AMERICAN BANKRUPTCY INSTITUTE

2023 Annual Spring Meeting

Bankruptcy Court Jurisdiction and Standing

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CONCURRENT SESSION

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General Jurisdictional Statutes

- 28 U.S.C. § 1334
  - Provides that the District Court shall have original and exclusive jurisdiction of all cases under title 11
- 28 U.S.C. § 157
  - Provides authority to District Court to refer to the Bankruptcy Court cases under title 11, proceedings arising under title 11, or arising in and related to a case under title 11
  - A case under title 11 refers solely to the filing of the bankruptcy petition
  - A proceeding arising under title 11 involves a cause of action created under title 11
  - A proceeding arising in a case under title 11 is one that is not based on a right created under title 11, but that would have no existence outside of bankruptcy
  - A proceeding related to a case under title 11 is one that may involve a cause of action belonging to a debtor that became property of the estate under 11 U.S.C. § 541 or a suit between third parties that have an effect on the bankruptcy estate

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General Jurisdiction *cont'd*

- 28 U.S.C. § 157(b)(2)
  - A non-exhaustive list of core proceedings
  - However, under Stern v. Marshall, a matter may be statutorily core, but not constitutionally core. A court may not enter final judgments on such a matter. Instead, the court can only submit proposed findings of fact and conclusions of law.
  - In non-core proceedings that are otherwise related to a case under title 11, a bankruptcy judge is required to submit proposed findings of fact and conclusions of law. A final order may be entered by the District Court, after de novo review.

Bankruptcy Court Standing

- Three types of standing:
- 1) constitutional standing (the constitutional case-or-controversy requirement);
- 2) prudential standing (judicially imposed limits on federal jurisdiction); and
- 3) statutory standing (legislatively imposed limits on a statutory cause of action).

Standing *cont'd*

- Section 1109(b) in Chapter 11 cases and Fed. R. Bankr. Proc. 6009 expressly recognize certain rights to appear and be heard.
- Rights to be heard ultimately require an analysis of the matter before the court and whether the party wishing to raise issues is within the zone of interests intended to be protected
- Standing in the bankruptcy case does not equate standing to appeal
- Case trustees and U.S. Trustees are exceptions to strict standing analysis

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Derivative Standing to Pursue Claims

- The pursuit of claims held by the estate can be an important factor in chapter 11 proceeding
- Who has the authority to bring those claims and/or settle those claims is also an important factor
- Absent consent, creditors/official committees need court approval to bring claims that have vested in the debtors' estates:
  - Courts generally, though not always, will look to whether the debtor/trustee has unjustifiably refused to pursue colorable claims that could maximize th evalue of the estates
  - 2d Cir. – <u>STN/Housecraft</u>
  - 3d Cir. – <u>Cybergenics</u>

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Derivative Standing *cont'd*

- Is the question of derivative standing one of bankruptcy law or state law? Some recent cases suggest the latter
  - In re Dura Automotive Systems, LLC, No. 19-12378 (KBI) (Bankr. D. Del. June 9, 2020)
  - In re Citadel Watford City Disposal Partners, L.P., 603 B.R. 897 (Bankr. D. Del. 2019)
- Standing to sue may not necessarily include standing to settle
  - Smartworld and its progeny

Barton

- *Barton v. Barbour,* 104 U.S. 126 (1881)
  - Plaintiff brought a claim for personal injury arising out of the operation of a railroad in receivership
  - She sued in District of Columbia court without first seeking leave from the Virginia court that appointed the receiver
  - Supreme Court held that the claim could not be brought outside the receivership court unless that court first granted leave
  - The Court expressly held that the non-receivership court did not have jurisdiction over the claim absent leave from the receivership court.
  - Court relied on cases arising in liquidations; this was an extension of the doctrine to operating receiverships

Barton, cont'd

- The extension to cover operating receiverships was controversial and there was a strong dissent.
- Within 6 years, Congress effectively reversed the extension to provide that receivers and trustees may be sued without leave of the court appointing them "with respect to any of their acts or transactions in carrying on business connected with such property."
- That exception is now in 28 U.S.C. 959(a), which has been in its current form since 1945.

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Basis for *Barton* Rule

- Barton covers two distinct kinds of claims:
  - Claims against the trustee in her *representative* capacity, and claims against the trustee in her *individual* capacity.
  - There are two exceptions:
    - 959(a) claims for carrying on on the business
    - Claims where the trustee acted *ultra vires*
      - Haven't seen claims where the second has successfully been asserted; it may be better to say that a claims that is entirely unrelated to the trustee's service on that case are not covered.

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Barton Rule Covered Individuals

- The Barton rule is non statutory; oddly, it is the exception (959(a) that is statutory
- Subsequent caselaw has extended the list of covered individuals:
  - Creditors' committee members
  - Trustee's counsel
  - Directors appointed to exercise the duties of a trustee
  - Liquidating plan trustees
  - Appointed auction house
  - Trustees of 524(g) trust

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Barton Test for Granting Leave

- Non-exclusive list of factors to consider:

- Whether the acts complained of "relate to the carrying on of the business connected with the property of the bankruptcy estate,"
- whether the claims concern the actions of the officer while administering the estate,
- whether the officer is entitled to quasi-judicial or derived judicial immunity,
- whether the plaintiff seeks a personal judgment against the officer, and
- whether the claims seek relief for breach of fiduciary duty, through either negligent or willful conduct.

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Raising *Barton* Post-Closing

- After a case is closed and the estate is fully administered, does Barton still apply?
  - Most courts: yes; leave is still required and the case should be re-opened to consider it.
  - 11th Circuit: No. If the case is full y administered and the action would not have an impact on the estate, then *Barton* does not apply

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Bankruptcy Court Jurisdiction and Standing

ABI Spring Meeting

Washington, D.C.

April 22, 2023

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Overview

Unlike courts that derive their authority from Article III of the U.S. Constitution, bankruptcy courts are courts of limited jurisdiction. Their authority is derivative of that granted to the district courts. Bankruptcy jurisdiction extends to four types of matters: (1) cases under title 11; (2) proceedings arising under title 11; (3) proceedings arising in a bankruptcy case; and (4) proceedings related to a bankruptcy case. In re Exide Techs., 544 F.3d 196, 205 (3d Cir. 2008). Cases under title 11, proceedings arising under title 11 of the U.S. Code and proceedings arising in a bankruptcy case are core proceedings, while proceedings related to a case under title 11 are noncore proceedings. Id.

Sections 157 and 1334 of title 28 of the U.S. Code describe the jurisdiction of courts sitting in bankruptcy. Although appearing at first blush to be arcane, the distinctions between the types of bankruptcy jurisdiction are essential to determining whether, to what extent and under what circumstances a bankruptcy court may exercise subject-matter jurisdiction over a particular matter or proceeding. For that reason, a good understanding of these distinctions is essential for any bankruptcy practitioner.

Marathon Pipe Line

As a court created by Congress, rather than explicitly provided for by the Constitution, a bankruptcy court is a creature of Article I of the Constitution. Accordingly, and as was subsequently confirmed by the Supreme Court, see infra, bankruptcy courts must be courts of limited jurisdiction. Congress did not recognize when it enacted the Bankruptcy Code in 1976.

In 1976, Congress provided the newly created bankruptcy courts with jurisdiction over "civil proceedings arising under title 11 or arising in or related to cases under title 11." 28 U.S.C. §1471(b) (1976). Moreover, the jurisdictional grant provided "in each judicial district, as an adjunct to the district court for such district, a bankruptcy court which shall be a court of record known as the United States Bankruptcy Court for the district." 28 U.S.C. §151(a) (1976). Title 28 also provided that bankruptcy judges were to be appointed for 14 years, and that their salaries were to be set by statute. 28 U.S.C. §§152, 154 (1976). As some of a bankruptcy court's powers, as prescribed initially by Congress, could only be held by Article III judges, a constitutional fight was imminent.

In Northern Pipeline v. Marathon Pipe Line, 458 U.S. 50 (1982), the Supreme Court considered the constitutionality of 28 U.S.C. §1471 and found that it was unconstitutional to vest full and final authority over any matter conceivably related to a bankruptcy case in an Article I judge. The Constitution requires that the certain powers vest only in Article III judges. In the wake of *Marathon Pipe Line*, the question then arose as to what to do about the administration of the bankruptcy courts until the problem was fixed.

Courts and Congress Respond to *Marathon Pipe Line*

Recognizing the impact of its decision, the Court in Marathon Pipe Line temporarily stayed the effectiveness of its decision to allow Congress to adopt appropriate measures. Marathon Pipe Line, 458 U.S. at 58. However, Congress failed to act timely, and the Judicial Conference of the United States promulgated a model Emergency Rule that was adopted as a local rule by the district courts to permit the bankruptcy system to continue to function.[1]

Congressional action did not come until 1984, when Congress codified the Emergency Rule by enacting 28 U.S.C. §157, which vests bankruptcy jurisdiction in the district court but permits the district court to "refer" bankruptcy cases and proceedings "to the bankruptcy judges for the district." 28 U.S.C. §157(a). Accordingly, bankruptcy courts only preside over bankruptcy cases and proceedings because the district courts have referred them. For instance, in the Southern District of New York, the automatic reference of cases and proceedings to the bankruptcy court is pursuant to Standing Order M-61, which is titled Referring to Bankruptcy Judges for the Southern District of New York Any and All Proceedings Under Title 11 (dated July 10, 1984). Every other district similarly provides for the reference of bankruptcy cases and proceedings to the bankruptcy courts.[2]

Once a bankruptcy case or proceeding is referred to the bankruptcy court, that reference is not irreversible. Under 28 U.S.C. §157(d), the district court "on its own motion or on timely motion of any party for cause shown" may withdraw the reference to the bankruptcy court. 28 U.S.C. §157(d). When resolution of a proceeding "requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce," then on a party's timely motion, withdrawal of the reference is mandatory. Id.[3]

Cases or Proceedings, Core or Non-core, and Why It Matters

A bankruptcy court's jurisdiction is most solid when it hears and determines either a case under title 11, a core proceeding arising under title 11, or a proceeding arising in a case under title 11. The distinction between core and non-core proceedings is critical because a bankruptcy court is delegated the authority to enter orders and judgments in core proceedings, subject to appellate review under 28 U.S.C. § 158. See 28 U.S.C. §157(b)(1). However, when a proceeding is non-core, the bankruptcy court is limited to submitting proposed findings of fact and conclusions of law, with the district court authorized to enter any final order or judgment after de novo review. 28 U.S.C. §157(c)(1). Because these distinctions go to the heart of a bankruptcy court's jurisdiction, it is important to understand the precise nature of the case or proceeding before the court and the court's ability to act with respect to such a case or proceeding.

Stern v. Marshall

In Stern v. Marshall, 564 U.S. 462 (2011), the Supreme Court determined that Congress' grant of certain authority to bankruptcy courts under 28 U.S.C. §157(b)(1) was unconstitutional even where Congress may have designated such issues to be core at 28 U.S.C. §157(b)(2). The Court held that non-Article III courts, such as bankruptcy courts, could not adjudicate certain causes of action, even when Congress provided that such issues are core. Therefore, while a bankruptcy court had statutory authority to enter judgment on such issues, it lacked constitutional authority to do so. In the case of Stern, the claim was a counterclaim arising under state common law. Accordingly, the Court held that a bankruptcy court could not enter final judgment, but could only submit proposed findings of fact and conclusions of law to the district court.

Cases Under Title 11

A case under title 11 refers only to the actual filing of the bankruptcy petition. See, e.g., In re Seven Fields Dev. Corp., 505 F.3d 237, 250 (3d Cir. 2007); In re Canion, 196 F.3d 579, 584 (5th Cir. 1999). A court's jurisdiction over a case under title 11 relates to the petition itself, and nothing more. In re Kovalchick, 371 B.R. 54 (M.D. Pa. 2006).

Because a "case under title 11" is only the petition itself, all other types of jurisdiction—each of which involve "proceedings"— debatably include any other type of event that takes place in a bankruptcy case. Specifically, a "proceeding" implicates "the steps within the 'case' and to any subaction within the case that may raise a disputed or litigated matter." In re Wolverine Radio Co., 930 F.2d 1132, 1141 n. 14 (6th Cir. 1991). Therefore, adversary proceedings, contested matters, and any other manner of action in a bankruptcy case are "proceedings."

Proceedings Arising Under Title 11

Proceedings arising under title 11 "involve a cause of action created or determined by a statutory provision of title 11." Maitland v. Mitchell (In re Harris Pine Mills), 44 F.3d 1431, 1435 (9th Cir. 1995). If "the proceeding involves a right created by the federal bankruptcy law" or "is one that would arise only in a bankruptcy," then it is a proceeding arising under title 11. See, e.g., In re Wood, 825 F.2d 90, 97 (5th Cir. 1987). Examples of proceedings arising under title 11 are preference actions under section 547 and fraudulent transfer actions under section 548. See 11 U.S.C. §§ 547, 548. See also, e.g., McDaniel v. ABN Amro Mortg. Group, 364 B.R. 644, 647 (S.D. Ohio 2007) (citation omitted).

Proceedings Arising in a Case Under Title 11

"Proceedings arising in" a case under title 11 are proceedings "that are not based on any right expressly created by Title 11, but nevertheless, would have no existence outside of the bankruptcy." Wood v. Wood (In re Wood), 825 F.2d 90, 97 (5th Cir. 1987). Examples "include administrative matters; counterclaims by the estate against persons filing claims against the estate; orders to turn over property of the estate and determinations of the validity, extent or priority of liens." McDaniel v. ABN Amro Mortg. Group, 364 B.R. 644, 647 (S.D. Ohio 2007), (citation omitted).

What is a Core Proceeding

A "core proceeding" is not defined in 28 U.S.C. §157(b), but it does provide a nonexclusive list of types of proceedings that are "core." In re Stone & Webster Inc., 367 B.R. 523, 525 (Bankr. D. Del. 2007). In determining whether a matter is core, a court should first consult the non-exclusive list of fifteen examples of core proceedings set forth at 28 U.S.C. §157(b)(2). See Halper v. Halper, 164 F.3d 830, 836 (3d Cir. 1999). 28 U.S.C. § 157(b)(2)(B) provides that:

Core proceedings include, but are not limited to—

(A) matters concerning the administration of the estate;

> (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12 or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
>
> (C) counterclaims by the estate against persons filing claims against the estate;
>
> (D) orders in respect to obtaining credit;
>
> (E) orders to turn over property of the estate;
>
> (F) proceedings to determine, avoid or recover preferences;
>
> (G) motions to terminate, annul or modify the automatic stay;
>
> (H) proceedings to determine, avoid or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security-holder relationship, except personal injury tort or wrongful-death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

28 U.S.C. §157(b)(2)(B).

The distinction between core and non-core jurisdiction is rooted in Marathon Pipe Line and its holding that bankruptcy courts, unlike Article III courts, do not have the power to adjudicate "state created private rights," because these rights are too distant from the core of bankruptcy courts' congressionally granted power. Marathon Pipe Line, 458 U.S. at 71.

A core proceeding is one that either (1) invokes a substantive right provided by title 11, or (2) by its nature could arise only in the context of a bankruptcy case. Corestates Bank NA v. Huls Am. Inc., 176 F.3d 187, 196 (3d Cir. 1999) (citation omitted). See also In re Wood, 825 F.2d at 97) ("If the proceeding does not invoke a substantive right created by the federal bankruptcy law and is one that could exist outside of bankruptcy it is not a core proceeding."). Although a proceeding may augment the amount of money in the estate, and therefore the availability of funds for distribution to creditors, there is a split of authority over whether the economic benefit to the estate is part of the "core" vs. "non-core" analysis. The Third Circuit teaches that economic benefit is not relevant to the analysis. See Phar-Mor Inc. v. Coopers & Lybrand, 22 F.3d 1228, 1239 n.19 (3d Cir. 1994) (prepetition breach-of-contract action is "precisely the type of proceeding that is non-core and outside the power of the bankruptcy court to adjudicate"). However, the Second Circuit holds that "proceedings having the effect of bringing property into the estate of the debtor are core proceedings as defined by section 157(b)." St. Paul Fire and Marine Ins. Co. v. PepsiCo, Inc., 884 F.2d 688, 701 (2d Cir. 1989).

On the other hand, courts generally find that state law causes of action brought by or on behalf of the debtor that do not fall within the provisions of 28 U.S.C. §157(b)(2)(B)-(N) are noncore matters. See, e.g., Piombo Corp. v. Castlerock Props. (In re Castlerock Props.), 781 F.2d 159, 162 (9th Cir. 1986); Stone & Webster, 367 B.R. at 526. For example, an adversary proceeding to determine insurance coverage has been held not to be a core proceeding. See, e.g., Delta Fin. Corp. v. Westchester Surplus Lines Ins. Co. (In re Delta Fin. Corp.), 398 B.R. 382 (Bankr. D. Del. 2008) (finding that coverage action arising out of prepetition litigation was noncore because "the proceeding does not fall within the categories set forth in 28 U.S.C. §157(b) (2), no substantive rights under the Bankruptcy Code are implicated, the proceeding could exist outside of the... bankruptcy case, and the claim arose prepetition."). Indeed, prepetition breach-of-contract actions have been held to be paradigmatic examples of noncore proceedings. See Stone & Webster, 367 B.R. at 529 ("Prepetition state law contract claims are precisely the type of claim that the Supreme Court held could not be decided by non-Article III judges in Northern Pipeline.").

Proceedings Related to a Case under Title 11

A bankruptcy judge may hear and determine a proceeding that is "related to a case under title 11." 28 U.S.C. §157(c)(1). However, it is when exercising "related to" jurisdiction that a bankruptcy court's jurisdiction is most limited. A bankruptcy court cannot enter a final judgment or order in a "related to" proceeding, but can only submit proposed findings of fact and conclusions of law to the district court. Id.

The extent of "related to" jurisdiction remains in controversy. The Supreme Court has stated that "[p]roceedings 'related to' the bankruptcy include (1) causes of action owned by the debtor which become property of the estate pursuant to 11 U.S.C. § 541 and (2) suits between third parties which have an effect on the bankruptcy estate." Celotex Corp. v. Edwards, 514 U.S. 300, 308 n. 5 (1995). An example of the former is a state law breach-of-contract action.

It is the latter subset of proceedings (i.e., those proceedings that "have an effect on the bankruptcy estate") that has caused more difficulty. In Pacor Inc. v. Higgins, 743 F. 2d 984, 994 (3d Cir. 1984), the Third Circuit articulated what has become the majority view of "related to" jurisdiction based on an effect on the estate. In Pacor, the Third Circuit held that:

> The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy... Thus, the proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.

Id. at 994 (emphasis in original; citations omitted).

The Pacor test has been adopted by the First, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth and Eleventh Circuits. See In re G. S. F. Corp., 938 F. 2d 1467, 1475 (1st Cir. 1991); Robinson v.

Michigan Consol. Gas Co., 918 F.2d 579, 583–584 (6th Cir. 1990); In re Fietz, 852 F.2d 455, 457 (9th Cir. 1988); In re Gardner, 913 F.2d 1515, 1518 (10th Cir. 1990); In re Lemco Gypsum Inc., 910 F.2d 784, 788, n. 19 (11th Cir. 1990); In re Wood, 825 F.2d 90, 93 (5th Cir. 1987); In re Dogpatch U.S.A. Inc., 810 F.2d 782, 786 (8th Cir. 1987); A. H. Robins Co. v. Piccinin, 788 F.2d 994, 1002, n.11 (4th Cir.). Whether a proceeding could conceivably have an effect on the estate is not an inquiry that is amenable to a precise test. Accordingly, questions of the existence of "related to" jurisdiction are presented frequently and are the subject of many decisions.

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[1] For more fulsome discussions of the Emergency Rule, see In re Comm. of Unsecured Creditors of F S Communications Corp., 760 F.2d 1194, 1198 (11th Cir. 1985); In re Finevest Foods Inc., 143 B.R. 964, 966 (Bankr. M.D. Fla. 1992); J. Ferriel, Core Proceedings in Bankruptcy Court, 56 UMKC L. Rev. 47 (1987).

[2] In the District of Delaware, for instance, all bankruptcy cases are automatically referred to the bankruptcy court under a standing order. Amended Standing Order of Reference (D. Del. Feb. 29, 2012).

[3] Whether to withdraw the reference is a question that is inextricably linked to the question of whether a proceeding is "core" or "non-core." In the District of Delaware, in fact, a party moving to withdraw the reference is required to file concurrently a motion to determine whether the proceeding in question is "core" or "non-core." Del. Bankr. L.R. 5011-1.

Standing Issues in Bankruptcy Cases

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Presented to ABI Spring Meeting 2023
Washington D.C.[1]

I. Standing Fundamentals.

U.S. Constitution article I, § 8, provides in pertinent part that: "The Congress shall have Power. . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States. . . . ." Standing is "whether the litigant is entitled to have the court decide the merits of the dispute or of particular issues. . . . and defines and limits the role of the judiciary . . . as a threshold inquiry to adjudication." *Johnson v. Deutsche Bank Nat'l Trust*, No. 3:12–CV–3542–L, 2013 WL 3810715, at *5 (N.D. Tex. 2013 July 23, 2013). Standing is a question of law reviewed de novo on appeal. *Furlough v. Cage (In re Technicool Sys.)*, 896 F.3d 382, 385 (5th Cir. 2018). Standing is determined as of the commencement of the action. *Furlough,* 896 F.3d at 386.

There are three types of standing: 1) constitutional standing (the constitutional case-or-controversy requirement); 2) prudential standing (judicially imposed limits on federal jurisdiction); and 3) statutory standing (legislatively imposed limits on a statutory cause of action). *Davis v. City of Phila.,* 821 F.3d 484, 487 (3d Cir. 2016).

A. Constitutional Standing – Case or Controversy

The Constitutional standards for standing are: "First, . . . 'injury' in fact--an invasion of a legally protected interest which is (a) concrete and particularized. . . and (b) 'actual or imminent,

[1] The views expressed here are the author's, and not those of Jones Walker LLP, its members or clients.

not ‘conjectural’ or ‘hypothetical’. . . . Second, there must be a causal connection between the injury and conduct complained of—the injury has to be ‘fairly. . . traceable to the challenged action . . . and not . . . the result of the independent action of some third party not before the court. . . . and. . . Third, it must be ‘likely,’ as opposed to merely speculative’ that the injury will be addressed by a favorable decision.” *Lujan v. Defenders of Wildlife,* 112 S. Ct. 2130, 2136 (1992).

B. Prudential Standing – Judicial Limitations

Prudential standing relates to judicially created limitations of a court’s exercise of jurisdiction and prohibits a party from raising another’s legal rights and generalized grievances. *Lexmark Int’l v. Static Control Components, Inc.*, 572 U.S. 118, 126 (2014); *Superior MRI Servs. v. Alliance Healthcare Servs,.* 778 F.3d 502, 506 (5th Cir. 2015); *see also In re Howard*, 533 B.R. 532, 542-44 (Bankr. S.D. Miss. 2015). “Bankruptcy standing is a form of prudential standing that is more narrow and exacting than constitutional standing under Article III.” *Howard*, 533 B.R. at 543; *see also Furlough,* 896 F.3d at 385-87; *St. Paul Fire & Marine Ins. Co. v. Labuzan,* 579 F.3d 533, 538-39 (5th Cir. 2009).

Although the traditional constitutional requirements represent the mandatory minimum requirements for a party to have standing, Congress can "modify or even abrogate prudential standing requirements, thus extending standing to the full extent permitted by Article III." *St. Paul Fire & Marine Ins. Co.,* 579 F.3d at 539. Congress does this in bankruptcy cases by allowing any "party-in-interest" to object to a proposed action. *Furlough,* 896 F.3d at 385-86; *Howard*, 533 B.R. at 543-544; *In re C-Power Prods., Inc.,* 230 B.R. 800, 804 (Bankr. N.D. Tex. 1998).

C. Statutory Standing – Legislative Limitations

The term "party-in-interest" appears in many different sections of the Bankruptcy Code but legislative history suggests the term was omitted from the list of definitions in 11 U.S.C. § 101 to allow flexibility in its application. *In re N. Am. Oil & Gas, Inc.,* 130 B.R. 473, 479 (Bankr. W.D. Tex. 1990), *abrogated on other grounds by Pritchard v. U.S. Trustee (In re England),* 153 F.3d 232 (5th Cir. 1998). It includes "any . . . person with a sufficient stake in [the] outcome of a [bankruptcy] proceeding so as to require representation." *Int'l Transactions, Ltd. v. Embotelladora Agral Regiomontana, S.A. de C.V.*, 347 F.3d 589, 595 (5th Cir. 2003); *Howard,* 533 B.R. at 543; *Johnson v. Deutsche Bank Nat'l Trust Co*., No. 3:12-CV-3542-L, 2013 U.S. Dist. LEXIS 103619, 2013 WL 3810715, at *6 (N.D. Tex. 2013); *In re Presto*, 376 B.R. 554, 564 (Bankr. S.D. Tex. 2007).

Whether someone is a party in interest is vital to avoiding the already chaotic nature of complex bankruptcy cases "'where clouds of persons indirectly affected by the acts and entitlements of others may buzz about, delaying the final resolution of cases.'" *In re Rimsat, Ltd.,* 193 B.R. 499, 501-02 (Bankr. N.D. Ind. 1996).

II. Who's Who of Standing

A. The Bankruptcy Trustee & U.S. Trustee

A trustee's standing is not limited to whether there is a personal or pecuniary interest either at the bankruptcy court level or the appellate court level. Section 1109(b) of the Bankruptcy Code and Fed. R. Bankr. Proc. 6009 specifically provide a trustee in a bankruptcy case with the right to appear and be heard on any issue in a case under Title 11 before any tribunal. A trustee not only has constitutional and prudential standing, but also has statutory standing. This is consistent with the trustee's statutory role as the representative of the estate under Section 323 of the Bankruptcy Code.

Trustee standing does not arise from the trustee's pecuniary interest, but rather from the trustee's "official duty to enforce the bankruptcy law in the public interest." *In re Clark*, 927 F.2d 793, 796 (4th Cir. 1991)(involving U.S. Trustee; *citing Sec. & Exch. Comm'n v. U.S. Realty & Improvement Co.,* 310 U.S. 434, 460, 60 S. Ct. 1044, 84 L. Ed. 1293 (1940)). A bankruptcy trustee's standing is necessary to the exercise of the "extensive" duties of a bankruptcy trustee. *Cf. Weintraub*, 471 U.S. 343, 358 (1985).

B. Everyone Else

Whether others in the bankruptcy case have standing will require a more detailed analysis of the issues at stake before the court within the confines of constitutional, prudential and statutory standing. For a party other than the debtor-in-possession or trustee to assert a direct cause of action, the party must assert a cause of action for an injury that it suffered separate and apart from the debtor's injuries or any other estate claim. *In re Salander*, 472 B.R. 213, 222 (Bankr. S.D.N.Y 2012).

In chapter 11 cases, section 1109(b) provides a "party in interest" the right to raise, appear and be heard on any issue in the case. This generally is intended to address the economic realities of chapter 11 cases that multiple issues can impact the rights of others affected by the case. Courts nevertheless apply the Article III limitations of whether the party in interest is within the "zone of interests" intended to be protected in the matter before the court. *Lexmark Int'l, Inc. v. Static Control Components, Inc.,* 134 S. Ct. 1377, 1387-88, 188 L. Ed. 2d 392 (2014). The Seventh Circuit explains the application of section 1109(b) as:

> [W]e do not think that this section [section 1109(b)] was intended to waive other limitations on standing, such as that the claimant be within the class of intended beneficiaries of the statute that he is relying on for his claim, although a literal reading of section 1109(b) would support such an interpretation. We think all the section means is that anyone who has a legally protected interest that could be affected by a bankruptcy proceeding *is entitled to assert that interest with respect to any issue to which it pertains*, thus making explicit what is implicit in an *in rem* proceeding—that everyone with a claim to the *res* has a right to be heard before the *res* is disposed of since that disposition will extinguish all such claims.

In re James Wilson Assocs., 965 F.2d 160, 169(7th Cir. 1992).

Where a party's "interests are so marginally related to or inconsistent with the purposes implicit in the statute that it cannot reasonably be assumed that Congress intended to permit [participation]" standing will be denied. *Clarke v. Securities Indus. Ass'n,* 479 U.S. 388, 399, 107 S. Ct. 750, 93 L. Ed. 2d 757 (1987). Examples:

- A creditor with derivative claims based on preference or fraudulent transfers has no standing to pursue claims directly through equitable relief. *Aimco Clo 10 Ltd v. Revlon, Inc. (In re Revlon, Inc.),* Case No 22-01167 (Bankr. S.D.N.Y. Judge David S. Jones, February 24, 2023)
- Bankruptcy statutes governing sales are meant to protect the estate and its creditors, not potential purchasers, therefore unsuccessful bidders may not attack the sale or auction process. *Natural Chem Holdings, LLC. v. United States DOE (In re New Energy Corp.)*, 2013 U.S. Dist. LEXIS 40008 (N.D. Ind. 2013)
- Plan that did not impair insurer's rights or otherwise alter quantum of liability was neutral eliminating insurer as party in interest under section 1109(b). *Hanson Permanente Cement, Inc. v. Kaiser Gypsum Co. (In re Kaiser Gypsum Co.*), 60 F.4th 473 (4th Cir. 2023)

III. Standing under Section 1109(b) Does Not Equal Appellate Standing

Regardless of the right to be heard under section 1109(b) in the case, such right does not equate standing to appeal. *NexPoint Advisors, L.P. c. Pachulski Stang Ziehl & Jones LLP (In re Highland Cap. Mgmt., L.P.),* 2022 U.S. Dist. LEXIS 83142 (N.D. Tex. May 9, 2022)(right to be heard under section 1109(b) on a fee application objection under section 330 did not equate appellate standing as a "person aggrieved" by fee awards given because there was no direct, adverse pecuniary impact to appellant); *Dugaboy Investment Trust v. Highland Capital Management, L.P. (In re Highland Capital Management, L.P.)*, Case No. 22-108831 (5th Cir. February 28, 2023)(Equity security holder whose economic interest was eliminated upon consummation of confirmed plan had no direct pecuniary harm to establish appellate standing).

"Appellate standing under the "person aggrieved" doctrine is narrower than Article III standing:

> The appellate standing requirement in bankruptcy cases is quite restrictive—it is much more limited than Article III standing or the prudential requirements associated with federal standing generally. Moreover, appellate standing is different from standing in bankruptcy court. As opposed to standing in the bankruptcy proceeding below—which is broadly granted to any "party of interest"—appellate standing is given only to "persons aggrieved" by the bankruptcy court's order. This principle, known as the "person aggrieved" doctrine, limits standing to persons with a direct, pecuniary interest in the bankruptcy court's order, which has been interpreted to mean the "order directly diminishes a person's property, increases his burdens, or impairs his rights." It is within the province of the [appellate court] hearing the appeal to determine if the party is a "person aggrieved," and in making that determination, the judge may rely on "practical common sense."

Consol Energy, Inc. v. Murray Energy Holdings Co. (In re Murray Energy Holdings Co.), 624 B.R. 606, 612 (BAP 6th Cir. 2021)(citing *Khan v. Regions Bank* (*In re Khan*), No. 3:12-cv-00025, 2012 U.S. Dist. LEXIS 157063, at *4-5 (E.D. Tenn. Oct. 31, 2012) (citations omitted), *aff'd*, 544 F. App'x 617 (6th Cir. 2013), *cert. denied*, 572 U.S. 1016, 134 S. Ct. 1545, 188 L. Ed. 2d 558 (2014). As the Fifth Circuit Court of Appeals has articulated, to avoid appeals of bankruptcy litigants "willy-nilly", a party in interest must be a person aggrieved, directly adversely affected with an interest in the outcome. *Furlough,* 896 F.3d at 385-86.

Both U.S. Trustees and appointed bankruptcy trustees have standing to appeal orders of the bankruptcy court, despite not having a direct, pecuniary interest in the matter appealed.[2] *See Edwards Family P'ship v. Johnson (In re Cmty. Home Fin. Servs.)*, 990 F.3d 422, 427 (5th Cir. 2021)(chapter 11 trustee had standing to appeal final fee award of former debtor-in-possession professionals despite their settlement of same because payment of fees affects estate administration); *Kloian v. Simon (In re Kloian)*, 137 F. App'x 780, 782 (6th Cir. 2005)(chapter 7 trustee; no pecuniary interest required); *Martin v. Monumental Life Ins. Co.,* 240 F.3d 223, 232 (3d Cir. 2001) ("The right to appeal is part of the debtors' estates."); *In re Quality Bev. Co.*, 181 B.R. 887, 894 (Bankr. S.D. Tex. 1995).*In re Clark*, 927 F.2d 793, 795 (4th Cir. 1991) (U.S. Trustee has standing to appeal order of bankruptcy court without pecuniary interest); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990)(same); *In re Plaza de Diego Shopping Center, Inc.*, 911 F.2d 820, 824 (1st Cir. 1990)(same).

The Supreme Court has also held that a public interest provides a sufficient stake in the outcome of a bankruptcy case to confer standing. *See, e.g., SEC v. U.S. Realty & Imp. Co.*, 310 U.S. 434 (1940). "Trustees act on behalf of the bankruptcy estates and appropriately concern

[2] "The pecuniary interest test was a judicial construction of § 39(c) of the original bankruptcy code adopted in 1898, which limited appellate standing to "persons aggrieved" by a court's actions. 11 U.S.C. § 67(c) (1976) (repealed 1978). That section of the Code has been repealed, but courts continue to limit appellate standing to persons aggrieved, by which they mean persons with a financial stake in the bankruptcy court's order." *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990).

themselves with orderly estate administration; . . . the public interest that supports a trustee's standing to prosecute an appeal also supports a trustee's standing to respond to a debtor's appeal." *Kloian*, 137 F. App'x at 782 (finding no discernable difference between case trustees and U.S. Trustees on standing). "Once appointed a trustee, the debtor's assets and claims pass to the trustee, making the trustee 'the proper party in interest, and the only party with standing to appeal the bankruptcy court's order.'" *Moneymaker v. CoBen (In re Eisen),* 31 F.3d 1447, 1451 (9th Cir. 1993)(*citing Hancock Bank v. Jefferson,* 73 Bankr. 183, 185 (Bankr. S.D. Mo. 1986)).

<u>Derivative Standing in Chapter 11 Cases</u>

As noted, 11 U.S.C. § 1109(b) provides a broad grant of standing to "appear" and "be heard" on "any issue" to any "party in interest. This general right to be heard, however, does not confer standing on creditors to pursue litigation on behalf of a debtor's estate. That said, the fact that claims may be vested in a debtor's estate, will not mean that those claims with remain the debtor's to pursue in all instances. Which party obtains/retains the ability to pursue and/or settle claims may play an important role in a chapter 11 proceeding in preserving value for creditors, maximizing the value of a debtor's estate, and determining the timeline for emergence.

As a general matter, in the absence of consent, a committee may be granted derivative standing to pursue estate causes of action only if (a) the claims are colorable, and (b) the debtor has unjustifiably refused to pursue them. "Courts generally perform a cost-benefit analysis of the claims to determine whether the creditors' claims have colorable merit and whether, in light of the probable costs of litigation, the claims would likely benefit the estate if pursued." <u>In re Nat'l Forge Co.</u>, 326B.R. 532, 548 (W.D. Pa. 2005). Because derivative standing extends rights to a stakeholder whose interests may not necessarily align with the best interests of all creditors, the granting of such standing is reserved for narrow circumstances "when the Bankruptcy Code's envisioned scheme breaks down." <u>In re Weyandt</u>, 544 F. App'x 107, 110 (3d Cir. 2013). Courts can be reluctant to extend derivative standing to creditors' committees, in part, because, unlike the debtor, who is the only fiduciary for all stakeholders, the committee is a fiduciary only for those whom it represents. <u>See, e.g.</u>, <u>U.S. for Use of Am. Bank v. C.I.T. Cons. Inc. of Texas</u>, 944 F.2d 253, 260 (5th Cir. 1991); <u>In re Committee of Major Funding Corp.</u>, 109 F.3d 219, 224 (5th Cir. 1997); (<u>In re Balt. Emergency Servs. II, Corp.</u>, 432 F.

3d 557, 562 (4th Cir. 2005) ("[e]ven if permitted under the Bankruptcy Code, derivative standing is the exception rather than the rule" and "the interests of a creditor or creditors' committee may not always align with those of the estate").

One of the seminal cases addressing this issue is Unsecured Creditors Committee of Debtor STN Enterprises, Inc. v. Noyes (In re STN Enterprises), 779 F.2d 901 (2d Cir. 1985). In STN Enterprises, the U.S. Court of Appeals for the Second Circuit Court ruled that, in considering an official creditors' committee's request for leave to sue a director for misconduct, a court is required to consider whether the debtor unjustifiably failed to initiate suit against the director and whether the action is likely to benefit the debtor's estate (i.e., the time and expense for such litigation is justified given the likelihood of success in such litigation).

The Second Circuit later refined the doctrine of "derivative standing" in Commodore Int'l Ltd. v. Gould (In re Commodore Int'l Ltd.), 262 F.3d 96 (2d Cir. 2001). In Commodore, the court ruled that a committee may bring suit even if the trustee or DIP does not unjustifiably refuse to do so as long as: (i) the trustee or DIP consents; and (ii) the court finds that the litigation is (a) in the best interests of the estate and (b) necessary and beneficial to the fair and efficient resolution of the bankruptcy proceedings. See also Glinka v. Murad (In re Housecraft Indus. USA, Inc.), 310 F.3d 64 (2d Cir. 2002) ("Housecraft").

The Third Circuit articulated a slightly different standard for derivative standing in Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548 (3d Cir. 2003). In Cybergenics, the court held that, to be granted derivative standing, a movant must demonstrate that: (i) the debtor-in-possession or trustee has unjustifiably refused either to pursue the claim or to consent to the movant's prosecution of the claim on behalf of the estate; (ii) the movant has alleged colorable claims; and (iii) the movant has received leave to sue from the bankruptcy court.[1]

In determining whether there has been an unjustifiable failure to bring suit, courts consider whether an action asserting the proposed claims would be likely to benefit the estate. See Sunbeam Corp. v. Morgan Stanley & Co. (In re Sunbeam Corp.), 284 B.R. 355, 375 (Bankr. S.D.N.Y. 2002). Courts seek to assure themselves that "there is sufficient likelihood of success to justify the anticipated delay and expense to the bankruptcy estate that the initiation and continuation of litigation will likely produce." Adelphia/BofA, 330 B.R. at 374. "At the least," this inquiry considers "whether the prosecution of the claims is consistent with the maximization of the value of the estate." Id. at 375. The question of whether a debtor has unjustifiably failed to bring suit is therefore inextricably linked to the question of whether the debtor has failed to fulfill its fiduciary duty to maximize the value of the estate. In re Smart World Techs., LLC, 423 F.3d 166, 175 (2d Cir. 2005); see also In re Adelphia Comm'cs Corp., 544 F.3d 420, 424 (2d Cir. 2008) (discussing the "central role" that the debtor's duty to manage the estate's legal claims plays in the debtor's ability to fulfill its fiduciary role); *In re Commodore Intern Ltd*., 262 F.3d 96, 98 (2d Cir. 2001) (noting that, "in the normal course," the

[1] Many other courts, including courts of appeals, have also countenanced the concept of derivative standing. See, e.g., PW Enters., Inc. v. N.D. Racing Comm's (In re Racing Servs., Inc.), 540 F.3d 892, 904 (8th Cir. 2008); Fogel v. Zell, 221 F.3d 955, 965 (7th Cir. 2000); Canadian Pacific Forest Prods. Ltd. v. J.D. Irving, Ltd. (In re Gibson Grp., Inc.), 66 F.3d 1436, 1446 (6th Cir. 1995).

debtor in possession would pursue the estate's viable legal claims in an effort to increase the size of the bankruptcy estate as part of its fiduciary duties under 11 U.S.C. § 1108 (citation omitted)). Based on this framework, a grant of standing may be warranted where a debtor has a colorable claim that will maximize the value of the estate but nevertheless fails to seek to recover on that claim, thereby failing to fulfil its fiduciary duty. See, e.g., In re Adelphia Comm'cs Corp., 544 F.3d at 425.

Courts recognize, however, that it can take time for a debtor to investigate the claims it may hold and to make a determination as to whether a matter should be pursued. As a result, it is fairly unusual for derivative standing to be sought, much less granted, within the first few months after the bankruptcy petition date. See, e.g., In re Sabine Oil & Gas, No. 15-11835 (Bankr. S.D.N.Y. July 15, 2015), ECF No. 518 (first *STN* motion filed approximately four months after the petition date); In re Adelphia Commc'ns Corp., No. 02-41729 (Bankr. S.D.N.Y. June 25, 2002).

In determining the types of claims that may be amenable to derivative standing, some courts have taken a different view as to whether this inquiry is primarily one of bankruptcy law or state law. For example, there are cases in the Delaware bankruptcy courts in which the court has rejected an application for derivative standing on the grounds that state law placed restrictions on the types of parties that court pursue derivative claims. See, e.g., In re Dura Automotive Systems, LLC, No. 19-12378 (KBI (Bankr. D. Del. June 9, 2020) (Unpublished bench ruling finding that law restricted standing to sue on behalf of LLC to only members of the LLC and its assigns); In re Citadel Watford City Disposal Partners, L.P., 603 B.R. 897 (2019) (Delaware LP and LLC statutes provide that only a partner of an LP or a member of an LLC has standing to pursue a derivative breach of fiduciary duty claim on behalf of an LP or LLC, and that the Creditors' Committee is not a partner/member and thus has no standing to pursue the claim). Courts outside of Delaware, however, have appeared reluctant to follow this reasoning.

Similarly, with respect to settling claims, the general rule is that a debtor has and retains the ability to settle any claim, even one for which derivative standing has been granted to a non-debtor. Smart World Techs., LLC v. Juno Online Servs., Inc. (In re Smart World Techs., LLC), 423 F.3d 166, 177 (2d Cir. 2005); see In re Centaur, LLC, No. 10-10799, 2010 WL 4624910, at *7 (Bankr. D. Del. Nov. 5, 2010) (explaining that debtors retained the ability to settle claims not withstanding grant of *STN*-equivalent standing to a creditors committee). This rule derives from Federal Rule of Bankruptcy Procedure 9019, which vests authority to bring a motion for compromise or a settlement exclusively in the debtor in possession where no trustee has been appointed. Fed. R. Bankr. 9019(a); In re Smart World Techs., LLC, 423 F.3d at 174. This exclusive authority pursuant Rule 9019 flows from the debtor's well-established authority to manage the estate and the estate's legal claims.[2] In re Smart World Techs., LLC, 423 F.3d at 174; see In re Adelphia Comm'cs Corp., 544 F.3d 420, 424 (2d Cir. 2008) ("It remains the debtor's duty to wisely manage the estate's legal claims, and this duty is

[2] For example, the Second Circuit has explained that the automatic stay—which enjoins non-debtor entities from exercising control over property of the estate—"evinces Congress' desire to leave the administration of the . . . estate solely in the hands of the debtor in possession." In re Smart World Techs., 423 F.3d at 174. Similarly, this Congressional intent is evinced in the debtor's role as the legal representative of the estate, with the ability to sue and be sued and the obligation to pursue claims and to settle them based upon the best interests of the estate. Id. at 174-75 ("In short, Rule 9019, which by its terms permits only the debtor-in-possession to move for settlement, is in complete harmony with the provisions of the Bankruptcy Code delineating the chapter 11 debtor's role."); see also 11 U.S.C. § 323(a).

implicit in the debtor's role as the estate's only fiduciary."); see also 11 U.S.C. §§ 1106, 1107.

The right to *settle* a claim, therefore, is not necessarily a corollary or follow-on to a grant of derivative standing to *pursue* certain claims belonging to the estate. In re Smart World Techs., 423 F.3d at 177 ("[D]erivative standing in the Rule 9019 context is not merely the mirror image of a typical derivative standing case, but is conceptually distinguishable."); see also In re Adelphia Comm'cs Corp., 544 F.3d at 424 (explaining an *STN* party's control over the estate does not rival the control of the debtor in possession). Instead, in order for a non-debtor to obtain standing to settle an estate claim, a separate, settlement-specific derivative standing motion and analysis may be required, pursuant to which the non-debtor must overcome a "heavier burden" than that in a "usual" derivative motion to demonstrate that the non-debtor's proposed settlement, notwithstanding the debtor's objection, is nonetheless in the best interests of the estate. In re Smart World Techs., 423 F.3d at 177 (cautioning courts to be wary of "perverse dynamics" where a creditor might seek to settle for less than the claim is worth in order to speed up the bankruptcy process). The Second Circuit has emphasized that the circumstances in which a movant could overcome such a burden are "rare." Id. at 180; see also In re Adelphia Commc'ns Corp., 368 B.R. 140, 234 (Bankr. S.D.N.Y. 2007) (explaining the decision in Smart World to deny STN standing for settlement was in part to caution courts about the dysfunction of many creditors committees).

Accordingly, Debtors may retain the right to settle the claims with adverse parties pursuant to Rule 9019, subject to the Court's power to review settlements in bankruptcy, even assuming *arguendo* that creditors or a creditors' committee had succeeded on a derivative standing motion to commence litigation. See, e.g., In re Centaur, LLC, No. 10-10799 (KJC), 2010 WL 4624910, at *7 (Bankr. D. Del. Nov. 5, 2010) ("A grant of derivative standing does not strip a debtor of ownership of the [c]laims and, accordingly, the [d]ebtors continue to have the right, subject to Court approval, to settle the [c]laims."); Official Comm. of Equity Sec. Holders v. Adelphia Commc'ns Corp. (In re Adelphia Commc'n Corp.), 371 B.R. 660, 670-71 (S.D.N.Y. 2007) ("[A] debtor-in-possession may assert control over an adversary proceeding notwithstanding a committee's derivative standing, where that standing was granted for reasons other than debtor misconduct.")); In re Exide Techs., 303 B.R. 48, 67 (Bankr. D. Del. 2003) (holding that the Bankruptcy Code "authorizes the [d]ebtor to propose a settlement" of an adversary proceeding prosecuted by a creditors' committee "in its plan"); see also In re Dewey & LeBoeuf LLP, No. 12-12321 (MG), 2012 WL 5985445, at *7-*8 (Bankr. S.D.N.Y. Nov. 29, 2012) ("Some courts have also held that a debtor has the authority to settle claims on behalf of its estate within a chapter 11 plan, even if derivative standing has been granted to a creditors' committee to prosecute such claim.").

Jurisdictional Issues raised by *Barton v. Barbour*

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Washington D.C.[1]

A. *Barton v. Barbour.*

The *Barton* doctrine stems from a case arising out a railroad receivership, *Barton v. Barbour,* 104 U.S. 126 (1881). Frances Barton was thrown from a train car when it derailed due, she said, to a defective track maintained by the defendant railroad. She was seriously injured, and sued for $5,000 in damages, naming both the railroad, which was in receivership, and the receiver in the local courts of the District of Columbia. The receivership court was the Circuit Court for the city of Alexandria. The receiver defended the lawsuit in the District of Columbia with a plea that that court lacked jurisdiction over the lawsuit because the plaintiff had failed to obtain prior leave of the receivership court.

The lower court upheld the receiver's motion, and the plaintiff sought review from the Supreme Court. Barton contended that leave should be required only to collect on a judgment, not to bring suit in the first place. The Supreme Court disagreed, noting that if a plaintiff were permitted to obtain a judgment, she might be able to execute on assets outside the territorial reach of the receivership court, so the rule would have to be that leave of the court is required in order to commence a lawsuit, whether it be for damages or specific property, and whether or not the relief seeks recovery from the personal assets of the receiver.

The Supreme Court said that, on plaintiff's request for leave, the receivership court could allow the suit to go forward in a court of law, or direct a trial to settle the contested facts, presumably in the receivership court. The Court further noted that the plaintiff's claim for personal injury "stands on precisely the same footing as any of the expenses incurred in the execution of the trust, and must be adjudged and satisfied in the same way." 104 U.S. at 131.

> If the court below had entertained jurisdiction of this suit, it would have been an attempt on its part to adjust charges and expenses incident to the administration by the court of another jurisdiction of trust property in its possession, and to enforce the payment of such charges and expenses out of the trust property without the leave of the court which was administering it, and without consideration of the rights and equities of other claimants thereto. It would have been an usurpation of the powers and duties which belonged exclusively to another court, and it would have made impossible of performance the duty of that

[1] This reflects the author's views, and not those of KTBS Law LLP or its members or clients.

> court to distribute the trust assets to creditors equitably and according to their respective priorities.

104 U.S. 136. As articulated by the Supreme Court, the rule is that the non-receivership court is without jurisdiction to adjudicate the lawsuit unless leave has been obtained. *Id.* at 136-137 *(*"We therefore declare it as our opinion that when the court of one State has a railroad or other property in its possession for administration as trust assets, and has appointed a receiver to aid it in the performance of its duty by carrying on the business to which the property is adapted, until such time as it can be sold with due regard to the rights of all persons interested therein, a court of another State has not jurisdiction, without leave of the court by which the receiver was appointed, to entertain a suit against him for a cause of action arising in the State in which he was appointed and in which the property in his possession is situated, based on his negligence or that of his servants in the performance of their duty in respect of such property.")

There was a strong dissent from Justice Miller. He observed that while receivership was traditionally thought of as a proceeding to wind up the affairs of a failed corporation where "the effects of the insolvent corporation are faithfully used to meet its liabilities and its dead body buried out of sight as soon as possible," 104 U.S. at 137, railroad receiverships did not work that way. Instead, the receiver "generally takes the property out of the hands of the owner, operates the road in his own way, with an occasional suggestion from the court, which he recognizes as a sort of partner in the business; sometimes, though very rarely, he pays some money on the debts of the corporation, but quite as often adds to them, and injures prior creditors by creating a new and superior lien on the property pledged to them." 104 U.S. at 138. He said that while he understood that it made sense in a liquidation to require leave of the court to sue the receiver when the receiver had no power to make new contracts and the sole duty is to convert the property into a fund to pay debts, the same considerations did not apply when a receiver was operating the business. In that case, he questioned why plaintiffs ought to be deprived of their normal procedural rights, including a jury trial, simply because the business was being managed by a receiver.

The majority's holding has come to be known as the *Barton* rule.

B. <u>Role of 28 U.S.C. § 959(a).</u>

Justice Miller's dissent appears to have had more impact on Congress than it did on his colleagues. A few years later, in 1887, Congress adopted legislation that carved out from the *Barton* rule actions against receivers incurred when carrying out the business of the receivership estate—in other words, claims like Barton's claim.[2] That section has been amended several

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[2] The original enactment, section 66 of the Judicial Code, provided as follows:

> Every receiver or manager of any property appointed by any court of the United States may be sued in respect of any act or transaction of his in carrying on the business connected with such property, without the previous leave of the court in which such receiver or manager was appointed; but such suit shall be subject to the general equity jurisdiction of the court in which

times over the years, most recently in 1948, to add trustees and debtors in possession to the list of entities who may be sued without leave. It was not altered in connection with the adoption of the 1978 Bankruptcy Code. Accordingly, since 1948, 28 U.S.C. § 959(a) has provided as follows:

> Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.

The second sentence of 959(a) appears to invite courts to issue injunctions that require court leave to bring an action that might otherwise be brought without leave under the first sentence, and courts have accepted that invitation. In *In re Investors Funding Corp.,* 547 F.2d 13, 16 (2d Cir 1976) the Second Circuit Court of Appeals interpreted the second sentence as authorizing the reorganization court to enjoin otherwise permitted lawsuits under section 959(a). It suggested a court "should generally make specific sequential findings before it enjoins a state court suit against a reorganization trustee. It must decide first whether the lawsuit relates to 'routine' business activities of the debtor that are carried on by the trustee. If the lawsuit is not so related, it may be enjoined. If the lawsuit is so related, however, the court must make a further finding before an injunction may issue: that the suit will embarrass, burden, delay or otherwise impede the reorganization proceeding."

C. <u>*Barton* under the Bankruptcy Code.</u>

In 1891, the Supreme Court held that section 66 of the Judicial Code did not overrule *Barton*, but merely created a statutory exception to it. *McNulta v. Lochridge,* 141 U.S. 327 (1891). Similarly, although *Barton* is non-statutory, all Circuit Courts of Appeal to have addressed it have held that it survived enactment of the 1978 Code.[3] The reasoning is that a bankruptcy trustee is a statutory successor to an equity receiver. *Chua v. Ekonomou,* 1 F.4th 948 (11th Cir. 2021). The *Barton* rule is regarded as a matter of federal common law. *Id.*

The *Barton* rule encompasses two rather different kinds of claims—claims against the receiver in the receiver's representative capacity, where the receiver is named in the stead of the corporation in receivership, and claims against the receiver in an individual capacity—alleging

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such receiver or manager was appointed so far as the same may be necessary to the ends of justice.

[3] *Muratore v. Darr*, 375 F.3d 140 (1st Cir. 2004); *Lebovits v. Scheffel*, 101 F.3d 272 (2d Cir. 1996); *In re Vista Care Group, LLC,* 768 F.3d 218 (3d Cir 2012); *McDaniel v. Blust,* 668 F.3d 153 (4th Cir. 2012); *Villegas v. Schmidt,* 788 F.3d 156 (5th Cir. 2015); *Allard v. Weitzman,* 991 F.2d 1236 (6th Cir. 1993); *In re Linton,* 136 F.3d 544 (7th Cir. 1998); *Alexander v. Hedback,* 718 F.3d 762 (8th Cir. 2013); *Beck v. Fort James Corp.,* 421 F.3d 963 (9th Cir. 2005); *Satterfield v. Malloy,* 700 F3d 1231 (10th Cir. 2012); *Lawrence v. Goldberg,* 573 F.3d 1265 (11th Cir. 2009).

that the receiver has personally acted wrongfully towards the plaintiff and should bear personal responsibility for the actions.

It should also be emphasized that the rule is a procedural one only. It is distinct from any rule of immunity or quasi-judicial immunity that a trustee may enjoy. If a bankruptcy trustee is sued outside the appointing court, and the trustee removes the action to the bankruptcy court, the defect is remedied and the lawsuit may proceed in the bankruptcy court. No leave is required to bring the action in the bankruptcy court. *Smith v. Hilton (In re Swan Transportation Co.),* 596 B.R. 127 (Bankr. D. Del. 2018) (action brought outside bankruptcy court in violation of *Barton* and removed to the bankruptcy court dismissed without prejudice to refiling an amended complaint in the bankruptcy court).

D. <u>Exceptions to the Rule.</u>

The rule is subject to two exceptions: claims of a kind described in section 959(a), and claims that the trustee acted entirely *ultra vires. Barton* itself gives an example of the second: "if, by mistake or wrongfully, the, receiver takes possession of property belonging to another, such person may bring suit therefor against him personally as a matter of right; for in such case the receiver would be acting ultra vires." 104 U.S. at 134.

As to the first, it is often hard to draw the line between the operation o the business and the conduct of the administration although it is likely, for example, that a lawsuit of a kind considered in *Barton* itself would today fall into the category described by section 959(a), as arising out of the day-to-day operations of the business, and not particularly implicating the trustee's actual conduct or discretionary decision-making. But there appears in the casewlaw to be a bias towards requiring leave. As *Collier* points out, "allegations of section 1983 violations and tort claims, breach of fiduciary duty and fraud, defamation and slander, breach of confidentiality agreement, negligence malicious prosecution, conspiracy to obstruct the due operation of law by improperly influencing a bankruptcy judge and the return of an alleged preferential payment have all been held to be outside of section 959(a) and therefore required leave of court to assert outside the bankruptcy court." 1 *Collier on Bankruptcy* ¶ 10.01[1][d] at 10-12-13 (16th ed. 2021) (citations omitted). Particularly where the actual conduct of the trustee is implicated, courts appear reluctant to allow lawsuits to proceed without leave of the bankruptcy court.

As to the second, although the exception has a venerable pedigree, it is hard to find examples of courts accepting that a particular set of allegations were *ultra vires* such as not to require court leave. For example, in *Satterfield v. Malloy,* 700 F.3d 1231 (10th Cir. 2012), the debtor filed a lawsuit alleging that the trustee undertook a variety of acts for retaliatory or other improper purpose to deliberately dissipate the value of the assets under administration. The court had no difficulty in characterizing all of these acts as "related to the official duties of the trustee [and] are barred by the *Barton* doctrine even if taken with improper motives." 700 F.3d at 1236. Given this and similar holdings, it is hard not to imagine that even if a trustee is alleged to have willfully taken possession of another's property, if the trustee is alleged to have done so in the course of the trusteeship, that lawsuit is likely subject to the *Barton* rule.

E. Bases for the Rule.

Various explanations for the basis of the rule have been articulated, not all of which are applicable in all cases:

(1) The trustee/receiver's appointing court owes a duty to protect the trustee/receiver from "unjustified personal liability" *Linton,* supra.

(2) It enhances the expenses of administration by preventing wasteful litigation. *Barton,* supra.

(3) Protecting trustees from lawsuits in other courts helps maintain a panel of qualified individual to act as trustees; *Linton*, supra.

(4) The rule protects against judgments enforcement of which may be beyond the purview of the receivership court. *Barton,* supra

(5) The rule avoids creditors forum shopping to challenge trustee's decision-making in a different court. *Linton,* supra.

F. Entities Protected by Barton.

The list of entities subject to protection under Barton has expanded under the Code practice. It now includes:

(1) Creditors' committee members *Blixeth v. Brown (In re Yellowstone Mountain Club),* 841 F.3d 1090 (9th Cir. 2016) (*Barton* applies to members of creditors' committees for post-petition acts taken in their official capacities because (i) the interests of creditors are closely aligned with those of a trustee, and (ii) they are statutorily obliged to perform tasks related to the administration of the estate);

(2) Counsel for a trustee *In re DeLorean Motor Co.,* 991 F.2d 1236 (6th Cir. 1993) (*Barton* applies to counsel for trustee as the "functional equivalent of a trustee for purposes of administering the estate)

(3) Directors appointed to exercise the duties of a trustee. *NexPoint Advisors, L.P. v. Highland Capital Management,* 48 F.4th 419 (5th Cir. 2022); *cert. pending* (2023) (directors of debtor in possession entitled to protection of *Barton* as the debtor in possession is entitled to the rights of a trustee)

(4) Trustees appointed pursuant to plans to liquidate assets and play claims. *In re Summit, Metals,* 477 B.R. 484 (Bankr. D. Del. 2012).

(5) Auction house appointed to sell assets in a chapter 7 case. *Carter v. Rodgers,* 220 F.3d 1249 (11th Cir. 2000).

(6) Trustees of 524(g) asbestos trust. *In re Swan Transportation, Co.* 596 B.R. 127 (Bankr. D. Del. 2018)

G. Showing to Proceed in Another Forum.

Some courts have employed a 5-factor test to decide whether to grant leave to allow a suit to go forward in another forum. These factors are:

(1) whether the acts complained of "relate to the carrying on of the business connected with the property of the bankruptcy estate,"

(2) whether the claims concern the actions of the officer while administering the estate,

(3) whether the officer is entitled to quasi-judicial or derived judicial immunity,

(4) whether the plaintiff seeks a personal judgment against the officer and

(5) whether the claims seek relief for breach of fiduciary duty, through either negligent or willful conduct.

Blixeth, supra, quoting In re Kashani, 190 B.R. 875, 886-87 (Bankr. 9th Cir. 1995).

Even satisfying "one . . . factor[] may be a basis for the bankruptcy court to retain jurisdiction." *Id.* at 887. A court's decision whether or not to let a lawsuit proceed in another court is reviewable on appeal for abuse of discretion. *In re VistaCare Group, LLC,* 678 F.3d 218 (3d Cir. 2012).

H. Limits and Duration of *Barton* Protection.

In a receivership court, where jurisdiction is based on the administration of the *res,* the *Barton* rule expires with the receivership itself. *Chua, supra,* 1 F.4th at 954. Applying that reasoning to bankruptcy cases, the Eleventh Circuit Court of Appeals has held that the *Barton* is inapplicable following the dismissal of a bankruptcy case where the claims being asserted could not have any conceivable effect on the estate. *Tufts v. Hay,* 977 F.3d 1204, 1210 (11th Cir. 2020).

In *Tufts,* two sets of lawyers represented an entity that was in a chapter 11 case. One, Hay, represented the debtor in the case in the North Carolina bankruptcy court, and the other, Tufts, represented the debtor in connection with certain litigation matters in Florida. Hay alleged that Tufts told him that there was a bench order authorizing Hay to represent the debtor, and that he relied on that representation in performing services during the chapter 11 case. Tufts also represented to the Bankruptcy Court that Hay was authorized to represent the estate as special counsel. These representations was not true. Hay acknowledged that Tufts relied on him for advice about how to proceed with the approval of attorneys' fees, and that Hay never told Tufts he needed to apply in advance for payment of those fees.

Tufts had to disgorge all the fees he received, and, after the bankruptcy case was dismissed, he sued Hay in federal district court in Florida. Hay moved to dismiss, in part based on *Barton*, which the court granted. Tufts appealed, and the Eleventh Circuit reversed.

Applying the reasoning of *Barton*, the Court held that in light of the dismissal of the case, the bankruptcy court no longer had any "powers and duties" that could be "usurped" by the Florida district court's consideration of the case. 977 F.3d 1204, 1209. The Court was careful to note that it was "creat[ing] no categorical rule that the *Barton* doctrine can never apply once a bankruptcy case ends." *Id.* at 1210.

Tufts has been followed by bankruptcy courts in the Eleventh Circuit. *In re Keitel,* 636 F.3d 845 (Bankr. S.D. Fla. 2022). In *Keitel,* the bankruptcy court denied the United States Trustee's motion to re-open a chapter 7 case and appoint a trustee after the debtor and certain entities controlled by him filed a lawsuit against the trustee and court-appointed counsel in federal district court in New York. Although the only motion the court was ruling on was the motion to re-open the case, the motion disclosed that the purpose was to enforce *Barton.* Concluding that *Tufts* had changed the law in the Circuit, the court analyzed whether the bankruptcy court had subject matter jurisdiction over the lawsuit that was filed. Since the case could not impact the administration, which was complete, there was no jurisdiction over the matter and hence *Barton* was inapplicable. Accordingly, the court denied the motion to re-open.

Other courts have authorized use of *Barton* following the closing of a case. The leading case is *In re Linton,* 136 F3d 544 (7th Cir. 1998). There, the debtor and spouse sought leave to sue a bankruptcy trustee for malicious prosecution following the trustee's dismissal of a fraudulent transfer against them. The bankruptcy case had been closed, but they both sought leave and a determination that no leave was required because of the closing of the bankruptcy case. The Seventh Circuit held that the requirement of leave survived the closing of the case and the full administration of the estate.

> Without the requirement, trusteeship will become a more irksome duty, and so it will be harder for courts to find competent people to appoint as trustees. Trustees will have to pay higher malpractice premiums, and this will make the administration of the bankruptcy laws more expensive (and the expense of bankruptcy is already a source of considerable concern). Furthermore, requiring that leave to sue be sought enables bankruptcy judges to monitor the work of the trustees more effectively. It does this by compelling suits growing out of that work to be as it were prefiled before the bankruptcy judge that made the appointment; this helps the judge decide whether to approve this trustee in a subsequent case.

136 F.3d at 547.

The Seventh Circuit noted that section 350 permits a case to re-opened, for "cause," so the fact that was case is closed is not determinative of the breadth of the *Barton* doctrine.

Can these cases be reconciled? It seems that the resolution of these cases depends not on *Barton*, but on the proper parameters of the district court's jurisdiction under 28 U.S.C. § 1334. *Tufts* analyzed the bankruptcy court's jurisdiction under the "related to" test, but the proper question is probably whether the action "arises in" a case under title 11 under section 1334(b). But the Eleventh Circuit has long employed a jurisdictional test that blends "arising in" and "related to" jurisdiction in *Barton* cases. *See, e.g., Carter v. Rodgers,* 220 F.3d 1249 (11th Cir. 2000) (dismissing a chapter 7 debtor's claims against trustee and auctioneer for selling estate assets without court authorization brought in district court without seeking leave of the bankruptcy court under *Barton* because the claims arose in a chapter 11 case and it related to the case because the recovery could be used to pay creditors); *Lawrence v. Goldberg,* 573 F.3d 1265 (11th Cir. 2009) (affirming dismissal of action under *Barton* brought by debtor against trustee, his counsel and a variety of other participants in a case because the claims could have an effect on the handling and administration of the bankruptcy estate").

Other circuits have not employed the related-to test to assess bankruptcy court jurisdiction over a *Barton* clam that arises in a bankruptcy case, and have held that leave is required even if a case has been fully administered and closed.[4]

A recent case from the Fifth Circuit exemplifies the contrary analysis. In *Foster v. Aurzuda (In re Foster),* Case No. 22-10310 (5th Cir. 2023) (unpub.), the debtor, Foster, following the bankruptcy court's approval of the trustee's final report and order closing the case, filed a motion to re-open her closed bankruptcy case for the purpose of suing the trustee. The bankruptcy court denied that motion. Ten months later, the debtor sued the trustee and her court-retained counsel, among others, in state court without first seeking bankruptcy court leave. The trustee and her counsel removed the lawsuit to the bankruptcy case and moved to dismiss on the basis of *Barton*, which the bankruptcy court did as to the trustee and her counsel, and remanded as to the other defendants. Foster appealed the district court's affirmation of the dismissal to the Fifth Circuit.

In a per curiam opinion, the Fifth Circuit began its analysis by noting that the bankruptcy court had jurisdiction over the claims against the trustee and counsel because they "all arise from their roles as trustee and counsel for the trustee in the underlying bankruptcy case and involve claims that Foster raised during the bankruptcy case." Slip Op. at 6. Foster contended there was no jurisdiction in the bankruptcy court because her complaint raised only state law claims, but the Fifth Circuit rejected that contention "when, as is the case here, the claims could not arise outside of the bankruptcy context." Slip Op. at 6. Quoting a prior decision, the Court noted that "a proceeding is core under section 157 if it invokes a substantive right provided by title 11 or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy case." Slip Op. at 5.

Finally the Fifth Circuit addressed the *Barton* basis for dismissal, holding that *Barton* was correctly applied as the lawsuit against the trustee and her counsel addressed conduct that they undertook in their official capacities.

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[4] *Satterfield v. Malloy,* 700 F3d 1231 (10th Cir. 2012); In re Crown Vantage,, Inc. (421 F.3d 963 (9th Cir. 2005); *Muratore v. Darr,* 375 F.3d 140 (1st Cir. 2004); *Linton, supra.*

Faculty

Hon. Thomas M. Horan is U.S. Bankruptcy Judge for the District of Delware in Wilmington, appointed in 2023. He previously practiced law in Wilmington for 18 years, focusing on financial restructuring and bankruptcy litigation. Most recently, Judge Horan had been a member of the Bankruptcy, Insolvency and Restructuring group at Cozen O'Connor, a national firm headquartered in Philadelphia with a Wilmington office. He joined Cozen in a group-wide 2020 defection from Fox Rothschild, for which he had worked since its own 2018 merger with Wilmington-based Shaw Fishman Glantz & Towbin. Judge Horan's national practice included representing debtors and official unsecured creditor committees in complex chapter 11 proceedings, but he also represented secured creditors and other parties in litigation. He also frequently provided opinion letters on commercial transactions and represented parties before the state's Court of Chancery and Superior Court. Last year, Judge Horan was named to *Lawdragon*'s list of the Top 500 U.S. bankruptcy and restructuring lawyers. He also serves on ABI's Board of Directors. Judge Horan received his B.A. in 1989 and his M.A. in 1992 from Fordham University, and his J.D. *cum laude* from St. John's University School of Law in 2002, where he was executive notes and comments editor for the *ABI Law Review*.

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Thomas E. Patterson is a partner with KTBS Law LLP in Los Angeles. He has represented debtors, creditors' committees and secured creditors in many large chapter 11 cases, and has also been involved in many significant insurer insolvency matters in California. Mr. Patterson has represented many chapter 11 debtors, including Brotman Medical Center, the developer of the Lake Las Vegas Resort and Development, Thorpe Insulation Co. (special appellate counsel in connection with a plan proposed under § 524(g) of the Bankruptcy Code), Imagyn Medical Technologies Inc., Aquarius Promotional Enterprises Inc. and Cool Fuel Incorporated. He also has extensive experience in representing secured creditors and the lenders, and has represented many committees. Mr. Patterson is a Fellow in the American College of Bankruptcy and has participated extensively in continuing education panels for the American Law Institute, Financial Lawyers Conference, ABI, the Los Angeles County Bar Association and other organizations. Mr. Patterson was named the 2011 Century City Bankruptcy Attorney of the year and is listed in *The Best Lawyers in America* and *Chambers USA*, among other honors. He has served as secretary (2004-05), vice president and seminar coordinator (2005-06), president (2006-07) and member of the board of governors (1998-2001, 2003-present) of the Financial Lawyers Conference, and has been a member of the Debtor-Creditor Relations Committee of the Business Law Section of the California State Bar (1992-95) and of the Bankruptcy Subcommittee of the Commercial Law and Bankruptcy Committee of the Los Angeles County Bar Association (1994-97). He is the author of "Current Issues Involving Adequate Protection in Real Estate Bankruptcies," 22 *California Bankruptcy Journal* 75 (1994), and is a contributing author to *Collier on Bankruptcy*. Mr. Patterson received his B.A. with first-class honors in philosophy from the University of Manitoba. He attended Oxford University on a Rhodes Scholarship, from which he graduated with a B.A. in jurisprudence (First Class) in 1984 and a Bachelor of Civil Law (First Class) in 1985. He subsequently served as a Bigelow Fellow and Lecturer in Law at the University of Chicago Law School from 1985-86.