commit a fraud on the Court, and will order appropriate relief." In re M.T.G., Inc., d/b/a Matrix Technologies, 366 B.R. 730 (Bankr. E.D. Mich. 2007).

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"[T]he trustee must disclose any potential conflicts on the court record or at the § 341(a) meeting, or both on the court record and at the § 341(a) meeting." *Chapter 5(C)*

Other References

9. A Trustee shall act with good faith and fair dealing.

Selected Statutes and Rules

Selected Caselaw

"A trustee must treat all parties fairly." *In re Michelex Ltd.*, 195 B.R. 993, 1009 (Bankr. W.D. Mich. 1996).

"The trustee owes a fiduciary duty to *all* the creditors, not just the unsecured creditors." *United Pac. Ins. Co. v. McClelland (In re Troy Dodson Contr. Co.)*, 993 F.2d 1211, 1216 (5th Cir. 1993).

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"The trustee is a fiduciary charged with protecting the interests of the various parties in the estate." *Chapter 6(A)*

"Trustees are fiduciaries who are held to very high standards of honesty and loyalty. Trustees who fail to maintain this high standard or who are otherwise deficient in their administration of cases will be subject to a wide range of corrective action by the United States Trustee or the court." *Chapter 10(A)*

Other References

A trustee must "[B]e free of prejudices against any individual, entity, or group of individuals or entities which would interfere with unbiased performance of a trustee's duties." *28 C.F.R. § 58.3(b)(4).*

10. A Trustee shall perform all responsibilities diligently.

Selected Statutes and Rules

"The trustee shall – (1) collect and reduce to money the property of the estate for which such trustee serves, and close such as estate as expeditiously as is compatible with the best interests of parties in interest." *11 U.S.C. 704(1).*

"In a chapter 7 case, dividends to creditors shall be paid as promptly as practicable." *Fed. R. Bankr. P. 3009.*

Selected Caselaw

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"To help ensure that case administration and closure are not unduly delayed, the trustee must implement a system to review the progress of each case and must be able to demonstrate that this review is performed on a regular basis. It is recommended that the review of all cases be conducted monthly, but it must be conduct not less than quarterly." *Chapter 8(T)*

"[T]he trustee's records must indicate regular and ongoing management of the cases." *Chapter 8(T)*

Other References

11. A Trustee shall investigate, identify, and administer assets in a timely and thorough manner to maximize the value of the estate.

Selected Statutes and Rules

"The trustee shall – (4) investigate the financial affairs of the debtor." *11 U.S.C. 704(4).*

"The trustee shall – (1) collect and reduce to money the property of the estate for which such trustee serves, and close such as estate as expeditiously as is compatible with the best interests of parties in interest." *11 U.S.C. 704(1).*

A trustee must file a complete inventory of the debtor's property (=must identify) within 30 days of qualifying as a trustee, unless it has already been filed. *Fed. R. Bankr. P. 2015(a)(1).*

"In a chapter 7 case, dividends to creditors shall be paid as promptly as practicable." *Fed. R. Bankr. P. 3009.*

Selected Caselaw

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"A chapter 7 case should be administered to maximize and expedite dividends to creditors and facilitate a fresh start for the debtors entitled to a discharge." *Chapter 6(A)*

"[T]he trustee must consider whether sufficient funds will be generated to make a meaningful distribution to creditors before administering a case as an asset case." *Chapter 6(A)*

"To properly represent the estate, the trustee must secure for the estate all assets properly obtainable under applicable provisions of the Bankruptcy Code, object to the debtor's discharge where appropriate, defend the estate against improper claims or other adverse interests, and liquidate the estate as expeditiously as possible for distribution to creditors." *Chapter 6(B)*

"A trustee should only sell assets that will generate sufficient proceeds to ensure a distribution to unsecured creditors, priority or general." Chapter 8(K)(1)

"Delays in case closure diminish the return to creditors, undermine the creditors,...[and] raise the costs of administration..." *Chapter 8(T)*

Other References

12. A Trustee shall conduct a meaningful meeting of creditors with a decorum that conveys the significance of the proceedings, dignity and respect for the participants, and sensitivity to the diversity of the participants.

Selected Statutes and Rules

"[T]he United States trustee shall convene and preside at a meeting of creditors." *11 U.S.C. 341(a).*

Selected Caselaw

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Handbook for Chapter 7 Trustees

"The trustee is the presiding officer at the § 341(a) meeting as designee of the United States Trustee." *Chapter 7*

"The meeting of creditors provided for in § 341(a) is the official forum where the debtor must appear and answer under oath questions from the trustee, creditors, and other parties in interest regarding the estate." *Chapter 7*

"The trustee may not delegate the duty to preside at the § 341(a) meeting...The trustee must seek prior approval, confirmed in writing, from the United States Trustee if the trustee is unable to preside at a scheduled meeting. If the United States Trustee designates another to serve at the § 341(a) meeting, the trustee is responsible for ensuring that the designated presiding officer is qualified and trained to conduct the meeting." *Chapter 7*
"The trustee must conduct the meeting in an orderly, yet flexible manner, and to provide for questioning of the debtor as to matters affecting the debtor's financial affairs and conduct." *Chapter 7(A)*

"The trustee's demeanor toward all parties should be appropriate and professional." *Chapter 7(A)*

"The trustee must exercise control over the demeanor of the debtors, attorneys, and creditors during the course of the § 341(a) meeting. Uncooperative or recalcitrant debtors should be reminded of their duties under § 521 and the FRBP 4002, especially the duty to cooperate with the trustee in the administration of the estate. Questioning should not be allowed to deteriorate to a level constituting harassment or to focus exclusively on the dischargeability of a particular debt." *Chapter 7(A)*

"The trustee should halt any examination that appears to be primarily aimed at harassing the debtor." *Chapter 7(A)*

Other References

13. A Trustee shall exercise due care regarding property in the Trustee's control.

Selected Statutes and Rules

"The trustee shall – (2) be accountable for all property received." *11 U.S.C. 704(a).*

A trustee must file a complete inventory of the debtor's property (=must identify) within 30 days of qualifying as a trustee, unless it has already been filed. *Fed. R. Bankr. P. 2015(a)(1).*

A trustee must "keep a record of receipts and the disposition of money and property received." *Fed. R. Bankr. P. 2015(a)(2).*

Selected Caselaw

"By the common law 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." *United States ex rel. Willoughby v. Howard*, 302 U.S. 445, 450 (1938).

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Handbook for Chapter 7 Trustees

"The trustee has the duty and responsibility to insure and safeguard all estate property and property that comes into the trustee's hands by virtue of his appointment." *Chapter 6(B)(2)*

"The trustee...should immediately obtain insurance in an amount sufficient to protect the estate property (which may include insurance against fire, theft, vandalism, liability and other possible hazards) and take any other steps which may be reasonably necessary to preserve the assets. The trustee should request proof of insurance from the debtor and should ensure that it is continued for the benefit of the estate." *Chapter 6(B)(2)*

"If a loss occurs as a result of the trustee's failure to insure or protect estate property, the trustee could be subject to liability including a surcharge." *Chapter 6(B)(2)*

Other References

14. A Trustee shall make decisions that are in the best interests of the estate.

Selected Statutes and Rules

"The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate." *11 U.S.C. 327(d).*

Selected Caselaw

A trustee's duty of loyalty requires him to refrain from "all opportunities to advance self-interest." *Mosser v. Darrow*, 341 U.S. 267, 271 (1951).

A trustee's conduct showing bias against a debtor establishes an "interest materially adverse to the interest of the estate," and thus a lack of disinterestedness under bankruptcy code sections 101(14) and 327(a)). *In re Vebeliunas*, 231 B.R. 181, 189 (Bankr. S.D.N.Y. 1999)

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"A trustee should not administer an estate or an asset in an estate where the proceeds of liquidation will primarily benefit the trustee or the professionals, or unduly delay the resolution of the case." *Chapter 6(A)*

"[T]he trustee must consider whether sufficient funds will be generated to make a meaningful distribution to creditors before administering a case as an asset case." *Chapter 6(A)*

"The trustee should object to a claimed exemption [of the debtor] if to do so benefits the estate." *Chapter 8(C)*

"The trustee should abandon any estate property that is burdensome or of inconsequential value to the estate." *Chapter 8(D)*

"The trustee should be able to justify the decision to abandon estate property. Any documentation in support of this decision should be kept in the estate file." *Chapter 8(D)*

Other References

15. A Trustee shall not have ex parte contacts with the judge concerning matters affecting a particular case or proceeding except as permitted by law.

Selected Statutes and Rules

"Except as permitted by applicable law, the United States trustee and assistants to and employees or agents of the United States trustee shall refrain from ex parte meetings and communications with the court concerning matters affecting a particular case or proceeding." *Fed. R. Bankr. P. 9003(b).*

Certain motions may be submitted on an ex parte basis. *See Fed. R. Bankr. P. 9013 and 7065(b).*

Selected Caselaw

A trustee may not have any "interest or relationship that would even faintly color the independence and impartial attitude required by the Code." *Mosser v. Darrow*, 341 U.S. 267, 271 (1951).

A trustee may have ex parte communications regarding a criminal referral under 18 U.S.C. § 3057. *Seidel v. Durkin (In re Goodwin)*, 194 B.R. 214, 223, 224 (B.A.P. 9th Cir. 1996).

Cases are in conflict on whether a trustee's submission of a proposed order to the court constitutes a prohibited ex parte communication. *E.g. In re Endicott*, 157 B.R. 255, 259 (W.D. Va. 1993) (holding that the ex parte submission of an order violates Fed. R. Bankr. P. 9003), *Texas Etrusion Corp. v. Lockheed Corp. (In re Texas Etrusion Corp.)*, 844 F.2d 1142, 1164 (5th Cir. 1988) (holding that the ex parte submission of an order does not violate Fed. R. Bankr. P. 9003).

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

Other References

16. A Trustee may have direct contact with a party represented by an attorney without consent of the attorney, unless prohibited by law.

Selected Statutes and Rules

Selected Caselaw

Selected Administrative Decisions of the Director of EOUST References

Handbook for Chapter 7 Trustees
Other References

"Although a trustee may be an attorney, his or her role as trustee is as the representative of the estate of the debtor – i.e., a party to the proceeding who has the capacity to sue and be sued. Hence, under the clear language of both the rule and Discussion, the Trustee, as a party, is permitted to communicate directly with other parties to the proceeding." *Cal. State Bar Standing Comm. on Prof'l Responsibility and Conduct*, Ethics Op. 1989-110, 1989 WL 253258.

"[W]here the lawyer is acting as the trustee, the lawyer-trustee, as a party, may directly contact other parties in the bankruptcy case without their counsel's consent." *State Bar of Ariz. Comm. on the Rules of Prof'l Conduct*, Formal Op. 2003-02, available at: http://www.myazbar.org/ethics/opinionview.cfm?id=295.

Disinterestedness and Conflicts

17. A Trustee shall promptly resign from any case in which the Trustee is an insider, creditor, or an equity security holder of the debtor, or in which the Trustee has an interest materially adverse to the bankruptcy estate.

Selected Statutes and Rules

The bankruptcy code addresses this duty in its requirement that the trustee be "disinterested." *11 U.S.C. § 701(a)(1)* is explicit in its requirement that an *appointed* trustee must be disinterested.

To be disinterested, a trustee must not be a creditor, an equity security holder or an insider of the debtor. *11 U.S.C. § 101(14)(A).*

The trustee must also not have an interest materially adverse to the estate by reason of any relationship to, connection with, or interest in the debtor, or for any other reason. *11 U.S.C. § 101(14)(E).*

Selected Caselaw

The Supreme Court has defined a bankruptcy trustee's duty of loyalty as the duty to forebear from "all opportunities to advance self-interest." *Mosser v. Darrow*, 341 U.S. 267, 271, 71 S.Ct. 680 (1951). The Restatement (Third) of Trusts §170(1) is to the same effect, "The trustee is under a duty to administer the trust solely in the interest of the beneficiaries." *See also* Uniform Trust Code, § 802(a) (National Conference of Commissioners on Uniform State Laws (July, 2002)). *See also*, G. Bogert, *Law of Trusts and Trustees* §§ 543 (rev.2d ed. 2003).

As Justice Jackson proclaimed in *Mosser v. Darrow*, "Equity tolerates in bankruptcy trustees no interest adverse to the trust." *Id.* 341 U.S. at 271, 71 S.Ct. at 682.

The Tenth Circuit stated that a bankruptcy trustee "must completely efface self-interest. His loyalty and devotion to his trust must be unstinted. Its well-being must always be his first consideration. These principles are inveterate and unbending." *Wootten v. Wootten* 151 F.2d 147, 149-50 (10th Cir. 1945) (citing *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546, (1928); *Johnston v. Loose*, 201 Mich. 259, 167 N.W. 1021, 1023 (1918); *Ball v. Hopkins*, 268 Mass. 260, 167 N.E. 338, 341. (1929)).

The Second Circuit agreed, stating, "[T]he law of trusts requires that the trustee, *in his role as trustee,* be disinterested and prohibits him from obtaining interests adverse to the estate. As with any trustee, a bankruptcy trustee owes a duty of loyalty to the beneficiaries of the trust." *In re Palm Coast, Matanza Shores Ltd. Partnership*, 101 F.3d

253, 258 (2d Cir. 1996) (Citing Austin W. Scott, *Scott on Trusts,* §§ 170 (3rd ed. 1967).). *See also In re Massaro*, 235 B.R. 757 (Bankr. D.N.J. 1999) (citing Scott On Trusts §§ 170 (4th ed.1987)).

The First Circuit characterized the duty of loyalty as "the most fundamental duty owed." *In re Baylis*, 313 F.3d 9, 20 (1st Cir. 2002) (citing 2A A. Scott, *The Law of Trusts* §§ 170 (W.F. Fratcher ed., 4th ed. 2001)).

In re BH & P Inc., 949 F.2d 1300, 1310 (3d Cir. 1991) ("An interim trustee appointed by the United States Trustee must, under the terms of the Bankruptcy Code, be a 'disinterested person.'"). The trustee must also not have an interest materially adverse to the estate by reason of any relationship to, connection with, or interest in the debtor, or for any other reason. 11 U.S.C. § 101(14)(E).

A trustee is not disinterested if the trustee has any "interest or relationship that would even faintly color the independence and impartial attitude required by the Code." *In re BH & P Inc.*, 949 F.2d 1300, 1308 (3d Cir.1991); *In re Crivello*, 134 F.3d 831 (7th Cir. 1998); *In re Paolino*, 80 B.R. 341 (Bankr. E.D. Pa. 1987) (Trustee who became affiliated with law firm representing defendant in suit brought by debtor was no longer disinterested.).

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Handbook for Chapter 7 Trustees

The Handbook, *Chapter 5(C)*, offers this non-exclusive list of actual or potential conflicts:

1. the trustee represents or has represented the debtor, a creditor, an equity security holder, or an insider in other matters;
2. the debtor or creditor is an employee of the trustee or of a professional providing services to the trustee in the case;
3. the trustee is appointed to serve as trustee for a corporate debtor and for a debtor who is an insider, officer, director or guarantor of the corporate debtor;
4. the estate has a potential cause of action against the trustee, an employee of the trustee, a client of the trustee or the trustee's firm or other person or entity with whom the trustee has a business or family relationship;
5. the trustee was an officer, director, or employee of the debtor or of the debtor's investment banker within two years before the commencement of the case;
6. the trustee is a creditor or an equity security holder of the debtor; or
7. the trustee had been an investment banker for a security of the debtor within three years before the commencement of the case or the trustee has represented such an investment banker in connection with the offer, sale, or issuance of a security of the debtor.

"FRBP 2008 allows the appointment of one trustee in jointly administered cases. The existence of interdebtor claims in jointly administered cases must be examined closely because such claims do not automatically disqualify the trustee. See, e.g., In re BH & P Inc., 949 F.2d 1300 (3rd Cir. 1991). However, these cases should be monitored because conflicts can develop and require the appointment of separate trustees." *Chapter 5(C)*

Other References

18. A Trustee shall not accept or continue an appointment that may adversely affect representation of a bankruptcy estate without resolving all adverse effects.

Selected Statutes and Rules

Selected Caselaw

Selected Administrative Decisions of the Director of EOUST

Handbook for Chapter 7 Trustees

"If a trustee discovers a conflict of interest or a lack of disinterestedness after accepting the appointment, the trustee should immediately file a notice of resignation in the case. Conflict waivers by either the debtor or creditor are not effective to obviate the trustee's duty to resign." *Chapter 5(C)*

Other References

In the section captioned "Conflict of Interest," the 1987 NABT Code states, "A Trustee may not serve in any case in which his interests, the interests of other bankrupt estates in which he is the Trustee, his personal interests, or those of his clients conflict with the best interests of the bankruptcy estate."

19. A Trustee shall not sell or transfer estate property to the Trustee, the Trustee's employees, or any parties with whom the Trustee has a connection that might affect or appear to reasonably affect the ability of the Trustee to perform responsibilities in an unbiased manner.

Selected Statutes and Rules

Trustees are prohibited from knowingly purchasing, directly or indirectly, any estate property. *18 U.S.C. § 154(1),*

Selected Caselaw

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Other References

In the section captioned "Self-Dealing," the 1987 NABT Code states, "Property held by a Trustee as fiduciary shall not be sold or transferred, by loan or otherwise, to the Trustee or its directors, officers, or employees, or to individuals with whom there exists such a connection or organization in which there exists such an interest, as might affect the exercise of the best judgment of the Trustee in selling or transferring such property."

20. A trustee shall only invest funds of a bankruptcy estate in a financial institution approved by the United States Trustee, but not in any financial institution or other investment in which the Trustee has any ownership interest or control.

Selected Statutes and Rules

Selected Caselaw

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Handbook for Chapter 7 Trustees

See generally, the Handbook, Chapter 9(A).

Other References

In the section captioned "Self-Dealing," the 1987 NABT Code states, "Trustees shall not invest funds of a bankruptcy estate in any financial institution, stock, bond, or other investment in which the Trustee exercises any ownership interest or control, except in a federally insured bank approved by the bankruptcy court."

Administration of Office and Supervision of Employees

21. A Trustee shall maintain and actively participate in an appropriate and comprehensive system of office operations and internal accounting to track case administration and progress, account for all estate property, and generate accurate reports.

Selected Statutes and Rules

The trustee shall "be accountable for all property received[.]" *11 U.S.C. §704(2)*

The trustee is required to "make a final report and file a final account of the administration of the estate with the court and with the United States trustee." *11 U.S.C. §704(9)*

"If in a chapter 7 . . . case the trustee has filed a final report and final account *and has certified that the estate has been fully administered*, and if within 30 days no objection has been filed by the United States trustee or a party in interest, there shall be a presumption that the estate has been fully administered." (Emphasis added.) *Rule 5009, F.R.Bankr.P.*

Selected Caselaw

The Supreme Court has addressed the issue, stating, "By the common law 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." United States *ex rel.* Willoughby v. Howard, 302 U.S. 445, 450 (1938) (footnote omitted).

The requirement is "to exercise that degree of care required of an ordinarily prudent person serving in such capacity, taking into consideration the discretion allowed." Sherr v. Winkler, 552 F.2d 1367, 1375 (10th Cir. 1977). *See also In re* Rigden, 795 F.2d 727-30 (9th Cir. 1986); *In re* Alpern, 246 B.R. 567, 577 (Bankr. N.D. Ill. 2000) ("Upon taking possession, the trustee owes a duty to the debtor to exercise ordinary care to protect the property.") (citing *In re* Reich, 54 B.R. 995, 1003 (Bankr. E.D. Mich. 1985)); *In re* Bowman, 181 B.R. 836 (Bankr. D. Md. 1995); Barrows v. Bezanson (*In re* Barrows), 171 B.R. 455, 457 (Bankr. D.N.H. 1994).

"The standard of care applicable to bankruptcy trustees in their official capacity, both as to affirmative and negative duties, is the exercise of due care, diligence, and skill. These are to be evaluated in the light of the information that was, or reasonably should have been, available at the time of the challenged conduct. . . . The measure is that of 'an ordinarily prudent [person] in the conduct of his private affairs under similar circumstances and with a similar object in view.'" *In re* NWFX, Inc., 267 B.R. 118, 159 (Bankr. W.D. Ark. 2001) (quoting *In re* Haugen Const. Service, Inc., 104 B.R. 233, 240 (Bankr. D.N.D. 1989)). *See also* Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 461 (6th Cir. 1982); *In re* Dalen, 259 B.R. 586, 604 (Bankr. W.D. Mich. 2001); *In re* Rollins, 175 B.R. 69, 74 (Bankr. E.D. Cal. 1994); United States v. Lasich (*In re* Kinross Mfg. Corp.), 174 B.R. 702, 705 (Bankr. W.D. Mich. 1994); *In re* Lundborg, 110 B.R. 106, 109 (Bankr. D. Conn. 1990).

This duty encompasses both accountability for the preservation of the assets and accountability for the distribution of the assets. The first duty is to maintain the assets, *In re Chicago Art Glass, Inc.*, 155 B.R. 180, 187 (Bankr. N.D. Ill. 1993) (The duty is "to carefully preserve the assets in his possession, upon pain of surcharge, from deterioration or dissipation.").

The second duty is to properly apply those assets to creditors' claims. *In re Wade*, 991 F.2d 402, 406 (7th Cir. 1993) ("A trustee must 'fully administer' creditors' claims against the bankrupt estate. The trustee controls the assets of the estate, which will be applied to satisfy these claims to the extent assets exist.").

This accountability is a financial accountability, and it extends not only to losses incurred directly by the estate but also to profits the trustee earns at the expense of the estate. *Mosser v. Darrow*, 341 U.S. 267, 71 S.Ct. 680, 95 L.Ed. 927 (1951); *In re San Juan Hotel Corp.*, 847 F.2d 931, 936-38 (1st Cir.1988); *In re Ferrante*, 51 F.3d 1473,1477-78 (9th Cir. 1995); *In re E Z Feed Cube Co., Ltd.*, 115 B.R. 684, 689 (Bankr. D. Or. 1990) ("When a trustee intentionally or negligently makes improper disbursements from the estate, his accounts are to be surcharged and he is personally liable to reimburse the estate for the amounts so disbursed."). *See also In re Harp*, 66 B.R. 740, 755-56 (Bankr. N.D. Ala. 1993); *In re Weber*, 99 B.R. 1001, 1013 (Bankr.

D. Utah 1989). The duty to account is also a continuing duty and any breach is a continuing breach. *In re Foodsource, Inc.*,130 B.R. 549, 563 (N.D. Cal. 1991).

The importance of this duty is underscored in section 322(a), which requires the trustee to file "a bond in favor of the United States conditioned on the faithful performance of such official duties." Effectively, the bond serves as collateral for this obligation. *In re Louis Rosenberg Auto Parts, Inc.*, 209 B.R. 668, 674 n. 11 (Bankr. W.D. Pa. 1997).

In re Wade, 991 F.2d 402, 406 (7th Cir. 1993) ("A trustee must 'fully administer' creditors' claims against the bankrupt estate. The trustee controls the assets of the estate, which will be applied to satisfy these claims to the extent assets exist.").

The final report and final account serves two purposes. The first is "to insure that trustees disclose and [are] held accountable for their handling of the estate." *In re San Juan Hotel Corp.*, 847 F.2d 931, 939 (1st Cir. 1988).

Second, when the trustee makes this filing and is discharged, the case is closed. Section 350(a) states, "After an estate is fully administered and the court has discharged the trustee, the court shall close the case." 11 U.S.C. § 350(a). See *In re Wade, id.* at 407. ("Chapter 7 cases come to an end in a final report indicating the distribution of proceeds from liquidated assets.").

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See also Case No. 03-0002 (Decision of Director Lawrence A. Friedman, January 21, 2004, available at http://www.usdoj.gov/ust/foia/ admin-decisions/case03-0002.pdf) (A trustee must "adhere to the high accounting and cash management standards that are expected of a fiduciary. Cash management and accounting are core trustee responsibilities.").

Handbook for Chapter 7 Trustees

"To help ensure that case administration and closure are not unduly delayed, the trustee must implement a system to review the progress of each case and must be able to demonstrate that this review is performed on a regular basis. It is recommended that the review be conducted monthly, but it must be conducted not less than quarterly. Evidence of the review must be preserved and made available for review by the United States Trustee, upon request, or during the course of an audit or review of the trustee's operation." *Chapter 8(T)*

Other References

The 2004 NABT Pledge (March, 2004), paragraph 4, states that trustees should "Actively participate in every facet of the trustee operation and maintain efficient systems that accurately track case administration, chart the progress of cases, account for all property that comes into the trustee's possession, and generate accurate reports."

The 2004 NABT Pledge, paragraph 5, states that trustees should "Maintain an appropriate and reasonably comprehensive system of internal controls over accounting and office operations to safeguard estate assets and trust funds."

One treatise asserts this expanded description of this duty:

> This duty is a statement of responsibility and liability; it means that the trustee must make a legally acceptable disposition of each item of property received. . . If the trustee gives up property to another, it must be in recognition of a legally enforceable right of a higher rank than that of the trustee. If property is sold, it must be sold for a reasonable price under all of the circumstances. . . No item may have vanished or have been put beyond the trustee's control to dispose of it. If any item of property clearly belongs to the estate that has little or no value and benefit to the estate, it should be abandoned as burdensome to the estate under the provisions of Code §§ 554(a), rather than leaving its disposition to inference.
>
> The ability of the trustee to meet the duty of accountability to the satisfaction of parties in interest or the Court requires that good records be kept. Without exception, money received should be deposited in a bank account. Duplicate deposit slips should be made and retained. A cash receipts list should be kept, giving dates, sources, descriptions of transactions, and amounts. All paid checks drawn by the trustee and bank statements should be retained.
>
> The trustee should keep a record of makes, models, and serial numbers or vehicle identification numbers of manufactured products. Appropriate identification listings should be made with respect to other property.
>
> All disbursements of funds should be by bank check, except in rare circumstances. If the trustee must make an out-of-pocket cash payment, a receipt should be obtained.
>
> If property of the estate is surrendered to a third party or placed in the hands of a third party for storage or repair, a receipt for it should be obtained.

Norton Bankruptcy Law and Practice (2d Ed. 2004) §§ 65:9.

22. A Trustee shall have a system in place to timely respond to reasonable inquiries on behalf of debtors, creditors, attorneys, the court, and other interested persons.

Selected Statutes and Rules

The trustee shall "furnish such information concerning the estate and the estate's administration as is requested by a party in interest[,]" unless the court orders otherwise. *11 U.S.C. § 704(7)*

"A person who, being a custodian, trustee, marshal, or other officer of the court— . . . (2) knowingly refuses to permit a reasonable opportunity for the inspection by parties in interest of the documents and accounts relating to the affairs of estates in the person's charge by parties when directed by the court to do so; . . . shall be fined under this title and shall forfeit the person's office, which shall thereupon become vacant." *18 U.S.C. § 154*

Accessibility "to all parties with reasonable inquiries or comments about a case" is a requirement for eligibility for appointment on the Chapter 7 trustee panel. *28 C.F.R. § 58.3(b)(3)*

Selected Caselaw

"Section 704(7) requires the turn over of information if two conditions are met: the information must concern the estate or the administration of the estate; and the request must be made by a party in interest. If these conditions are met, the trustee has a fiduciary duty to provide that information. The language in this code section makes a request for information difficult for a trustee to avoid absent a court order to the contrary." NWFX, Inc., 267 B.R. 118, 209 (Bankr. W.D. Ark. 2001). *See also In re* Vlachos, 61 B.R. 473, 477 (Bankr. S.D. Ohio 1986) ("While the court would not require a trustee who has filed appropriate interim reports to respond to every inquiry received from a party in interest, the court cannot allow repeated inquiries from counsel for a creditor to remain unanswered in a case . . . ."). *See In re* Sports Accessories, Inc., 34 B.R. 80, 82 (Bankr. D. Md. 1983) ("Considering the overriding duty of the trustee to keep creditors informed, the court will order the disclosure of information to [the creditor]").

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Handbook for Chapter 7 Trustees

"The trustee should reply in an expeditious manner to inquiries from creditors and other parties in interest." *Chapter 6(B)(7)*

Other References

23. A Trustee shall have a system in place to screen new cases for lack of disinterestedness and to identify circumstances that arise during the case creating a lack of disinterestedness.

Selected Statutes and Rules

The United States trustee shall immediately notify the person selected as trustee how to qualify and, if applicable, the amount of the trustee's bond. A trustee that has filed a blanket bond pursuant to Rule 2010 and has been selected as trustee in a chapter 7, chapter 12, or chapter 13 case that does not notify the court and the United States trustee in writing of rejection of the office within five days after receipt of notice of selection shall be deemed to have accepted the office. Any other person selected as trustee shall notify the court and the United States trustee in writing of acceptance of the office within five days after receipt of notice of selection or shall be deemed to have rejected the office. *Rule 2008, F.R.Bankr.P.*

Selected Caselaw

A five day delay from appointment until resignation is too long. *See also In re* S. Diversified Prop., Inc., 110 B.R. 992 (Bankr. N.D. Ga. 1990).

"[W]aivers under § 327(a) are ordinarily not effective." Century Indem. Co. v. Congoleum Corp. (*In re* Congoleum Corp.), 426 F.3d 675, 692 (3d Cir. 2005); *In re* Am. Energy Trading, Inc. 291 B.R. 154, 158 (Bankr. W.D. Mo. 2003); *In re* Wheatfield Bus. Park LLC, 286 B.R. 412, 420-21 (Bankr. C.D. Cal. 2002); *In re* Granite Partners LP, 219 B.R. 22, 34 (Bankr. S.D.N.Y. 1998); *In re* Quality Beverage Co., 216 B.R. 592, 595 (Bankr. S.D. Tex. 1995); *In re* Envirodyne Indus., Inc., 150 B.R. 1008, 1016 (Bankr. N.D. Ill. 1993); *In re* Amdura Corp., 121 B.R. 862, 866 (Bankr. D. Colo. 1990)

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See also Case No. 98-0004, Decision by Director Joseph Patchen, October 2, 1998, available at http://www.usdoj.gov/ust/foia/admin-decisions/case98-0004.PDF. (Trustee removed for repeated failure to resign promptly in two cases.)

Handbook for Chapter 7 Trustees

"A trustee must be knowledgeable of § 701(a)(1), § 101(14), and § 101(31), as well as any other applicable law or rules, and must decline any appointment in which the trustee has a conflict of interest or lacks disinterestedness. A trustee should have in place a procedure to screen new cases for possible conflicts of interest or lack of disinterestedness upon being appointed. If a trustee discovers a conflict of interest or

a lack of disinterestedness after accepting the appointment, the trustee should immediately file a notice of resignation in the case." *Chapter 5(C)*

"The trustee must advise the United States Trustee upon the discovery of any potential conflict or lack of disinterestedness so that a determination can be made as to whether the appointment of a successor trustee is necessary. In addition, the trustee must disclose any potential conflicts on the court record or at the § 341(a) meeting, or both on the court record and at the § 341(a) meeting. The trustee should also advise the United States Trustee upon discovery of any circumstances which might give rise to the appearance of impropriety." *Chapter 5(C)*

Other References

24. A Trustee shall timely file all required reports and shall cooperate with required government audits and examinations.

Selected Statutes and Rules

A trustee who: (3) knowingly refuses to permit a reasonable opportunity for the inspection by the United States Trustee of the documents and accounts relating to the affairs of an estate in the person's charge, shall be fined under this title and shall forfeit the person's office, which shall thereupon become vacant. *18 U.S.C. § 154*

Establishing the qualifications for membership on the panel of trustees - "(b) The qualifications for membership on the panel are as follows: . . . (7) Be willing to provide reports as required by the United States Trustee." *28 C.F.R. § 58.3,*

A trustee may be removed or suspended for "(8) Failure to file timely, accurate reports, including interim reports, final reports, and final accounts[.]" *28 C.F.R. § 58.6(a)*

Selected Caselaw

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Handbook for Chapter 7 Trustees

"To properly perform the trustee's duties and effectively administer an asset case, the trustee must establish an appropriate accounting system and maintain financial records on a contemporaneous basis for each estate." *Chapter 9(B)*

A trustee's performance review takes into account, "7. the trustee's cooperation in furnishing reports and requested information to the United States Trustee[.]" Chapter 2(D)

"The trustee will be advised at least two weeks in advance of when the audit, examination, or review will be conducted. The trustee must have all records available and make every effort to ensure that all appropriate employees are on hand." *Chapter 9(E)*

Other References

25. A Trustee shall supervise the work of employees and be responsible for their work product.

Selected Statutes and Rules

A trustee may be removed or suspended for "(7) Failure to adequately monitor the work of professionals or others employed by the trustee to assist in the administration of cases[.]" *28 C.F.R. § 156(a)*

Selected Caselaw

A trustee is permitted and even encouraged to delegate duties to a paraprofessional. *In re Jenkins*, 188 B.R. 416, 421 (B.A.P. 9th Cir. 1995), *aff'd*, 130 F.3d 1335 (9th Cir. 1997) ("Congress intended to encourage trustees to delegate their duties where such delegation would *lower* costs of administration."). *See also In re Orthopaedic Technology, Inc.*, 97 B.R.596 (Bankr. D. Colo. 1989). ("[T]rustees should be encouraged to use paraprofessionals wherever practical[.]").

"The trustee can *not* delegate the ultimate responsibility or the decisionmaking that is part and parcel of her office." (emphasis in original). *See also In re Abraham*, 163 B.R. 772, 779 (Bankr. W.D. Tex. 1004)

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See also Case No. 02-0005, Decision by Director Lawrence A. Friedman (February 28, 2003) available at http://www.usdoj.gov/ust/foia/admin-decisions/case02-0005.pdf. (The trustee was removed from the panel of trustees in part for failing to properly supervise an associate. The associate had suggested to a software vendor and to several real estate brokers financial arrangements that the U.S. Trustee characterized as "kickbacks.")

Handbook for Chapter 7 Trustees

"The trustee shall oversee the entire trustee operation and shall actively supervise employees and independent contractors in the performance of their cash management and accounting duties." *Chapter 9(D)(1)(a)*

Other References

In the section captioned, "Integrity and Competence," the 1987 NABT Code states, "A Trustee often delegates tasks to clerks, secretaries, and other lay person. Such delegation is proper if the Trustee maintains a direct relationship with the debtor [sic], supervises the delegated work, and has complete responsibility for the work product."

Employment of Professionals

26. A Trustee shall employ competent professionals who are disinterested, unless otherwise authorized by law.

Selected Statutes and Rules

The trustee may not retain any professionals who have a claim against the estate. *11 U.S.C. § 327(a)*

"The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate." *11 U.S.C. § 327(d)*

A trustee is permitted to employ an attorney who has represented the debtor, for a "specified special purpose," unless there is an actual conflict of interest. *11 U.S.C. § 327(e)*

Selected Caselaw

In re BH & P, Inc., 949 F.2d 1300, 1314 n.14 (3d Cir. 1991): *In re 22 Acquisition Corp.*, 2004 WL 870813 at *3 (E.D. Pa. 2004); *In re Woodworkers Warehouse, Inc.*, 303 B.R. 740, 742 (Bankr. D. Del 2004); *In re Creative Restaurant Management, Inc.*, 139 B.R.

902, 909 (Bankr. W.D. Mo. 1992); *In re Doors & More, Inc.*, 126 B.R. 43 (Bankr. E.D. Mich. 1991); *In re Vettori*, 217 B.R. 242 (Bankr. N.D. Ill. 1998).

"These statutory requirements - disinterestedness and no interest adverse to the estate - serve the important policy of ensuring that all professionals appointed pursuant to § 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities." Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994). *See also* Bank Brussels Lambert v. Coan (*In re* AroChem Corp.), 176 F.3d 610, 621 (2d Cir. 1999); Electro-Wire Prods., Inc v. Sirote & Permutt, P.C. (*In re* Prince), 40 F.3d 356 (11th Cir. 1994). An attorney's representation of a creditor, however, is not disqualifying, unless there is an objection and an actual conflict of interest. *In re* Lee Way Holding Co., 100 B.R. 950 (Bankr. S.D. Ohio 1989). Similarly, a professional's prior, unrelated representation of the trustee is not disqualifying. *In re* Builders Capital & Servs., Inc., 291 B.R. 258 (Bankr. W.D.N.Y. 2003).

The trustee may not retain any professionals who have a claim against the estate. Michel v. Federated Dep't. Stores, Inc. (*In re* Federated Dep't. Stores, Inc.), 44 F.3d 1310 (6th Cir. 1995); *In re* Watervliet Paper Co., 111 B.R. 131 (W.D. Mich. 1989); Levin v. DiLoreto (*In re* DiLoreto), 277 B.R. 607 (Bankr. E.D. Pa. 2000); Buckley v. Transamerica Inv. Corp. (*In re* S. Kitchens, Inc.), 216 B.R. 818 (Bankr. D. Minn. 1998); *In re* HSD Venture, 178 B.R. 831 (Bankr. S.D. Cal. 1995); *In re* River Ranch, Inc., 176 B.R. 603 (Bankr. M.D. Fla. 1994); *In re* Sky Valley, Inc., 135 B.R. 925 (Bankr. N.D. Ga. 1992); *In re* Frederick Petroleum Corp., 75 B.R. 774 (Bankr. S.D. Ohio 1987).

In re Siliconix, Inc., 135 B.R. 378 (N.D. Cal 1991) ("[W]hatever efficiency might be gained by employing creditors is outweighed by the need to preserve both the integrity and the appearance of integrity of the bankruptcy system. Congress obviously desired to avoid even the appearance of a conflict of interest between the debtor and the professionals hired by the estate."); *In re* Gray, 64 B.R. 505, 508 (Bankr. E.D. Mich. 1986) ("[W]ith respect to questions of efficiency, it is by now plain that Congress when it enacted § 327(a), made a choice that efficiency would be sacrificed for the appearance of propriety.").

The trustee is permitted to retain such a professional when the professional waives the claim and thus becomes disinterested. Watervliet Paper Co., 111 B.R. 131; *In re* Git-N-Go, Inc., 321 B.R. 54, 60 (Bankr. N.D. Okla. 2004); *In re* Princeton Med. Mgmt. Inc., 249 B.R. 813, 816 (Bankr. M.D. Fla. 2000); *In re* Howard Smith, Inc., 207 B.R. 236, 237 (Bankr. W.D. Okla. 1997); *In re* Fulgham, Enters, Inc., 181 B.R. 139, 142 (Bankr. N.D. Ala. 1995); *Eastern Charter Tours, Inc.*, 167 B.R. 995; *In re* Hub Bus. Forms, Inc., 146 B.R. 315 (Bankr. D. Mass. 1992). *But see In re* Marion Carefree Ltd. P'ship, 171 B.R. 584 (Bankr. N.D. Ohio 1994) (holding that an agreement to waive the claim in the future is insufficient to be disinterested)

The trustee may retain a spouse as a professional, on the grounds that nothing in the Bankruptcy Code prohibits it and with the condition that the trustee establish that the retention is in the best interest of the estate. *In re* Interamericas, Ltd., 321 B.R. 830

(Bankr. S.D. Tex. 2005); *In re* Alexander, 129 B.R. 183 (Bankr. D. Minn. 1991).

The obligation of loyalty exists throughout the tenure of the trustee and the trustee's professionals with the estate. *In re* Sauer, 191 B.R. 402 (Bankr. D. Neb. 1995); *In re* Diamond Mortgage of Ill., 135 B.R. 78, 93 (Bankr. N.D. Ill. 1990).

One court recently announced that it would consider the following factors in determining whether the proposed retention under § 327(d) would be in the estate's best interest:

> 1. The qualifications of the members of the firm compared to the complexity of the case;
> 2. Whether the firm is regularly hired by others to handle similar litigation;
> 3. Whether the anticipated litigation predominantly involves issues of bankruptcy law with which the law firm has particularized expertise;
> 4. Whether the time commitment required to handle the case is consistent with the size of the firm and the balance of the firm's time commitments;
> 5. Whether only a nominal amount of work must be performed;
> 6. The availability of other qualified firms to handle the case;
> 7. The rates charged by the firm compared to the rates charged by other qualified firms;
> 8. Whether there will be material cost savings to the estate; and
> 9. Other case-specific factors.

Interamericas, Ltd., 321 B.R. at 834.

Other courts consider slightly different factors. *See, e.g., In re* Butler Indus., Inc., 114 B.R. 695, 698 (C.D. Cal. 1990).

The trustee may not, however, serve in any other professional position for the estate. *In re* Palm Coast, Matanza Shores Ltd. P'ship, 101 F.3d 253, 257 (2d Cir. 1996) ("A trustee who hires his own professional firm to assist him cannot be a 'disinterested person' who has no interest adverse to the estate. Once the trustee's firm is hired by the estate, the trustee's personal interests are implicated." Accordingly, trustee's appointment as a real estate broker was disapproved.); *In re* Mandell, 203 B.R. 345 (Bankr. S.D. Fla. 1996); *In re* Blue, 146 B.R. 856, 858 (Bankr. W.D. Okla. 1992); *Alexander*, 129 B.R. at 185; *In re* Cont'l Nut Co., 44 B.R. 48, 49 (Bankr. E.D. Cal. 1984); Assistant United States Trustee v. John Galt, Ltd. (*In re* John Galt, Ltd.), 130 B.R. 464, 465-66 (S.D. W. Va. 1989). *But see In re* Wilkinson Distrib. Co., 106 B.R. 658, 660 (Bankr. D. Haw. 1989) (stating that "[t]he Code does not prohibit the Trustee from serving in one of the other professional capacities enumerated in 11 U.S.C. § 327(a) and being compensated independently for those professional services" and allowing the trustee to receive a commission for acting as a real estate broker).

In Harold & Williams Dev. Co. v. United States Trustee (*In re* Harold & Williams Dev. Co.), 977 F.2d 906, 910 (4th Cir. 1992), the court stated regarding section 327(e):

> [T]he discretion of the bankruptcy court must be exercised in a way that it believes best serves the objectives of the bankruptcy system. Among the ultimate considerations for the bankruptcy courts in making these decisions must be the protection of the interests of the bankruptcy estate and its creditors, and the efficient, expeditious, and economical resolution of the bankruptcy proceeding.

See also In re AroChem Corp., 176 F.3d 610, 621 (2d Cir. 1999); Stoumbos v. Kilimnik, 988 F.2d 949, 964 (9th Cir. 1993); Johnson v. Richter, Miller & Finn (*In re* Johnson), 312 B.R. 810, 819-20 (E.D. Va. 2004).

See also 11 U.S.C. § 327(c) (allowing a trustee to retain an attorney that has represented a creditor if no one objects and there is no actual conflict of interest); *In re* Carbide Cutoff, Inc., 703 F.2d 259, 265 n.9 (7th Cir. 1983); COM-1 Info, Inc. v. Wolkowitz (*In re* Maximus Computers, Inc.), 278 B.R. 189, 196 (B.A.P. 9th Cir. 2002); Graham v. Lennington, 74 B.R. 963, 965 (S.D. Ind. 1987).

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"Routine matters may be handled quickly and economically by this kind of representation. However, a trustee should be sensitive to the best interest of each individual estate and any conflict of interest problems that may be posed by acting as an attorney or accountant for the estate." *Chapter 8(M)(5)*

The Handbook further states that when serving as a professional for the estate, the trustee must keep: [D]etailed time records of the tasks performed as a trustee and as an attorney or accountant . . . . The importance of distinguishing trustee duties from attorney or accountant for trustee functions cannot be overemphasized. The demarcation of the roles of the trustee and the professional is made to ensure that an estate incurs only appropriate costs for administration. *Chapter 8(M)(5)*

Other References

27. A Trustee shall supervise the work of employed professionals.

Selected Statutes and Rules

A trustee may be removed or suspended for "(7) Failure to adequately monitor the work of professionals or others employed by the trustee to assist in the administration of cases[.]" *28 C.F.R. § 156(a)*