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Bankruptcy Trustees and Receivers Beware: The California Second District Court of Appeal Tests the Barton Doctrine's Limits on Claims Against a Court-Appointed Officer Over a Distressed Commercial Real Estate Entity

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In *Breanne Martin v. Leslie Gladstone*, the Second District Court of Appeal recently decided a case that could reverberate throughout the receivership and bankruptcy industries. This case comes at a propitious moment as bankruptcy proceedings and receiverships – particularly for distressed commercial real estate entities – trend upward in California. Receivers and bankruptcy trustees alike should consider this case before operating a commercial real estate distressed entity.

The Doughertys' Bankruptcy Proceeding

The case emerged from Christopher Dougherty and Nereida Dougherty's Chapter 11 bankruptcy proceeding.[1] Their bankruptcy estate included their operating entity, JTA Real Estate Holdings, LLC ("JTA"), and JTA's three properties, including one residential rental property located in Alpine, California ("Alpine Property").[2] The bankruptcy court later converted the Doughertys' bankruptcy case to Chapter 7 and appointed a Chapter 7 Trustee, Leslie Gladstone ("Trustee").[3] Soon after her appointment, the Trustee sought the bankruptcy court's consent to "Operate Business Pending Sale of Debtor's Assets."[4] Invoking its authority under 11 U.S.C. § 721, the bankruptcy court authorized the Trustee to operate JTA consistent with the orderly liquidation of the estate.[5] Under this authority, the Trustee could operate the Doughertys' business assets, including the Alpine Property, until the Trustee liquidated the estate.[6] Three months after taking over the Doughertys' business, the Trustee sought to abandon the Alpine Property because it was underwater and had "numerous" uncorrected code violations.[7] Shortly thereafter, the Trustee suffered a major setback: plaintiff Breanne Martin ("Martin") sustained injuries at the Alpine Property before the Trustee abandoned it.[8]

Martin Sues the Trustee for Injuries She Incurred at the Alpine Property and the Trustee Seeks to Dismiss Martin's Lawsuit

Martin sued the Trustee, asserting claims for negligence and premises liability.[9] The Trustee sought to

[1] *Breanne Martin v. Leslie Gladstone*, Case No. D080534, 2023 WL 6889015, at *2 (2023).
[2] *Id.*
[3] *Id.*
[4] *Id.*
[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.* at *3.

dismiss Martin's claims on two grounds. First, the Trustee argued that the *Barton* doctrine barred Martin's claims because the bankruptcy court had not authorized her lawsuit.[10] Second, the Trustee contended that she was immune from Martin's claims because she had abandoned the Alpine Property retroactively to the Doughterys' bankruptcy filing date.[11] The trial court rejected the Trustee's *Barton* doctrine defense but accepted the Trustee's immunity defense from her abandonment of the Alpine Property.[12] The *Martin* Court reversed the trial court's judgment.[13]

The Court of Appeal Reverses the Trial Court Judgment Against Martin

Considering the Trustee's abandonment argument first, the *Martin* Court analyzed the transfers of a debtor's property that occur during a debtor's bankruptcy proceeding.[14] After a bankruptcy filing, the debtor's legal and equitable interests in property become the property of the bankruptcy estate for creditors.[15] The debtor, however, may regain ownership and control over estate property during the bankruptcy case if the trustee abandons it.[16] After assessing these principles, the *Martin* Court focused on the impact of bankruptcy abandonment. As the *Martin* Court explained, "ownership and control of the asset is reinstated in the debtor with all rights and obligations before filing a petition in bankruptcy."[17] Thus, the *Martin* Court conceived the key issue as the retroactive effect of the Trustee's abandonment. The Trustee claimed the abandonment did more than just revert the Alpine Property to the Doughertys: It "operated as if the Doughertys retained … the Alpine Property, without interruption, throughout … the bankruptcy case."[18] Although abandoned property reverts to the debtor from the petition date, the *Martin* Court refused to expand the bankruptcy abandonment rule as far as the Trustee urged.

The *Martin* Court recognized that retroactive abandonment is neither automatic nor absolute.[19] "Courts do not blindly give retroactive effective to a trustee's abandonment of bankruptcy estate property in every situation."[20] From this point, the *Martin* Court agreed with other bankruptcy courts that retroactive abandonment should occur only where justice requires it.[21] After searching nationwide, the *Martin* Court found no bankruptcy case where a court at the pleading stage applied abandonment retroactively to relieve a trustee of liability for injuries sustained on the bankruptcy estate property.[22] Comforted by this dearth of cases, the *Martin* Court declined to apply the legal fiction of relation back abandonment because it would have caused an unfair result – leaving Martin without a judicial remedy.[23] Retroactive abandonment also would have frustrated California's policy of requiring those who exert control over property to ensure that such property remains reasonably safe.[24] Because Martin's injuries occurred before the Trustee effectuated

[10] *Breanne Martin*, 2023 WL 6889015, at *3.
[11] *Id.*
[12] *Id.*
[13] *Id.* at *1.
[14] *Id.* at *4.
[15] 11 U.S.C. § 541(a).
[16] 11 U.S.C. § 554(d); *Huennekens v. Walker* (*In re Southern Int'l Co., L.P.*), 165 B.R. 815, 819 (Bankr. E.D. Va. 1994).
[17] *Breanne Martin*, 2023 WL 6889015, at *5 (citing *In re Frankling Signal Corp.*, 65 B.R. 268, 274 (Bankr. D. Minn. 1986)).
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.* at *6.
[22] *Id.*
[23] *Id.* at *8-9.
[24] *Id.*

the abandonment, the Trustee was not absolved from liability for Martin's injuries.

The Trustee implored the *Martin* Court to uphold the trial court's dismissal anyway, citing the Supreme Court's century-old *Barton* doctrine from *Barton v. Barbour*, 104 U.S. 126 (1881).[25] Under the *Barton* doctrine, an aggrieved party, before filing a lawsuit against a court-appointed officer, must obtain the appointing court's consent.[26] The *Barton* doctrine safeguards trustees and receivers from "having to defend against suits by litigants disappointed by his actions on the court's behalf, which would impede their work for the court."[27] This vital protection for receivers and trustees is not limitless.[28] As the dissent in *Barton* acknowledged, the *Barton* doctrine exceeds its purpose in cases where the court-appointed official does more than liquidate assets.[29] Congress, heeding this concern, precluded the *Barton* doctrine inqq situations where the court-appointed official continued the debtor's business, rather than administered the estate.[30] Under 28 U.S.C. § 959(a), parties may sue "trustees, receivers, or managers of any property" for claims regarding "any of their acts or transactions in carrying on business connected with such property."[31] Section 959 preserves the *Barton* doctrine for an aggrieved party's claims against a trustee or receiver for actions consistent with preserving and liquidating the estate.[32] But if an aggrieved party challenges the trustee's conduct in operating the debtor's business, the aggrieved party need not obtain the appointing court's consent to pursue such claims.[33]

Relying on bankruptcy cases nationwide limiting the *Barton* doctrine in similar scenarios, the *Martin* Court declined to apply it to Martin's claims at the pleading stage.[34] Martin's complaint alleged that the Trustee "owned, leased, occupied, maintained, or controlled" the Alpine Property as landlord during the relevant period.[35] The Trustee's request to operate the Doughertys' business and her monthly reports to the bankruptcy court supported this allegation.[36] Those documents showed that the Trustee was "carrying on an ongoing rental business connected with the premises" when Martin suffered her injuries.[37] Thus, the *Martin* Court concluded that Martin had sufficiently invoked § 959(a)'s exception to the *Barton* doctrine.[38]

Lessons from *Martin*

The *Martin* Court tried to protect Martin from a perceived Catch 22 – in which the debtor could not be liable because the accident happened post-petition and while the trustee owned and controlled the estate property, but the trustee could not be liable because she had "retroactively" abandoned the estate property. The *Martin* Court believed equity required it to apply § 959's exception to the *Barton* doctrine and hold the

[25] *Breanne Martin*, 2023 WL 6889015, at *9.
[26] *Id.* at *10 (citing *Harris v. Wittman* (*In re Harris*), 590 F.3d 730, 741 (9th Cir. 2009)).
[27] *Akhlaghpour v. Orantes*, 86 Cal. App. 5th 232, 243 (2022).
[28] *Breanne Martin*, 2023 WL 6889015, at *10.
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.* at *11 (citing *In re VistaCare Group, LLC*, 678 F.3d 218, 225-26 (3d Cir. 2012)).
[33] *Breanne Martin*, 2023 WL 6889015, at *10 (citing *In re VistaCare Group, LLC*, 678 F.3d at 225-26).
[34] *Id.*
[35] *Id.* at *13.
[36] *Id.*
[37] *Id.*
[38] *Id.*

Trustee responsible for Martin's injuries. While *Martin* did not break new ground, it illuminates a risk that bankruptcy trustees and federal receivers take in operating a distressed commercial real estate entity. After *Martin*, an aggrieved party may now try to sue a court-appointed official (a bankruptcy trustee or a federal receiver) for injuries at a property owned and controlled by the court-appointed official. For the *Martin* Court's attempts to protect the aggrieved party though, the opinion does not sweep as far as it may seem.

A bankruptcy trustee or a federal receiver faced with an aggrieved party's lawsuit could try to distinguish *Martin* on its facts. The *Martin* Court seems to have overemphasized the effect of the Trustee's decision to operate the Doughertys' business. That decision, the *Martin* Court believed, unequivocally showed that the Trustee went beyond "the mere administration of property" and operated the Alpine Property like the Doughertys' prebankruptcy. The decision though was consistent with the Trustee's principal duty to "collect and reduce to money property of the estate …."[39] The bankruptcy court authorized the Trustee to operate the Doughertys' business for a limited time and consistent with an orderly liquidation. The Trustee undertook this task early to preserve the business assets while the Trustee sought to market them. That function should have been incidental to preserving the Doughterys' business assets – a result that ordinarily should have triggered the *Barton* doctrine. The *Martin* Court did not hold that whenever a bankruptcy trustee seeks to temporarily operate a debtor's business, the trustee automatically loses the *Barton* doctrine's protection.

If the *Barton* doctrine does not apply when a bankruptcy trustee or a federal receiver operates a debtor's business, both court-appointed officials still may be immune from an aggrieved party's claims. The *Martin* Court did not address or purport to decide the Trustee's potential immunity to Martin's claims. Courts have long recognized that bankruptcy trustees enjoy immunity because they "perform an integral part of the judicial process."[40] Federal receivers also have "absolute quasi-judicial immunity from damages."[41] While judicial immunity does not encompass every kind of lawsuit that might be filed against a federal receiver or a bankruptcy trustee, judicial immunity should extend to damage claims, such as those in *Martin*, for acts within the court-appointed official's duties.[42] Following *Martin*, federal receivers and bankruptcy trustees confronted with litigation for acts within the scope of their duties should raise the immunity protection "at the very earliest stage of the proceeding."[43] As courts have acknowledged, for this protection "to be meaningful, it must be effective to prevent suits … from going beyond" the pleading stage.[44]

A California state court receiver, unlike a bankruptcy trustee or a federal receiver, might argue that *Martin* minimally impacts state court receiverships. Section 959's exception to the *Barton* doctrine generally applies to bankruptcy trustees and federal receivers, not state court receivers.[45] California has no state corollary

[39] See 11 U.S.C. § 704(a)(1).
[40] *Lonneker Farms, Inc. v. Klobucher*, 804 F.2d 1096, 1097 (9th Cir. 1986).
[41] *Mullis v. United States Bankr. Ct.*, 828 F.2d 1385, 1390 (9th Cir. 1987).
[42] *See Forrester v. White*, 484 U.S. 219, 229-30 (1988) (recognizing that judicial immunity is not absolute); *see also New Alaska Dev. Corp. v. Guetschow*, 869 F.2d 1298 (9th Cir. 1989) (finding a court-appointed receiver had absolute immunity from claims alleging the receiver negligently managed business assets of a marital estate during a dissolution proceeding).
[43] *Howard v. Drapkin*, 222 Cal. App. 3d 843, 905 (1990).
[44] *See Id.*
[45] *Republic Bank of Chicago v. Lighthouse Mgmt. Grp., Inc.*, 829 F. Supp. 2d 766, 773 (D. Minn. 2010*)*; *accord Freeman v. County of Orange*, Case No. SACV 14-107-JLS, 2014 WL 12668679, at *4 (C.D. Cal. May 29, 2014).

exception to § 959; in California, an aggrieved party must obtain the appointing trial court's permission to sue a state court receiver in state court.[46] But a plaintiff's failure to obtain leave is not jurisdictional and it may be cured at any stage of the *proceedings*.[47] Thus after *Martin*, a state court receiver that seeks to operate a debtor's business should ensure that the appointing order acknowledges the receiver's immunity for its work in operating the business and managing the debtor's business assets. That language would bolster the receiver's quasi-judicial immunity for acts within the receiver's duties, and the receiver could use this immunity protection at the earliest stage of the aggrieved party's action.[48]

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[46] Cal. Civ. Proc. Code § 568; *Helvey v. United States Building & Loan Ass'n*, 81 Cal. App. 2d 647, 649 (1947).
[47] *Vitug v. Griffin*, 214 Cal. App. 3d 488, 492-94 (1989).
[48] *Howard*, 222 Cal. App. 3d at 905.