

Note

Motivating Disclosure by a Debtor in Bankruptcy: The Bankruptcy Code, Intellectual Property, and Fiduciary Duties

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The fiduciary duties of a bankrupt debtor in possession have not been discussed in detail by the courts. This Note makes a simple and original claim about such duties: that the fiduciary duties of a bankrupt debtor in possession are too low and should be reformed to comport with fiduciary duty standards in related areas of the law, most notably corporate law. In particular, the Note advocates a duty to disclose relevant information about the value of assets dispersed in a bankruptcy proceeding. In coming to this conclusion, the Note considers relevant sections of the Bankruptcy Code, legal precedent, economic analysis, and other bankruptcy policy considerations such as preventing fraud and protecting the honest but unfortunate debtor. Focusing on one important aspect of bankruptcy law, § 363 sales of assets, the Note provides an eclectic and useful framework for further research, both normative and positive, on fiduciary duties in bankruptcy.

The Note adds a number of original insights to the existing literature on bankruptcy and fiduciary duties. First, the Note discusses creative and novel alternatives to heightening the debtor's fiduciary duty, such as looking to intellectual property concepts. Second, the Note analyzes a key Seventh Circuit decision, which remains good law, and illuminates its sundry missteps. Next, the Note provides a novel application of the corporate opportunities doctrine to § 363 sales of assets. The Note also provides new suggestions for reform of fiduciary duties in bankruptcy.

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Introduction

In bankruptcy, a debtor in possession owes fiduciary duties¹ to the creditors that the debtor does not owe if solvent.² The nature of these fiduciary

1 A fiduciary duty can be defined as “a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person (such as the duty that one partner owes to another).” BLACK’S LAW DICTIONARY 428 (abridged 8th ed. 2005). A fiduciary duty of disclosure, the focus of this Note, clearly falls under the requirement of honesty and loyalty. See RESTATEMENT (THIRD) OF AGENCY § 8.11 (2006) (“An agent has a duty to use reasonable effort to provide the principal with facts that the agent knows, has reason to know, or should know when (1) subject to any manifestation by the principal, the agent knows or has reason to know that the principal would wish to have the facts or the facts are material to the agent’s duties to the principal; and (2) the facts can be provided to the principal without violating a superior duty owed by the agent to another person.”).

2 “Debtor in possession” means the debtor in a Chapter 11 case. 11 U.S.C. § 1101(1) (2006). See *infra* Part II for more about the debtor in possession. Several cases hold that solvent debtors do not owe fiduciary duties to creditors. See *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 103 (Del. 2007) (holding that creditors of a Delaware corporation do not have standing to file a direct claim against the corporation’s directors for breach of fiduciary duties when the corporation is not insolvent); *Katz v. Oak Indus., Inc.*, 508 A.2d 873, 878-79 (Del. Ch. 1986) (holding that the obligation of a corporation’s management to the corporation’s creditors is held not to a fiduciary standard but to one of contractual good faith). Other cases describe the rule that a bankrupt debtor in possession is a fiduciary for the bankruptcy estate and its creditors. See *Wolf v. Weinstein*, 372 U.S. 633, 649 (1963) (noting that a debtor in possession “bears essentially the same fiduciary obligation to the creditors as does the trustee for the Debtor out of possession”); Official Comm. of Unsecured Creditors of United Healthcare Sys., Inc. v. United Healthcare Sys., Inc. (*In re United Healthcare Sys., Inc.*), 200 F.3d 170, 177 n.9 (3d Cir. 1999) (“United Healthcare, as a debtor-in-possession, is a fiduciary for its estate and for its creditors.”); *Bowers v. Atlanta Motor Speedway, Inc.* (*In re Se. Hotel Props. Ltd. P’ship*), 99 F.3d 151, 152 n.1 (4th Cir. 1996) (“[F]or purposes of Chapter 11 bankruptcies, a ‘debtor-in-possession’ is a debtor who remains in possession of the pre-petition assets and administers them for the benefit of the creditor body”); *Kremen v. Hartford Mut. Ins. Co.* (*In re J.T.R. Corp.*),

duties has not been addressed in detail by the courts,³ nor by scholarly commentators, without room for many additional insights.⁴ In fact, as this Note will argue, fiduciary law in bankruptcy is so muddled that the fiduciary duties of a debtor in possession are nearly non-existent for important sections of bankruptcy in which there are very strong arguments for imposing a more substantial fiduciary duty. This Note will make those arguments, relying on legal precedent, economic analysis, and other policy considerations. The Note thus engages in an original analysis of the fiduciary duties of the debtor in possession in bankruptcy, and provides a clear policy recommendation for reform.

This Note centers on the fiduciary duty of disclosure in the context of Bankruptcy Code § 363 sales of assets outside the ordinary course of business

958 F.2d 602, 605 (4th Cir. 1992) (“The debtor-in-possession does not act in his own interests, but rather in the interests of the creditors.”); *Dunes Hotel Assocs. v. Hyatt Corp.*, 245 B.R. 492, 506 (D.S.C. 2000) (“A trustee or debtor-in-possession is a fiduciary that should act in the interests of the creditors, not in its own interests.”); *Brent Explorations, Inc. v. Karst Enterprises, Inc.* (*In re Brent Explorations, Inc.*), 31 B.R. 745, 752 (Bankr. D. Colo. 1983) (“[A]t the filing of the bankruptcy petition the debtor becomes a new entity, the debtor-in-possession with its own rights and duties. This second entity has a fiduciary duty to the estate.”) (citation omitted).

3 *Fulton State Bank v. Schipper* (*In re Schipper*), 109 B.R. 832, 835 (Bankr. N.D. Ill. 1989) (“A debtor-in-possession holds its powers in trust for the benefit of the creditors and has the duty to protect and conserve property in his possession for their benefit. The scope and breadth of this duty, however, is somewhat undefined.”), *aff’d*, 112 B.R. 917 (N.D. Ill. 1990), *aff’d*, 933 F.2d 513, 515 (7th Cir. 1991) (“[L]ittle or no case law exists addressing the specifics of a debtor in possession’s fiduciary duty in the context of a sale of assets.”). The cases cited in note 2, *supra*, do not discuss in detail what it means for a debtor in possession to be a fiduciary of the creditors.

4 To be sure, the topic of fiduciary duties in bankruptcy has been addressed previously. John T. Roache, Note, *The Fiduciary Obligations of a Debtor in Possession*, 1993 U. ILL. L. REV. 133, is probably the most on point of the literature relevant to this Note’s discussion of the fiduciary duty of disclosure. Roache analyzes *Schipper* and concludes that the common-law trustee standard should be applied in similar situations, and that the business judgment rule of corporations law is insufficient to incentivize the proper outcome. Thomas G. Kelch, *The Phantom Fiduciary: The Debtor in Possession in Chapter 11*, 38 WAYNE L. REV. 1323 (1992), proposes wholesale rejection of fiduciary duties on the part of the debtor in possession because the concepts are too confusing for bankruptcy courts. C.R. Bowles & John Egan, *The Sale of the Century or a Fraud on Creditors?: The Fiduciary Duty of Trustees and Debtors in Possession Relating to the “Sale” of a Debtor’s Assets in Bankruptcy*, 28 U. MEMPHIS L. REV. 781 (1998), discusses the debtor in possession’s fiduciary duty with regard to *Revlon* duties, which is a related topic, but is more about the duty of care than the duty to disclose. A full critique of these articles is omitted.

Very lengthy commentaries about fiduciary duties and bankruptcy do appear in specialized journals such as the *American Bankruptcy Law Journal*. These are comments on case law, and though they are sometimes helpful, the analysis is not always reliable. For example, Daniel B. Bogart, *Liability of Directors of Chapter 11 Debtors in Possession: “Don’t Look Back—Something May Be Gaining on You,”* 68 AM. BANKR. L.J. 155 (1994), premises its entire argument on the notion that a bankruptcy trustee is in fact a common-law trustee as defined by the *Restatement (Second) of Trusts* and the *Restatement (Third) of Trusts*. However, the *Restatement (Third) of Trusts*, which Bogart cites several times, *see, e.g., id.* at 235, clearly says: “The following are not trusts: . . . receiverships and bankruptcy trusteeships . . .” RESTATEMENT (THIRD) OF TRUSTS § 5(d) (2003). The Restatement continues: “[T]he word ‘trust’ or ‘trustee’ does not necessarily mean that a trust relationship is involved. A property arrangement is a trust as long as it has the characteristics, and gives rise to the rights and duties, the law recognizes as a trust.” *Id.* cmt. a (citation omitted). While a bankruptcy trustee is called a “trustee,” it should not be confused with a common-law trustee.

free and clear of liens,⁵ as a point of departure for future work on fiduciary duties in bankruptcy and fiduciary duties more generally. Section 363 asset sales are arguably one of the more important instruments of bankruptcy law, as they are useful in all bankruptcy cases in which the debtor has salable assets but also suffers liens on those assets. Focusing on § 363 is thus warranted.⁶

This Note analyzes the requirements placed on the bankrupt debtor in possession to disclose information that is materially relevant for a creditor's decision to object to certain of the debtor's transactions, and how the Code or bankruptcy jurisprudence should be reformed to bring § 363 standards of disclosure in line with corporate law doctrines and indeed with other sections of the Bankruptcy Code. The animating goal is to answer the question of how to motivate a debtor in possession to disclose materially relevant information to its creditors during a sale of assets.

A comparison of bankruptcy law with corporate law concludes that the duties of disclosure of a bankrupt debtor in possession are actually less than those of a corporation's management when the corporation is solvent, contrary to the claims of courts and other commentators,⁷ if we take Delaware corporate law as the standard.⁸ In particular, the debtor in possession is sometimes not required to disclose materially relevant information even though disclosure of that information would be required by corporate law in a non-bankruptcy setting. Because bad incentives to file for bankruptcy when it is otherwise not needed are engendered by a mismatch between fiduciary duties in corporate law and duties in bankruptcy, and because disclosure is shown to be efficient, this Note concludes that in the context of § 363, the duties of disclosure of a bankrupt debtor in possession should be higher than what the current bankruptcy standard requires.

This Note first provides a relevant overview of the debtor in possession, discussing the property of the estate. The Note then considers potential avenues for requiring disclosure, first through the notion that intellectual property of the debtor comprises property of the estate. Next, the Note then turns to the Code

5 See 11 U.S.C. § 363(b), (f) (2006).

6 Section 363 is particularly useful for getting cash to the debtor in a Chapter 11 case. "The scarcest and most precious commodity in a Chapter 11 case is cash. Without cash, you cannot even get to confirmation. The way in which most debtors generate the cash necessary to get to confirmation, to pay all of the things that have to be paid in cash on confirmation is through asset sales." Transcript of Oral Argument at 27, Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc., 128 S. Ct. 2326 (2008) (No. 07-312) (opening statement of G. Eric Brunstad, Jr., on behalf of the Respondent).

7 See, e.g., *Schipper*, 933 F.2d at 515 ("As to Schipper's general fiduciary duty to his creditors, the [bankruptcy] court analogized to the duties of a corporate fiduciary under state law. . . . With all of these conclusions the district court agreed. We are inclined to agree as well."); Roache, *supra* note 4.

8 This Note will focus on Delaware corporate law in comparisons between federal bankruptcy law and corporate law because Delaware is the most popular state for incorporation. See, e.g., Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 242-44 (1985) (presenting evidence that over eighty percent of reincorporations were to Delaware in a survey of corporations from 1960 through the mid-1980s). For reasons why Delaware is the leading state for corporations, see Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987).

to describe and analyze its disclosure requirements, and turns to case law to verify the analysis. It goes on to discuss how corporate law jurisprudence would suggest bankruptcy disclosure requirements should be structured, and offers specific routes to implement the policy reform. Finally, the Note considers why bankruptcy law fiduciary standards are different from fiduciary standards in other areas of the law, offers suggestions for further research, and counters potential objections. The final Part concludes.

I. The Debtor in Possession: Definitions and Preliminary Issues

Upon the commencement of a case in bankruptcy, an estate is created, comprising all “legal or equitable interests of the debtor in property as of the commencement of the case.”⁹ Thus, courts have found that the estate encompasses the debtor’s intangible property, including insurance policies,¹⁰ licenses,¹¹ and business goodwill.¹² Unless a particular federal interest requires a different result, property interests are created and defined by state law.¹³

This is just one example of how state law helps define the substance of federal law, and bankruptcy law in particular, itself a separate paper topic.¹⁴ As another example relevant to this Note’s discussion of fiduciary duties, the corporate fiduciary standards of state law might also influence how courts construe similar duties in bankruptcy, if Congress or the federal courts were to adopt a single standard for fiduciary principles in bankruptcy. An alternative would be to hold corporations in bankruptcy to the fiduciary standards of the

9 11 U.S.C. § 541(a)(1) (2006). There are some exceptions, of which the most important for our purposes is the exemption for earnings from services performed by the individual debtor. 11 U.S.C. § 541(a)(6) (2006). This exemption seems to be in consideration of the Thirteenth Amendment’s prohibition of involuntary servitude. U.S. CONST. amend. XIII.

10 *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89 (2d Cir. 1988).

11 *See, e.g., F.C.C. v. NextWave Personal Commc’ns, Inc.*, 537 U.S. 293 (2003).

12 *See, e.g., Walsh v. Fitzsimmons (In re Fitzsimmons)*, 725 F.2d 1208 (9th Cir. 1984); *In re Cooley*, 87 B.R. 432 (Bankr. S.D. Tex. 1988).

13 *Butner v. United States*, 440 U.S. 48, 55 (1979) (holding, under the old Bankruptcy Act, that property interests are the domain of state law); *see also Bd. of Regents v. Roth*, 408 U.S. 564, 577 (1972) (“Property interests, of course, are not created by the Constitution. Rather they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law—rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.”). Thus, differences in property law among the states may mean differences in what exactly comprises the estate and in the results of a bankruptcy proceeding.

14 Federal law of course also shapes the substance of state law, since corporate directors will be expected to adhere to federal regulations and disobeying them may be a breach of fiduciary duties. Bankruptcy law today is primarily the domain of federal law, as allowed by the Constitution. U.S. CONST. art. I, § 8, cl. 4 (granting to Congress the power to establish “uniform laws on the subject of bankruptcies throughout the United States”). Prior to the Bankruptcy Act of 1898, however, bankruptcy issues in the United States were largely handled by state courts. Only beginning at the turn of the twentieth century “has Congress, armed with an expansive interpretation of its powers under the commerce clause, become an active participant in business affairs; originally, authority over the enforcement of contracts and the regulation of property was left almost exclusively to the states.” ELIZABETH WARREN, *BUSINESS BANKRUPTCY* 2-3 (1993).

state in which they incorporate. Neither standard has yet developed in a clear and coherent fashion.

The Bankruptcy Code envisions that either the debtor or a trustee will manage the estate once the debtor has filed for bankruptcy. The main benefit of having a bankruptcy trustee is that the administration of the estate may be more impartial and trustworthy to the creditors. However, there are a number of downsides, all related to each other, compared to having a debtor in possession. This discussion is relevant to a discussion of fiduciary duty reforms in that the costs and benefits of allowing a debtor in possession, including the necessity of imposing a strong fiduciary duty on a debtor in possession in order to mitigate the agency problem of allowing a debtor in possession,¹⁵ need to be weighed against the costs and benefits of having a trustee.

One major concern is administrative cost or, perhaps more accurately, agency costs as compared to agency benefits. Depending on the skills and information structure (the relative expertise) of the trustee or debtor in possession, the net agency costs of a non-interested trustee may be less, or they may be more. The gross agency costs of a trustee are typically less than those of a debtor in possession: trustees are usually more impartial, having less expertise about and involvement with the debtor's business, and so there is less of a concern of a breach of a duty of loyalty.¹⁶ On the other hand, the debtor in possession usually has more skills and knowledge to continue the business as a going concern, and would be in a better position to maximize its value. This will often be true—despite the fact that a corporation is in bankruptcy, which may be for reasons unrelated to the management's talents—because businesses or groups of assets are often more valuable as a going concern rather than when liquidated: there are future profits to be earned.

Another important concern in the choice of when to appoint a trustee is whether there will even be a choice between the bankruptcy trustee and the debtor in possession in the first place. The future imposition of a trustee affects the debtor's decision whether or not to enter bankruptcy, so there is a third option: the debtor chooses to stay out of bankruptcy even when it is beneficial to enter bankruptcy.¹⁷ The debtor out of bankruptcy derives both non-pecuniary benefits and pecuniary benefits (legitimate benefits such as salary, but also potentially illegitimate benefits such as fraudulent conveyances that are not voided) from being the debtor out of bankruptcy. These benefits disappear

15 Agency problems arise in bankruptcy due to conflicting interests between the creditors and the debtor in possession acting as their agents. This is analogous to the conflicting interests of shareholders and their agents, the management of the firm. See, e.g., Minh Van Ngo, *Agency Costs and the Demand and Supply of Secured Debt and Asset Securitization*, 19 YALE J. ON REG. 413, 421 (2002); Roberta Romano, *A Guide to Takeovers: Theory, Evidence, and Regulation*, 9 YALE J. ON REG. 119, 129 (1992).

16 Consider also the discussion in Part IV, *infra*, on potential differences between the duty of loyalty of trustees and that of the debtor in possession, as imposed by the courts.

17 One could draw a simple game tree to illustrate the decision. For a primer on game trees, see MICHAEL L. KATZ & HARVEY S. ROSEN, *MICROECONOMICS* 521-23 (3d ed. 1998).

when a trustee is appointed.¹⁸ Increasing the fiduciary duties of the debtor in possession in bankruptcy has a similar, though more attenuated, effect.¹⁹

Because of the costs of having an external bankruptcy trustee, many corporations filing for bankruptcy file under Chapter 11, in which case a trustee is generally not required. While Congress primarily intended Chapter 11 bankruptcy for businesses, the Supreme Court has held that individuals not engaged in business may file for Chapter 11 bankruptcy.²⁰ This holding was codified by the 2005 amendments to the Bankruptcy Code.²¹ Thus, the debtor in possession may be a corporation or an individual.

II. An Alternative to the Duty To Disclose: Construing Intellectual Property as Property of the Estate

A. *Intellectual Property in Bankruptcy*

Courts have shied away from requiring a fiduciary duty of disclosure on the part of debtors,²² so it would be wise to examine an alternative. How the intellectual property of knowledge may be an asset in bankruptcy is relevant to a discussion of the fiduciary duty of disclosure, in that treating intellectual property as an asset may lessen the need for a fiduciary duty of disclosure when considering how to motivate the debtor in possession to disclose materially relevant information.

It is not clear what standard a court should use in ruling on the management in bankruptcy of the intellectual property of knowledge, for example a trade secret or other private information. Section 107(b) of the Bankruptcy Code provides that “the bankruptcy court may . . . protect an entity with respect to a trade secret or confidential research, development, or commercial information,”²³ but the Bankruptcy Code does not otherwise address such intellectual property. The Supreme Court has not ruled on trade secrecy issues in bankruptcy, and apparently no federal court of appeals has either.²⁴ The standard thus appears to be highly equitable in nature, with even district courts tending not to interfere in a bankruptcy court’s decision regarding trade secrets.²⁵ Of course, the courts have ruled on the sale of certain

18 For a fuller discussion of relevant considerations, see, for example, Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (pt. 2), 57 AM. BANKR. L.J. 247 (1983).

19 See Part IV.B, *infra*, for a fuller discussion of these effects.

20 See *Toibb v. Radloff*, 501 U.S. 157, 166 (1991).

21 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 321(a), 119 Stat. 23, 94-95 (2006) (codified at 11 U.S.C. § 1115 (2006)).

22 See, e.g., *Fulton State Bank v. Schipper* (*In re Schipper*), 933 F.2d 513, 516 (7th Cir. 1991).

23 11 U.S.C. § 107(b) (2006).

24 See 2008 COLLIER PAMPHLET EDITION, BANKRUPTCY CODE: BANKRUPTCY REFORM ACT OF 1978, AS AMENDED, AND RELATED STATUTORY PROVISIONS 115 (Alan N. Resnick & Henry J. Sommer eds., 2008) (listing no Supreme Court or court of appeals cases under relevant cases for § 107).

25 *Id.* (listing mostly bankruptcy court cases under relevant cases for § 107).

intellectual property assets,²⁶ but these decisions do not relate to the duties of disclosure of a debtor in possession in bankruptcy, the focus here.

B. *Intellectual Property as Typical Property*

There are two ways in which knowledge can be considered an asset of the bankruptcy estate. First, relevant knowledge of an estate can be like all other property in that its disclosure is required when the insolvent entity files for bankruptcy. However, this approach imposes costs that are likely too great for the debtor in possession, as the debtor in possession will have lots of information to disclose. The cost of this approach is great for the creditors as well, as there may be too much information to sift through.

Further, the non-excludability of intellectual property means that there may be difficulties in conceptualizing it as a regular piece of property subject to the bankruptcy process. Everyone can have a full share in information, so it may not be sensible to consider it an asset subject to division in the bankruptcy process. On the other hand, certain information, such as trade secrets, may have maximal value when its dissemination is limited—hence the reason for the protection of trade secrets in law generally and in § 107(b). Thus, having intellectual property fully spelled out at the beginning of a bankruptcy process for all the creditors to consider may inherently decrease its value.²⁷

For example, when the bankruptcy estate is distributed at confirmation, wide dissemination to creditors of trade secrets might be beneficial to creditors. However, doing so typically hinders the functioning of the business after bankruptcy, going against the bankruptcy policy of rehabilitating sound businesses. Wide dissemination might also be harmful to society overall if the effect is to decrease *ex ante* investment in trade secrets or other production of commercial information. Further, once information is disclosed, there is often no going back, so courts would be wise to err on the side of less disclosure of confidential information. Thus, it is appropriate that the approach of treating intellectual property as regular property of the estate is rejected, and that there is a special equitable protection for confidential intellectual property as given in § 107(b).²⁸

26 See, e.g., *Smart World Techs., LLC v. Juno Online Servs., Inc.* (*In re Smart World Techs., LLC*), 423 F.3d 166 (2d Cir. 2005).

27 It may be possible to have creditors sign a confidentiality agreement, but in general the administrative costs would be prohibitive because there are typically many creditors of a corporation. The greater the number of confidentiality agreements that would have to be enforced, the less effective the enforcement or the greater the enforcement costs.

28 Notice that trade secrecy and proprietary information issues are implicated outside of bankruptcy, and the operation of the relevant law may be similar. For example, if a minority or controlling shareholder tries to usurp a corporation's trade secrets, this may be considered fleecing of corporate assets and would be disallowed. However, trade secret law is generally in the domain of the states, and § 107 seems to allow bankruptcy courts the ability to circumvent state law in bankruptcy settings if necessary; § 107 does not reference the trade secret laws of any other jurisdiction.

Notice also that because of § 107's specific grant to the bankruptcy courts to protect trade secrets "on the bankruptcy court's own motion," trade secret protection would be a core proceeding arising in a

C. Intellectual Property as Goodwill

The second way in which private information and procedures can be considered an asset of the bankruptcy estate is that relevant knowledge might be considered part of an entity's goodwill. Thus, the institutional structures and institutional knowledge of a corporation may be considered business goodwill, and profits derived from this goodwill could be considered part of the estate.²⁹ As an extension, *profits* deriving from the relevant intellectual capital (the business acumen, knowledge of trade, or developed skill sets) of the managers or employees of a corporation might also be considered part of the estate, to the extent that they either continue to work for the firm or are contractually obligated to work for the firm.

There are significant problems with conceiving of private information solely as goodwill, if disclosure of materially relevant information is important. To the extent that the knowledge or skills are held solely by the employees, including private information in goodwill means that disclosure of materially relevant knowledge is not required. The specific nature of a business's goodwill in the form of human capital need not be spelled out in bankruptcy disclosure documents. It is accepted practice that goodwill is labeled just that in books and records, with no further description. Further, business goodwill is difficult to value and is often greatly misvalued on the books.³⁰ Thus, it does not need to be disclosed at all in any specificity, which does not help the goal of informing creditors.

Notice that here is one place where an individual debtor differs from the corporate or partnership debtor. If knowledge is held to be part of personal goodwill, then the earnings deriving from the personal knowledge or skills of the individual debtor may be exempt from the estate. This is so even though the same earnings would be part of the estate if the debtor were a corporation, and the only employee is the one person with the relevant knowledge or skill set. The corporation may be owned in small part by other people, with the one person being the sole employee. In that case, the value added of the knowledge is not exempt from the bankruptcy estate, and this is so simply because the debtor is not an individual debtor and thus does not meet the requirements of § 541(a)(6),³¹ even though in reality the debtor in possession is an entity run by an individual. This somewhat arbitrary distinction between the result for a

case under Title 11. *See, e.g.*, 28 U.S.C. § 157(b) (2006); *Specialty Mills, Inc. v. Citizens State Bank*, 51 F.3d 770, 773 (8th Cir. 1995) ("Core proceedings under 28 U.S.C. § 157 are those which arise only in bankruptcy or involve a right created by federal bankruptcy law."). Thus, the bankruptcy court can decide as a final matter, subject to normal judicial review, issues of protecting trade secrets.

²⁹ *See, e.g.*, *Fitzsimmons v. Walsh (In re Fitzsimmons)*, 725 F.2d 1208 (9th Cir. 1984); *In re Cooley*, 87 B.R. 432 (Bankr. S.D. Tex. 1988).

³⁰ Microsoft, for example, had a stock valuation of over \$267 billion at the close of the market on June 30, 1998, but its book value on that date was less than negative \$15 billion. Much of the difference is attributable not to fraud, but to the goodwill that was valued properly but inaccurately on the books. RICK ANTLE & STANLEY J. GARSTKA, *FINANCIAL ACCOUNTING* 143-49 (2d ed. 2002).

³¹ *See supra* note 9.

corporation or partnership and the result for an individual further argues against using the notion of intellectual property being part of the estate as an exclusive means in attempting to get a debtor in possession to disclose materially relevant information about the estate; there lie many difficulties along this route.

D. *From Intellectual Property to a Fiduciary Duty of Disclosure*

Thus, while intellectual property notions may be relevant, they are insufficient to protect the interest of disclosing information to creditors. Intellectual property is certainly an asset from which the creditors of a bankrupt debtor can benefit. However, administrative costs and the policy considerations of protecting trade secrets embodied in § 107 mean that creditors can only benefit from them indirectly and cannot easily utilize the concept of intellectual property as property to compel useful disclosure of information relevant for purposes of objecting to the debtor in possession's actions.

The question remains: How do we protect the trade secrets and private information of a debtor in possession, which may have maximal value when the private information is protected, while getting a business to disclose materially relevant information to its creditors? As this Note will argue, a more appropriate way to incentivize disclosure by a debtor in possession is by characterizing the disclosure of materially relevant knowledge about the estate as a fiduciary duty. In other words, the solution is to impose a fiduciary duty of disclosure, to require the debtor in possession to disclose materially relevant information, and to place the burden on the debtor in possession's judgment to determine which parts of the estate's intellectual property of knowledge should be disclosed. The duty of disclosure can thus be seen as a way to utilize the intellectual property of knowledge for the benefit of the beneficiaries, without having to disclose more than is necessary, and this vision is consistent with the general definitions of fiduciary duties. As the next Parts show, however, a fiduciary duty of disclosure is not the law in bankruptcy.

III. Certain Substantive Disclosure Duties of a Debtor in Possession

The debtor in possession generally has a number of specific duties. These duties are spelled out in §§ 521 and 1107 of the Bankruptcy Code and include, importantly for our purposes, a number of duties of disclosure. The debtor in possession must file a list of creditors, a schedule of assets and liabilities, a statement of financial affairs, income tax statements, and other basic financial information.³² The debtor in possession must satisfy certain duties of the bankruptcy trustee, as mentioned in § 704, which is referred to by § 1106, which in turn is referred to by § 1107.³³ Following the § 1107 trail, the debtor in possession must, among other things, "furnish such information concerning

32 11 U.S.C. §§ 521, 1107 (2006).

33 *Id.* §§ 704, 1106, 1107.

the estate and the estate's administration as is requested by a party in interest."³⁴ For a validly operating business, the debtor in possession must also "file with the court [and other relevant entities] . . . periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires."³⁵

None of these duties is characterized as a fiduciary duty, and this is appropriate, given the definition of fiduciary duties provided earlier.³⁶ These enumerated duties are specific duties of a debtor. They are not fiduciary duties, which are typically characterized by a level of discretion or judgment that would trigger the loyalty concerns that are definitional to fiduciary duties. Notice that loyalty to whom a fiduciary duty is owed is not a concern when considering whether the duties are fulfilled. In contrast, fulfillment of a fiduciary duty would require a consideration of loyalty.

To see how loyalty is not required to fulfill the specific duties of the debtor in possession in this context, notice that *beyond* disclosing basic information, such as tax returns and periodic reports on books and records, the disclosure duties of a debtor in possession are only those that are triggered *upon request* by a third party. The debtor in possession must "furnish such information concerning the estate and the estate's administration *as is requested by a party in interest*,"³⁷ but is not obliged to volunteer relevant information beyond the statutorily required basic disclosures. Although the debtor in possession must file "such other information as the United States trustee or the court requires,"³⁸ unless the U.S. trustee or the court requires the debtor in possession to disclose relevant information—the form or even existence of which may be unknown to the court or to other third parties—the debtor in possession is not obliged to volunteer relevant information beyond the required specific disclosures. Loyalty would require the debtor in possession to volunteer pertinent information, but that is not a feature of the duties of the debtor in possession under current law.

The consequence is that, in bankruptcy, the burden is often placed on a validly interested third party to request potentially important information which it may not even know exists. This is so even though the debtor in possession may know the information to be relevant, and even though the lack of required disclosure leads to an inefficient outcome: shifting the burden to disclose information would lead to a more efficient outcome.³⁹

This level of the duty of disclosure is evident in other sections of the Bankruptcy Code. Most relevantly for this discussion, § 363(b) allows the

34 *Id.* § 704(a)(7).

35 *Id.* § 704(a)(8).

36 *See supra* note 1. A fiduciary duty of disclosure, the focus of this Note, clearly falls under the requirement of honesty and loyalty.

37 11 U.S.C. § 704(a)(7) (2006) (emphasis added).

38 *Id.* § 704(a)(8).

39 *See* Part IV.B, *infra*, for a discussion of efficiency considerations.

debtor in possession “after notice and a hearing [to] use, sell, or lease, other than in the ordinary course of business, property of the estate”⁴⁰ Section 363(f) allows the debtor in possession to sell property under § 363(b) free and clear of any interest of an entity other than the estate, subject to certain conditions.⁴¹ However, none of these conditions is the debtor’s unbidden disclosure of relevant information that might cause a creditor or a court to validly object to the sale. There will be a hearing at which a creditor and judge can question the debtor in possession, but the creditor or the judge may not even know what information to ask about in order to fully inform herself of all material facts in the given situation. Even in a situation in which the creditor values property at \$8000 and the debtor in possession has private information to accurately estimate the value of the property at \$45,000, the debtor in possession has no duty to disclose this information voluntarily.⁴² Thus, the debtor in possession can rely on the ignorance of the creditors and of the court in order to benefit herself at the expense of the creditors, and this is allowed under the Bankruptcy Code.⁴³ In the context of § 363, the case law supports the view that the debtor in possession need not disclose information beyond the statutory requirements, even though *ex post* it is discovered that knowledge of the information would likely have been material to the actions of a court or the creditors.

IV. Case Law and Commentary

A. Schipper

The case that most clearly illustrates the prevailing law on providing information beyond the required statutory disclosures in bankruptcy, at least in the context of § 363 asset sales, is *Fulton State Bank v. Schipper (In re Schipper)*. The facts are summarized as follows, culled from the decisions.⁴⁴

In May 1986, John Dornfeld offered \$45,830 for two tracts of land that Schipper owned in Rock Island County, Illinois.⁴⁵ Installment contracts were prepared, but before the deal could be consummated, Dornfeld backed out.⁴⁶ The deal apparently went sour because Schipper was unable to clear up the title

40 11 U.S.C. § 363(b) (2006).

41 *Id.* § 363(f).

42 This is the summary fact pattern and holding of *Fulton State Bank v. Schipper (In re Schipper)*, 933 F.2d 513 (7th Cir. 1991), discussed in Part IV, *infra*.

43 Thus, another cost of having the debtor in possession manage the bankruptcy estate is that the debtor in possession under current bankruptcy jurisprudence has a strong incentive to withhold private information that she can use to benefit herself or her associates without benefitting creditors. This consideration falls under the benefits of having a trustee appointed instead of allowing the debtor to remain in possession, already mentioned: the trustee will be more impartial as between creditor and debtor. See *supra* text accompanying note 16.

44 *Schipper*, 933 F.2d 513, *aff'g* 112 B.R. 917 (N.D. Ill. 1990), *aff'g* 109 B.R. 832 (Bankr. N.D. Ill. 1989).

45 109 B.R. at 833.

46 *Id.*

to the property due to a lien held by Fulton State Bank.⁴⁷ The debtor's attorney at the time testified that the debtor's attorney for the sale had sought to "finesse" the bank by first transferring the property to the parents and then to Dornfeld.⁴⁸ This is exactly what happened, suggesting that the disappearance and reappearance of Dornfeld, discussed below, may have been in part staged.

Dornfeld left the picture and purchased some property in Wisconsin.⁴⁹ In July 1986, Schipper filed for bankruptcy, with the bank being the largest creditor.⁵⁰ Early in the administration of Schipper's estate, Schipper's parents offered to purchase the two tracts of land for \$7791, the value of the property according to an appraisal ordered by the bank.⁵¹ Schipper filed in the bankruptcy court a petition to sell the property free and clear of liens, in accordance with § 363 procedures.⁵² At the hearing for the petition, neither the bank nor any other creditor lodged an objection, so the bankruptcy court granted the petition and the property was sold to Schipper's parents free and clear of liens.⁵³

More than a year later, Dornfeld reappeared and reasserted his interest in buying the two tracts. Dornfeld offered Schipper's parents the same price he offered their son: \$45,830.⁵⁴ The parents sold Dornfeld the two tracts and made a profit of nearly 500%.⁵⁵ The bank soon found out and requested an order directing Dornfeld's attorney to turn over for distribution to the creditors the proceeds of the sale.⁵⁶

The Seventh Circuit held in favor of Schipper, affirming both the bankruptcy court and the district court.⁵⁷ In accordance with the analysis in the previous section of this paper, the court held that § 363 and any related fiduciary duties did not require Schipper to disclose the serious and eventually consummated offer from Dornfeld to the creditors.⁵⁸ The court analogized the fiduciary duties in this context to the "duties of a corporate fiduciary under state law."⁵⁹

One thing to notice about this decision is that it is not itself clear what is meant by "duties of a corporate fiduciary under state law." As a preliminary matter, no state is specified, and not all states have the same corporate fiduciary

47 *Id.*

48 *Schipper*, 109 B.R. at 833 n.1.

49 109 B.R. at 833.

50 *Id.*

51 *Id.*

52 *Id.*

53 *Id.* at 834.

54 *Id.*

55 109 B.R. at 833-34.

56 *Id.* at 834.

57 *Fulton State Bank v. Schipper (In re Schipper)*, 933 F.2d 513, 516 (7th Cir. 1991).

58 *Schipper*, 933 F.2d at 515.

59 *Id.*

standards.⁶⁰ The bankruptcy court cites decisions from a number of different states in its only somewhat more thorough discussion of corporate fiduciary duties, though none of the states was Illinois.⁶¹ Most importantly, on the point that matters the most for this case, the court is not clear on the content of the standard. The court says, “The essence of the fairness test is whether or not under the circumstances the transaction carries the earmarks of an arm’s length bargain,” without clarifying what is meant by or required to prove “an arm’s length bargain.”⁶² The case to which the court cites after this statement also does not tell us what is meant by an “arm’s length bargain.”⁶³ In fact, the analogy to corporate law is misplaced, because corporate law has developed a standard for interested transactions that is materially different in analogous circumstances.⁶⁴

B. *Economic Efficiency*

Before discussing the corporate law standards, it is relevant that the holding adopted by the Seventh Circuit, and by extension the law under § 363, is economically inefficient. Efficiency considerations can be easily generalized and bolster the claim for reform.

In Schipper’s situation, the economically efficient result is such that the person who most values a plot of land receives title to the land at the earliest possible time. A lag in time until that person receives the land causes two deadweight losses: the lost opportunity cost related to greater beneficial uses of the land during that time, and the summed probability that the buyer will settle for a second-best solution and thus will no longer be able to purchase the land. Had the higher valuation been disclosed to the bank, it is more likely that Dornfeld would have gotten the land sooner because the bank could have sought out Dornfeld. Not requiring relatively costless disclosure thus leads to a less efficient outcome.

Further, in this situation and in similar ones, it is more likely that the person in Dornfeld’s position would have gotten the land sooner even if the bank did not pursue the person in Dornfeld’s position. If Schipper’s parents had sold the land to Dornfeld soon after buying it from Schipper, that would have looked fraudulent, and the court might have ruled against Schipper. Thus, the holding of the Seventh Circuit includes an incentive to wait longer before selling because of the increased probability that a court will be persuaded that

60 See, e.g., *Joy v. North*, 692 F.2d 880 (2d Cir. 1982) (Winter, J.) (construing Connecticut corporate law as following the stricter Delaware corporate law standard in the non-application of the business judgment rule when a special litigation committee recommends dismissal of a shareholder lawsuit, and not following New York corporate law, which has a laxer standard). Differences, though minor, do sometimes materially affect the outcome.

61 *Schipper*, 109 B.R. at 835.

62 *Id.* at 835-36.

63 *Id.* (citing *In re Western World Funding, Inc.*, 52 B.R. 743 (Bankr. D. Nev. 1985)).

64 The most relevant analogy is the corporate opportunities doctrine. See *infra* Part V.A.

fraud has not occurred. This is contrary to efficiency principles because the dilatory incentive contributes to a deadweight loss.

Objections to the above economic efficiency reasoning can be made but should be discounted or rejected. Admittedly, an alternative ruling in favor of the bank could have the potentially negative inframarginal effect of reducing the likelihood of filing for bankruptcy. But these effects are either minimal or very desirable. When not minimal, they have the desired effect of encouraging good faith on the part of debtors, a key bankruptcy policy.⁶⁵ Inframarginal effects of greater fiduciary duties are at their largest when the fiduciary duties are most useful in curbing abuses of the bankruptcy system and weeding out possible fraud.⁶⁶ For example, in the case in which a major purpose of entering bankruptcy is, as was suggested by Dornfeld's attorney, to use the bankruptcy system to clear title to land and then to bag a profit on the sale of that land, the requirement of disclosure prevents these abuses of the system when no fraud can be proven, as was the case in *Schipper*.⁶⁷ It is in these types of cases that the inframarginal effects are greatest. This is so because heightened duties deter entering bankruptcy to the extent that unobservable fraud is a motive for filing for bankruptcy. Thus, the net effect may be positive if the abuses prevented outweigh the few good-faith cases that are discouraged by a justifiably heightened standard.⁶⁸

It could also be argued that a heightened fiduciary standard makes a prospective buyer less willing to buy the property or that the prospective buyer would only purchase the property at a lower price because of the risk that the debtor in possession has breached a fiduciary duty and any profits received by the purchaser might be disgorged. Following this argument, this result would be contrary to the goal of maximizing the value of the estate. However, a

65 See, e.g., *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007) (noting that bad faith is a cause for dismissal or conversion of a bankruptcy case); Brief of Amicus Curiae G. Eric Brunstad, Jr. in Support of Petitioners at 4, *Archer v. Warner*, 538 U.S. 314 (2003) (No. 01-1418), 2002 WL 1885044 ("The history of the discharge in bankruptcy is one of an expanding concept marked by three interrelated themes: the promotion of relief for the 'honest but unfortunate debtor,' the corresponding denial of relief for obligations arising from fraud, and the generous exercise of the equitable powers of the bankruptcy courts to ensure the fulfillment of both goals.").

66 Scholars of fiduciary law have characterized the heightened duties of fiduciaries as designed to discourage fraud, especially when the evidence is solely in the hands of the fiduciary. See Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045 (1991). In some cases, especially older ones, the fiduciary is held to a strict liability standard. See, e.g., *Mosser v. Darrow*, 341 U.S. 267 (1951), discussed in Part IV.C, *infra*.

67 Fraud can always be present though there may inadequate proof of it. In *Schipper*, [a]lthough at first blush the facts as alleged appear to smack of fraud, the testimony and documents presented at the trial do not bear this out. At the conclusion of the trial, the Court held on the record that it could not find the existence of a fraudulent scheme, a conspiracy, or dishonesty, based upon the evidence.

Fulton State Bank v. Schipper (In re Schipper), 109 B.R. 832, 834 (Bankr. N.D. Ill. 1989).

68 There are also arguments that can be made in favor of fiduciary duties from philosophical points of view. See, e.g., H.L.A. HART, *THE CONCEPT OF LAW* 18-25 (1961) (arguing that the law is not merely sanction-threatening, but rather is obligation-imposing, and that people respond to obligations even without explicit sanctions).

prospective buyer does not have to bear the risk of liability in order for a duty of disclosure to be enforced. The debtor in possession could be the one that is held liable.⁶⁹ Further, the debtor in possession should be the one held liable because she is the least-cost avoider, in that she could have easily disclosed the information and because she is the one who holds a fiduciary duty to the creditors. This would have some effect on enforcing the duty, even if the debtor is still in bankruptcy, for it would increase the debt, even if it is ultimately dischargeable, and could be a consideration for findings of good faith. Although holding the debtor in possession liable increases her debts, this is no different than other torts or breaches we want to deter: the debtor in bankruptcy should not suffer less deterrence simply because she is in bankruptcy.

One might also argue that imposing these fiduciary duties on the debtor increases her administrative costs in that she must remember and disclose certain information. These costs are minimal, however. If not, the courts have discretion to determine what is reasonable to require a debtor to remember and disclose. In Schipper's case, in which the debtor had negotiated with Dornfeld just two months prior to filing for bankruptcy, and the failure to sell the land in the first place was clearly related to problems of Schipper's insolvency, it would not seem unreasonable to have expected that Schipper would remember Dornfeld's substantially higher offer. Indeed, it was Schipper's former attorney, not even Schipper himself, who, feeling uneasy about the transfer to the parents, alerted the bank to the previous offer.⁷⁰ In any case, the minimal administrative cost imposed on Schipper of requiring him to remember and disclose clearly relevant information is drastically lower than the benefit, even when considered in a probabilistic sense, that would have accrued to the estate. A little disclosure can go a long way.

Finally, one may argue that transaction costs in the form of lawsuits over fiduciary duties should dissuade against having a fiduciary duty. Consider the various lawsuits over breach of fiduciary duty in the corporate setting.⁷¹ However, the transaction costs would be insignificant and much less in the bankruptcy context. Lawsuits claiming breach of a fiduciary duty in a corporate setting are typically separate or *de novo* lawsuits,⁷² while any claim of breach of fiduciary duty in bankruptcy could be easily brought within an existing

69 In fact, a purchaser in good faith is protected from reversal or modification on appeal of a sale under § 363(b). See 11 U.S.C. § 363(m) (2006).

70 *Schipper*, 109 B.R. at 834.

71 See, e.g., *Hallwood Realty Partners, L.P. v. Gotham Partners, L.P.*, 286 F.3d 613 (2d Cir. 2002); *Kaplan v. Rand*, 192 F.3d 60 (2d Cir. 1999); *Croton River Club v. Half Moon Bay Homeowners Ass'n*, 52 F.3d 41 (2d Cir. 1995); *Lewis v. S.L. & E., Inc.*, 629 F.2d 764 (2d Cir. 1980); *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 906 A.2d 114 (Del. 2006); *Applebaum v. Avaya, Inc.*, 812 A.2d 880 (Del. 2002); *Gimes v. Alteon Inc.*, 804 A.2d 256 (Del. 2002); *Emerald Partners v. Berlin*, 787 A.2d 85 (Del. 2001); *Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001); *McMullin v. Beran*, 765 A.2d 910 (Del. 2000); *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000); *Malone v. Brincat*, 722 A.2d 5 (Del. 1998); *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135 (Del. 1997); *Williams v. Geier*, 671 A.2d 1368 (Del. 1996); *Broz v. Cellular Info. Sys., Inc.*, 673 A.2d 148 (Del. 1996); *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971).

72 See *supra* note 71.

bankruptcy case, as just one of a number of issues to sort out, with facts already gathered for other claims. The extra transactions costs would thus be relatively minor in the bankruptcy setting. The benefits to the bankruptcy system of promoting efficiency and of promoting two key bankruptcy policies—granting relief only to the honest but unfortunate debtor and preventing fraud—would outweigh the costs.

C. *A Missing Citation: Mosser v. Darrow*

The *Schipper* decisions omitted any discussion of an important Supreme Court precedent that may well have persuaded the judges to reconsider their positions. *Mosser v. Darrow*, a 1951 Supreme Court decision, held that a bankruptcy trustee was subject to a strict liability standard for breaches of the duty of loyalty:⁷³

Equity tolerates in bankruptcy trustees no interest adverse to the trust. . . . By its exclusion of the trustee from any personal interest, it seeks to avoid such delicate inquiries as we have here into the conduct of its own appointees by exacting from them forbearance of all opportunities to advance self-interest that might bring the disinterestedness of their administration into question.⁷⁴

It would seem that *Mosser* would be a very relevant case to cite in *Schipper* because of *Schipper*'s clear conflict of interest.

Some explanations for this omission should be dismissed outright. First, the omission could not have been simply because *Mosser* was a decision under the old Bankruptcy Act of 1898; the bankruptcy court in *Schipper* cited the 1939 bankruptcy case of *Pepper v. Litton*,⁷⁵ and in any case, the older cases still have persuasive effect. Second, *Mosser* has not been overruled. Third, the old Bankruptcy Act and the new Bankruptcy Code are not that different with regard to fiduciary duties. Fiduciary duties to the estate are not fleshed out in the Bankruptcy Code, and this rule was novel, so that it was not in the original Bankruptcy Act either. As Justice Black noted in his lone dissent, "This rule of trustee liability did not exist before today, as is shown by the fact that no statute or case is cited in support of the Court's decision."⁷⁶ Fourth, it may be possible to interpret the holding in *Mosser* as relying on the fact that the guilty trustee was a bankruptcy trustee for two common-law trusts, and that the common-law trust standard for common-law trustees drove the final result. However, the courts have interpreted *Mosser* as applying to general bankruptcy trustee cases, not only those involving common-law trusts.⁷⁷

73 *Mosser v. Darrow*, 341 U.S. 267 (1951).

74 *Id.* at 271.

75 *Schipper*, 109 B.R. at 836 (citing *Pepper v. Litton*, 308 U.S. 295 (1939)).

76 *Mosser*, 341 U.S. at 275 (Black, J., dissenting).

77 *See, e.g.*, *Dirks v. SEC*, 463 U.S. 646 (1983); *In re Big Rivers Elec. Corp.*, 355 F.3d 415 (6th Cir. 2004); *In re Mailman Steam Carpet Cleaning Corp.*, 196 F.3d 1 (1st Cir. 1999); *In re Hutchinson*, 5 F.3d 750 (4th Cir. 1993); *In re Cochise Coll. Park, Inc.*, 703 F.2d 1339 (9th Cir. 1983); *N.Y., New Haven & Hartford R.R. v. Iannotti*, 567 F.2d 166 (2d Cir. 1977).

There are a few plausible explanations. First, one likely influence on the omission is that the *Mosser* decision did not use the term fiduciary duties, so that it did not appear in an index to court decisions concerning fiduciary duties in bankruptcy. The lawyers arguing the case would have had an easier time finding this rather pertinent case if fiduciary duties were explicitly mentioned in *Mosser*.

Another rationalization is that *Mosser* is actually not perfectly applicable in the context of a debtor in possession. *Mosser* may be somewhat inapplicable because *Mosser* is about “a strict trusteeship, not one of those quasi-trusteeships in which self-interest and representative interests are combined.”⁷⁸ The debtor in possession would fit the description of a quasi-trusteeship, and the language of *Mosser* appears to limit the holding to trustees. Further, although § 1107(a) of the Code requires that the Chapter 11 debtor in possession “shall perform all the functions and duties, except [some specific duties irrelevant for this discussion], of a trustee serving in a case under this chapter,” § 1107(a) subjects the equivalence to “such limitations or conditions as the court prescribes.”⁷⁹ This allowance of court-imposed limitations permits *Mosser* to impose a higher fiduciary obligation of loyalty on trustees than on the debtor in possession, even though the Code otherwise imposes the same duties with minor exceptions.⁸⁰

Indeed, a fiduciary standard lower than the one in *Mosser* would seem to be necessary for the debtor in possession. In practice it would be impossible for a debtor in possession to satisfy the condition of having “no interest adverse to the trust.” A debtor in possession, by being a bankrupt debtor, is by definition adverse to its creditors. Moreover, prior to bankruptcy, the debtor in possession acted in its self-interest and owed no duty of loyalty to its creditors as such. The debtor in possession can be presumed to have interests adverse to the creditors, as equity holders and debt holders typically have conflicts of interest. The sources of conflict include: (1) dividend payments (the value of bonds is reduced by raising the dividend rate and financing the increase by reducing investment); (2) claim dilution (the value of bondholders’ claims may be reduced by issuing additional debt of the same or higher priority); (3) asset substitution (if a bond was contracted for when the firm engaged in low-risk projects, and then the firm takes on high-risk projects, the bond may be undervalued); and (4) underinvestment (a firm may not invest at the optimal level for bondholders, who might have a longer time horizon).⁸¹

78 *Mosser*, 341 U.S. at 271.

79 11 U.S.C. § 1107(a) (2006).

80 Section 105(a) also seems to allow the court to impose a higher fiduciary obligation on the bankruptcy trustee, or at least allows *Mosser* to continue to be good law. See 11 U.S.C. § 105(a) (2006) (“The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”).

81 Clifford W. Smith, Jr. & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117, 118-19 (1979).

Of course, this does not mean that *Mosser* is irrelevant for *Schipper*. Nor does it mean that fiduciary duties for the debtor in possession cannot approach the high standards for trustees, just that the strict liability standard is too strict. *Mosser*, a standing precedent on the fiduciary duties of a trustee in bankruptcy, is clearly relevant as a guidepost for the fiduciary duties of the entity taking the place of the trustee in bankruptcy. By taking the place of the trustee, and thus by analogy to the trustee, the debtor in possession owes the estate at least some duty of loyalty. By logical extension, the debtor in possession owes the estate a duty of disclosure, since the duty of disclosure is a subset of the duty of loyalty.

Somewhat more relaxed fiduciary duties arise in the corporate law context, as the *Schipper* decisions made clear. However, as the next Part shows, the appropriate analogies to corporate law show the *Schipper* decisions are misguided. The next Part further proposes a correction, which, along with the rationales of economic efficiency and consistency with Supreme Court precedent, suggests a necessary change of the doctrine apparent in *Schipper*.

V. Corporate Law Fiduciary Standards

A. *The Corporate Opportunities Doctrine*

The most relevant corporate analogy for disclosure duties under § 363 can be found in the corporate opportunities doctrine. The classic statement of the doctrine is derived from the 1939 case *Guth v. Loft, Inc.*:

[I]f there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself.⁸²

The sale of assets outside the ordinary course of business to a higher bidder can be analogized to a corporate opportunity in that it is an opportunity that, given a conflict of interest, should be given to the estate and not diverted to the debtor herself or a closely related entity.

For example, the corporate opportunities doctrine was the primary grounds for the decision against the corporate insider defendants in *In re eBay, Inc. Shareholders Litigation*.⁸³ In that case, plaintiff shareholders alleged that Goldman Sachs, eBay's investment bank, engaged in the practice of "spinning," which involved allocating shares of lucrative IPO stock to favored eBay insiders. The spinning rewarded the insiders for bringing business to Goldman Sachs, and in effect bribed them to bring more. The plaintiffs

⁸² *Guth v. Loft, Inc.*, 5 A.2d 503, 511 (Del. 1939), *quoted in* *Broz v. Cellular Info. Sys., Inc.*, 673 A.2d 148, 154 (Del. 1996).

⁸³ *In re eBay S'holders Litig.*, No. C.A. 19988-NC, 2004 WL 253521 (Del. Ch. Jan. 23, 2004) (denying motion to dismiss).

successfully argued that the investment opportunities were owed to eBay the corporation, and not to the officers who usurped those opportunities without disclosing them to the equity-holders. The parallels to the *Schipper* case are clear.

In *Schipper*, the opportunity to sell to Dornfeld was a veritable one: it was available just before the commencement of the bankruptcy case, and was consummated later. It is also clear that the opportunity is one that belonged to the estate because all such opportunities to increase the value of the estate belong to the estate in bankruptcy, just as opportunities to increase the value of a solvent corporation belong to the corporation and not to its fiduciaries.

Presenting the opportunity to the equity-holders (the creditors), or the representatives thereof, would have provided a “safe harbor” for the fiduciary,⁸⁴ but Schipper did not do that. Further, in corporate law, disloyalty is seen as “preferring the adverse self-interest of the fiduciary or of a related person to the interest of the corporation.”⁸⁵ Thus, by diverting the opportunity to his family, Schipper breached his fiduciary duty of loyalty, if we use an appropriate corporate analogy.

B. *Analogy to Corporate Mergers and Acquisitions*

Other corporate analogies are possible, but they are less apt. The corporate cases that appear in the law review literature and the *Schipper* decisions do not discuss the corporate opportunities doctrine. Instead, the corporate cases to which they analogize involve mergers or complete sales of assets. Such analogies are not necessarily appropriate for all § 363(b) situations, since many § 363(b) sales are for parts of a company, not for entire companies. For example, the *Schipper* fact pattern is such that only a part of the debtor’s assets were sold.⁸⁶ If the entire entity were being sold, the sections of the Code that discuss plans might be more relevant, as they specifically contemplate a sale of the complete entity.⁸⁷ The sections about plans also include more protections

84 “[P]resenting the opportunity to the board creates a kind of ‘safe harbor’ for the director, which removes the specter of a *post hoc* judicial determination that the director or officer has improperly usurped a corporate opportunity.” *Broz v. Cellular Info. Sys., Inc.*, 673 A.2d 148, 157 (Del. 1996).

85 *In re The Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 66 (Del. 2006) (emphasis added). The parents of a fiduciary are more likely than almost anyone else to qualify as “related to” the fiduciary. Thus, if one were to follow Delaware’s construal of loyalty, Schipper can be seen to have breached the duty of loyalty, even if he did not himself benefit or intend himself to benefit. It may also be relevant that under federal securities law, a parent can owe derivative fiduciary duties to an entity for purposes of insider trading if the parent’s child owes direct fiduciary duties to that entity. *See* 17 C.F.R. §§ 240.10b5-1, -2 (2008).

86 “The proportionate value of the real estate to the estate as a whole is negligible.” *Fulton State Bank v. Schipper (In re Schipper)*, 109 B.R. 832, 836 (Bankr. N.D. Ill. 1989).

87 A plan may “provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests” 11 U.S.C. § 1123(b)(4) (2006).

for creditors, including, rather relevantly, greater disclosure duties on the part of the debtor.⁸⁸

Similarly, the fiduciary duties of disclosure in the context of corporate mergers when there is a conflict of interest are, if anything, even greater than under the corporate opportunities doctrine. The fiduciary duties are greater in this context because of the typically greater value of the trade, and also the finality of corporate mergers, since shareholders will often be “frozen out” of the new company. The burdens under plan confirmation, detailed in §§ 1121-1146, as compared to § 363 assets sales are greater in part for similar reasons.

Nevertheless, sales of entire entities may be possible under § 363, so the analogy to corporate merger cases is worth considering.⁸⁹ In *Weinberger v. UOP, Inc.*, the standard was one of “inherent fairness.”⁹⁰ “The concept of fairness has two basic aspects: fair dealing and fair price. . . . Part of fair dealing is the obvious duty of candor Moreover, one possessing superior knowledge may not mislead any stockholder by use of corporate information to which the latter is not privy.”⁹¹ In *Weinberger*, the court found against the defendant directors because they were on both sides of the transaction and knew but neglected to disclose that a higher price would have been acceptable, which would have earned the selling shareholders a less than twenty percent increase in return.⁹²

If this is the standard, then Schipper clearly did not meet the criterion of fairness because he was not fully candid about the value of his property, just as the *Weinberger* directors were not. Further, Schipper was on both sides of the transaction, being the son of the purchasers, just as the defendant directors in *Weinberger* were on both sides of the transaction. Nevertheless, perhaps because the bankruptcy court did not look closely enough at the decision to notice that the corporate requirement in interested transactions includes “candor” and is not limited to the amorphous standard of “the earmarks of an arm’s length bargain,” the bankruptcy court in *Schipper* held that:

The similarities between a bankruptcy estate and a solvent corporation are sufficient enough for the court to consider the fairness standard applied under state law in the corporate cases. Under the circumstances here, the Court is

88 11 U.S.C. §§ 1121-1146 (2006). Section 1125, for example, requires “adequate information” to be provided to claimants:

An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information.

11 U.S.C. § 1125(b) (2006).

89 Why the fiduciary standard is different between § 363 and the plan sections is an interesting issue discussed in Part VII.A, *infra*.

90 *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983) (en banc).

91 *Id.* at 711.

92 The shareholders received \$21 per share, *id.* at 708, but the defendant directors knew that the buyers would have purchased at \$24 per share, *id.* at 705.

unable to find a breach of a fiduciary duty, or a duty of trust owed to the estate and the creditors, by the Debtor under either standard.⁹³

A correct analogy to either the corporate opportunities doctrine or the *Weinberger* standard suggests a result quite different than that of the *Schipper* decisions.

All of this suggests the need for bankruptcy law reform. All else equal, having lower fiduciary duties in bankruptcy incentivizes filing for bankruptcy because it is a way for the debtor in possession to avoid the typical fiduciary duties outside of bankruptcy.⁹⁴ Filing for bankruptcy solely for that reason of course may constitute an abuse of the system and thus bad faith, but when it is coupled with other potential reasons that may prevent a finding of bad faith, it becomes an incentive upon which the debtor might act. It would thus be wise to revise the bankruptcy law to diminish this discrepancy, and to include a fiduciary duty of disclosure that tracks the fiduciary duties of state corporate law.

The debtor in possession should be compelled to disclose relevant information about the value of assets dispersed in a § 363 proceeding, in accordance with either the safe harbor of the corporate opportunities doctrine or the concept of fair dealing under *Weinberger*. This disclosure should occur within a reasonable time before the completion of the § 363 proceeding, so that the creditors or the court can act to stop the § 363 sale if necessary. A more specific version of this proposal is considered in the next Part.

VI. Solutions

Legislation is one solution to the confusion of the *Schipper* decisions. However, this seemingly straightforward answer is complicated by the fact that bankruptcy legislation often takes a long time. The 2005 bankruptcy reforms,

93 *Fulton State Bank v. Shipper (In re Schipper)*, 109 B.R. 832, 836 (Bankr. N.D. Ill. 1989).

94 Delaware explicitly recognizes this, but trusts the bankruptcy court to direct the debtor in possession:

Any corporation of this State, an order for relief with respect to which has been entered pursuant to the Federal Bankruptcy Code, 11 U.S.C. § 101 et seq., or any successor statute, may put into effect and carry out any decrees and orders of the court or judge in such bankruptcy proceeding and may take any corporate action provided or directed by such decrees and orders, without further action by its directors or stockholders. Such power and authority may be exercised, and such corporate action may be taken, as may be directed by such decrees or orders, by the trustee or trustees of such corporation appointed or elected in the bankruptcy proceeding (or a majority thereof), or if none be appointed or elected and acting, by designated officers of the corporation, or by a representative appointed by the court or judge, with like effect as if exercised and taken by unanimous action of the directors and stockholders of the corporation.

DEL. CODE ANN. tit. 8, § 303 (2008). Because the fiduciary duties in bankruptcy are less than outside of bankruptcy, however, this trust may be misplaced.

for instance, required eight years to achieve,⁹⁵ and the 1978 bankruptcy reforms were a decade in the making.⁹⁶

Barring a legislative solution, the gap can be filled in by judges. Just as the standard in *Mosser* can still be construed as good law because of the discretion provided in §§ 105 and 1107, courts can require a fiduciary duty of disclosure, which we might construe as imposing an obligation to disclose information that parties in interest would want to know. Because *Mosser* is still interpreted by the courts as good law, it would seem that a court-imposed fiduciary duty on debtors in possession would not be an abuse of discretion granted to the courts in bankruptcy matters.⁹⁷ This would also be consistent with granting relief only to the “honest but unfortunate debtor” as well as consistent with policies against fraud.

Federal rulemaking is another solution. It is possible to amend the Federal Rules of Bankruptcy Procedure to include a rule that requires a fiduciary duty or its equivalent in the above contexts. For example, Rule 4002 of the Federal Rules of Bankruptcy Procedure lists the duties of the debtor.⁹⁸ The rule could be amended to require the debtor to, among other things, “disclose within a reasonable timeframe any relevant knowledge about the actual value of the estate or the portions of it to be dispersed in a bankruptcy proceeding,” and to allow the court to avoid transactions in which the debtor has not complied. To the extent that the Federal Rules do not require legislative action or a test case for the courts, this could be an expedient route to implementing the suggestions in this Note. Authority for the federal judiciary to promulgate such a rule is given in the Rules Enabling Act.⁹⁹ Although Congress can overrule rules adopted by the Judicial Conference, such a rule would be consistent with existing bankruptcy statutes, as noted in the previous paragraph and earlier.

One could argue that requiring a fiduciary duty would not be a procedural rule but would be a substantive one and thus not within the power of the courts granted by 28 U.S.C. § 2075. This would be incorrect because § 2075 allows the Supreme Court to prescribe both the “practice” and the “procedure” in cases under Title 11.¹⁰⁰ In bankruptcy, the judiciary is granted authority to regulate something beyond mere “procedure.” Further, this is in accordance

95 H.R. REP. NO. 109-31, at 6 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 92 (“Proposed reforms to bankruptcy law and practice have been under consideration by Congress for nearly eight years and have generally enjoyed broad support from the business community”) (citation omitted).

96 1 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, Preface (Alan N. Resnick & Eugene M. Wypyski eds., 1979).

97 *See supra* note 80 and accompanying text; *cf. Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007) (“[T]he broad authority granted to bankruptcy judges to take any action that is necessary or appropriate ‘to prevent an abuse of process’ described in § 105(a) of the Code, is surely adequate to authorize an immediate denial of a motion to convert”).

98 FED. R. BANKR. P. 4002.

99 28 U.S.C. § 2075 (2000).

100 *Id.*

with 11 U.S.C. § 105: “The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”¹⁰¹

The key to 28 U.S.C. § 2075 is that the rules promulgated by the judiciary may increase the duties of the debtor. “Such rules shall not abridge, enlarge, or modify any substantive right,” but nothing prohibits modifying the duties of the debtor.¹⁰² Indeed, the courts have promulgated additional duties, and rules promulgated under this authority are already quite substantive. For example, Rule 4002 includes a duty on the part of the debtor to:

inform the trustee immediately in writing as to the location of real property in which the debtor has an interest and the name and address of every person holding money or property subject to the debtor’s withdrawal or order if a schedule of property has not yet been filed pursuant to Rule 1007.¹⁰³

A duty to inform on the value of bankruptcy estate property would not be significantly more burdensome, nor would it be any less procedural.

VII. Other Potential Objections: Positive Accounts of Fiduciary Duties in Bankruptcy

A. *How Duties Came To Be Less in § 363*

How duties came to be less for § 363 sales of assets free and clear of liens and whether a lower level of duty is desirable are interrelated and contestable questions. On the one hand, the lack of a fiduciary duty of disclosure may just be another way in which American bankruptcy law is relatively pro-debtor. Consider that bankruptcy regimes in most other developed countries are much less pro-debtor. For example, bankrupt debtors in most other countries following the British common law system are not even allowed to maintain possession of the estate in the way that the debtor in possession is allowed in the American setting;¹⁰⁴ in such a case the fiduciary duty of a debtor in possession would not even arise. The United States is more pro-debtor than other countries in other ways: the United States is one of the few common-law countries whose bankruptcy regime has an automatic stay on assets when a debtor enters bankruptcy, and one of the few common-law countries that does not have restrictions for going into reorganization.¹⁰⁵ A pro-debtor orientation may simply reflect a political desire to protect the debtor, and imposing fiduciary duties on the debtor in possession would be contrary to that end.

On the other hand, having lower fiduciary duties of disclosure for § 363 sales may have been unintended. First, recall that § 1125 includes some additional disclosure duties for plans; it does not make much sense for § 363 to have fewer disclosure duties when similar results—namely, complete sales of

101 11 U.S.C. § 105 (2006).

102 28 U.S.C. § 2075 (2000).

103 FED. R. BANKR. P. 4002.

104 Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1136 (1998).

105 *Id.*

assets—could be achieved through both § 363 and the plan sections (§§ 1121-1146).¹⁰⁶ The one difference might be that § 363 sales are quicker, by not requiring approval of creditors but only a hearing, while plans require both creditor approval and a proposal for the distribution of assets. However, that is not enough of a reason to omit disclosure duties of unbidden but relevant information, since disclosure of relevant information will not slow the § 363 process to an unnecessarily dramatic extent. If anything, the fact that creditors have less power in § 363 sales as compared to § 1123 sales means that creditors should be given more or as much information, not less. Further, the lower burdens in § 363 provide an incentive to engage in sales of assets prematurely, in order to avoid the greater obligations of plans, and it may be wise to negate this incentive by having similar levels of obligations.

Second, the bankruptcy court in *Schipper* thought that a debtor's responsibilities in bankruptcy, though similar to corporate fiduciary duties, are actually *higher* than they are outside of bankruptcy:

[T]he fiduciary's obligations in bankruptcy and the standards upon which they are measured are not the same, for all types of transactions, as those applied outside of bankruptcy. While a debtor's business discretion has an important role in Chapter 11, that role is reduced as the nature of the decision becomes increasingly significant. The discretion afforded the debtor gives way to the processes established under the Bankruptcy Code. The processes may require negotiation and voting, or Court approval, rather than unilateral action by the debtor. The relevant inquiry becomes not the quality of the decision, but whether the necessary processes were followed.¹⁰⁷

It is true that there are heightened responsibilities on the debtor, though these responsibilities are not exactly fiduciary duties, as has been discussed. The heightened responsibilities make sense because of the many benefits that the debtor in possession receives—discharge of debts, other reorganizations of the corporate structure, and, while in bankruptcy, ultimate accountability to the courts instead of shareholders.¹⁰⁸ At least with regard to disclosure in the context of a § 363 interested sale, however, bankruptcy fiduciary duties are actually less demanding than they are in the analogous corporate setting because they do not require the unbidden disclosure of relevant information.

More generally, the lack of a fiduciary disclosure duty in this section of bankruptcy law could have just been an oversight because one of the animating goals of bankruptcy is protection of the “honest but unfortunate debtor,” and related to this goal is the policy of preventing fraud.¹⁰⁹ Higher duties of disclosure are a straightforward way to combat fraud.¹¹⁰

106 11 U.S.C. §§ 1121-1146 (2006); see *supra* note 88.

107 *Fulton State Bank v. Schipper (In re Schipper)*, 109 B.R. 832, 836 (Bankr. N.D. Ill. 1989).

108 See *supra* note 94.

109 See *supra* note 65.

110 Consider all the disclosure requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934. Disclosure requirements can go awry of course, as in the Sarbanes-Oxley Act of

Finally, a fiduciary duty to creditors on the part of a debtor in possession nominally arises out of the filing for bankruptcy, and as noted earlier, such a duty did not exist before the filing for bankruptcy.¹¹¹ The sudden shift to a nominal fiduciary duty combined with the inertia of the prior relationship between debtor and creditor may explain the lower fiduciary duties in bankruptcy. However, while cognitive dissonance from a sudden change in legal relations may explain a doctrinal outcome as a positive matter, this is not a compelling reason for maintaining a low-to-non-existent level of fiduciary duties toward creditors while the debtor is in bankruptcy.

It may be interesting to trace the history and legislative history of fiduciary duties in bankruptcy. Such an exercise may illuminate whether the lack of a fiduciary duty was an unintentional oversight or whether it was intended to be simply a pro-debtor policy, despite any inefficiencies, inconsistencies with general bankruptcy policies, or departures from prior precedents or other areas of the law.

A search of the legislative history of the passage of the Bankruptcy Act of 1978 provides no evidence that the lack of a fiduciary duty was due specifically to a pro-debtor stance.¹¹² This is not surprising: one is especially unlikely to find clear evidence that this omission from the Code was because of a certain pro-debtor policy. This is because to argue against requiring a debtor to disclose materially relevant information would be to argue against policies designed to thwart fraud.

The title of the latest bankruptcy reforms, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, shows that Congress was attuned to the problem of bankruptcy fraud and intended to curb abusive practices.¹¹³ A search of the legislative history of the 2005 Act confirms that reducing bankruptcy fraud of the sort that is made possible by not requiring a debtor to disclose materially relevant information beyond specific questions was a target of the Act. For example, the “Purpose and Summary” section at the beginning of the House Report states:

The heart of the bill’s consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism . . . which is intended to ensure that debtors repay creditors the maximum they can afford. [The new law] also establishes new eligibility standards for consumer bankruptcy relief and includes provisions intended to deter serial and abusive

2002. See, e.g., Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 *YALE L.J.* 1521 (2005).

111 See *supra* note 2.

112 See, e.g., MICKIE A. PIATT & K. SCHIMPOCK, *THE BANKRUPTCY REFORM ACT OF 1978: ANALYSIS, LEGISLATIVE HISTORY AND SELECTED BIBLIOGRAPHY* (1981). This source was used to review the legislative history of the Act, and the lack of a fiduciary duty did not appear to be the result of a pro-debtor motivation.

113 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2006) (codified as amended in scattered sections of 11 U.S.C. (2006)). The law was passed in the House by a vote of 302-126, and in the Senate by a vote of 74-25. See 151 CONG. REC. S2474 (daily ed. Mar. 10, 2005) (Senate roll call vote for S. 256, 109th Cong.); 151 CONG. REC. H2076-77 (daily ed. Apr. 14, 2005) (House roll call vote for S. 256, 109th Cong.).

bankruptcy filing. It substantially augments the responsibilities of those charged with administering consumer bankruptcy cases¹¹⁴

Dissenters to the bill agreed: “Reform of the bankruptcy system, and the principle that every debtor should repay as much of her debt as she can reasonably afford, is a sound and uncontroversial idea.”¹¹⁵

Even if § 363 was not reformed in the 2005 Act to include greater duties on the part of the debtor, this does not mean that such a reform would be against the intentions of Congress. As the Bankruptcy Code contains thousands of provisions, it would be difficult to reform them all at once, and Congress clearly intended to prevent bankruptcy abuses. On balance, then, while Congress did not enact fiduciary duties on the part of the debtor in § 363 sales of assets, it seems likely that Congress would not be against such a rule, given the social benefits that such a rule would bring and the bankruptcy policy goals that the rule would help achieve. Even if American bankruptcy law is relatively pro-debtor, there are strong reasons to require greater duties, and the underlying rationales have begun to play out in related contexts as noted.¹¹⁶

B. *Fiduciary Duties in Different but Related Contexts*

It may be useful to compare bankruptcy with other statutory trust schemes, such as the Uniform Probate Code or the Uniform Trust Code, to tease out how fiduciary duties came to be what they are in bankruptcy law. One particularly interesting comparison may be with the Employment Retirement Income Security Act of 1974 (ERISA). ERISA is like the Bankruptcy Code in that it is a federal statutory scheme that regulates a trust form, without mandating all the requirements of the common-law trust.¹¹⁷

ERISA differs from the Code, however, in that it spells out fiduciary duties quite explicitly. For example, there is an analogue to the trust law duty of loyalty, the exclusive benefit rule of ERISA. The rule provides that “a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and the beneficiaries and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries.”¹¹⁸ This rule has been

114 BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, REPORT OF THE COMMITTEE ON THE JUDICIARY, HOUSE OF REPRESENTATIVES, TO ACCOMPANY S. 256, H.R. REP. NO. 109-31, at 2 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89.

115 *Id.* at 557.

116 Further, any additional difference from other foreign bankruptcy regimes, toward an even greater pro-debtor stance, puts American bankruptcy law even more at odds with the consensus among the common-law countries, and is an additional reason to support heightening a debtor’s duties when it would be helpful to the estate.

117 *See, e.g.,* Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 467 (1998) (“ERISA’s insistence on use of the trust form does *not* serve as a means of imposing on the managers of pension funds the standard form fiduciary duties that trust law imposes on trustees. Instead, ERISA spells out those fiduciary duties on its own and thus imposes them directly without relying on trust law. One reason for this is to impose on the managers of pension funds a number of detailed obligations appropriate to such funds.”).

118 29 U.S.C. § 1104(a)(1) (2006).

interpreted by the Supreme Court as encompassing disclosure-related obligations, even though the statute contains no general disclosure requirement.¹¹⁹

The strong fiduciary duties and derivative duties codified in ERISA, and the duties of disclosure in place in some parts of the Bankruptcy Code, support the possibility that the lack of fiduciary duties in certain sections of the Bankruptcy Code was and is not a congressional oversight. It also cannot be said that the authors of the Bankruptcy Code were completely uninformed about fiduciary law; the concept of a fiduciary does appear in the Bankruptcy Code, though these mentions do not affect the relationships between debtor and creditor.¹²⁰

Moreover, to take the contrast with ERISA further, bankruptcy is a broader topic that can affect almost any legal entity, while pension funds are much more specific and limited. Greater levels of discretion may be necessary in bankruptcy proceedings because of the range of situations that are encountered and the greater number and types of beneficiaries that exist in bankruptcy cases.¹²¹ A rigid rule requiring fiduciary duties in bankruptcy might not suit all cases. Indeed, § 1125(a) contemplates a flexible disclosure standard that relies on the facts of the case: “[I]n determining whether a disclosure statement provides adequate information, the court shall consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information.”¹²² But why § 363 as used in Chapter 11 cases lacks a similar requirement, one that could remain flexible, for example in determining what exactly the debtor should disclose given the circumstances, continues to be a puzzle.¹²³

119 *Varity Corp. v. Howe*, 516 U.S. 489, 504 (1996).

120 *See* 11 U.S.C. §§ 101(2)(A)(i), 523(a)(11) (2006).

121 *But cf.* Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1107 (1988) (“We emphasize that the mess in ERISA fiduciary law cannot be ameliorated until courts and other decision makers recognize the multiplicity of interests that inhere in the modern pension and employee benefit trust.”).

122 11 U.S.C. § 1125(a) (2006). The quoted provision was added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2006) (codified as amended in scattered sections of 11 U.S.C. (2006)). Given the supposed mess in ERISA fiduciary law, *see supra* note 121, a flexible standard may be desirable there as well. Although there are costs of uncertainty and judicial administrative costs associated with flexible standards, the wide variety of situations may mean that flexibility is necessary or efficient.

123 Thus, although this Note advocates a stronger fiduciary duty of disclosure, the duty could be flexible to fit the situation. In the extreme, the fiduciary duty would not be a mandatory feature for debtors entering bankruptcy as the bankruptcy procedures currently exist for such actors. In such a case, the creditor may allow the debtor to waive away such fiduciary duties. However, it is unlikely that a creditor would want to allow the debtor to contract away such an obligation, since it is in general efficient to have such a fiduciary duty, given the agency problems inherent in the creditor-debtor relationship and the very low cost of selective disclosure. But it would be easy to turn the proposed duty of disclosure into a default rule under a contractarian version of bankruptcy law, should a policymaker wish to go that route. *See, e.g.*, Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807 (1998) (advocating allowing debtors and creditors to select particular bankruptcy procedures rather than having to accept mandatory bankruptcy procedures as in the current system).

Finally, one might explain the difference in fiduciary duties by noting that there is a fundamental purposive difference between bankruptcy and non-bankruptcy law. ERISA, for example, is about protecting future claims for pension funds, while bankruptcy is in large part ultimately about discharging claims. More generally, bankruptcy morality is different from non-bankruptcy morality. Outside of bankruptcy, in the realm of contracts and corporate law, a general duty to fulfill contracts and promises exists.¹²⁴ In contrast, bankruptcy law has a policy of granting equitable relief to debtors, and contracts or promises to pay debts are forgiven routinely.¹²⁵ The differing ends may explain, without necessarily justifying, some of the differences in fiduciary duties in bankruptcy and those outside of bankruptcy: the less stringent morality of bankruptcy naturally suggests lesser fiduciary duties.

However, despite any interesting positive accounts explaining why fiduciary duties may be less in bankruptcy settings than outside of bankruptcy, a positive description is not a compelling normative justification for what fiduciary duties should be in bankruptcy. Most importantly, although a forgiving philosophy in bankruptcy may lead one to suggest relatively less fiduciary duties, and although this causal explanation is an interesting consideration, this is no more than a cognitive nicety of consistency; it is not a justification based on general policy matters, such as relief to the honest but unfortunate debtor, prevention of fraud, and the promotion of efficiency. One can be forgiving and still insist that a debtor hold a relatively light duty of disclosure to aid in the administration of an estate. Thus, the positive accounts do not provide a compelling rebuttal of the normative arguments in favor of a heightened fiduciary duty considered in this Note.

VIII. Conclusion

The fiduciary duties of a bankruptcy debtor in possession are too low and should be reformed to comport with fiduciary duty standards in related areas of the law, including corporate law and other parts of bankruptcy law itself. Such a reform would negate bad incentives to file for bankruptcy or to make sales in bankruptcy when it is otherwise not desirable. A heightened fiduciary duty would be economically efficient, would comport with Supreme Court precedent and other sections of the Bankruptcy Code, and would support bankruptcy policies of granting relief only to the honest but unfortunate debtor and of requiring the debtor to pay as much of her debt as she reasonably can.

In coming to its conclusion, the Note explored a number of interesting considerations. The Note considered alternatives to a fiduciary duty, but found that the alternative of looking to intellectual property concepts actually compelled the use of fiduciary duties in bankruptcy. The Note also considered

124 See, e.g., CHARLES FRIED, *CONTRACT AS PROMISE* (1981); Daniel Markovits, *Contract and Collaboration*, 113 *YALE L.J.* 1417 (2003).

125 Of course, sophisticated parties to contracts made outside of bankruptcy contemplate the possibility of bankruptcy and the discharge in bankruptcy of promises made outside of bankruptcy.

and rejected potential objections based on positive accounts—such as the history, legislative history, and other peculiarities of bankruptcy law—that might suggest that debtor in possession duties should be left undisturbed.

Ultimately, the Note provided a specific policy recommendation, focusing on curing the deficits in the limited parts of the Bankruptcy Code that the Note considered, in particular § 363. The Note suggested legislation and legal rulings as solutions, but recommended amending the *Federal Rules of Bankruptcy Procedure* to require the debtor in possession to disclose more than the current law requires. This Note is just one step towards reforming bankruptcy law fiduciary duties to comport with other statutory provisions, legal precedent, economic analysis, and general bankruptcy policy considerations. It is hoped that the substance and methods embodied in this Note will inform and assist further analysis and reform of fiduciary duties in bankruptcy, and perhaps in other areas of the law.