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APPLICATION OF THE CASH COLLATERAL PARADIGM TO THE PRESERVATION OF THE RIGHT TO SETOFF IN BANKRUPTCY

by
Jack F. Williams*

*"I will admit if you start reading all of the bankruptcy law that you reach a state of great intellectual confusion."***

Senator Ervin's comment carries no greater weight than in the area of the interplay among setoff,¹ the administrative freeze,² and the auto-

* Associate, Hughes & Luce, Dallas, Texas. George Washington University National Law Center, J.D., 1985; United States Coast Guard Academy, University of Oklahoma, B.A., 1982. I wish to thank William B. Finkelstein, Esq. and Stephen R. Voelker, Esq. for their comments on earlier drafts of this article. I also wish to thank Marie Kenning, Diana Tunnell and Dorothy Beaver for aiding in the preparation of this article. Without them, I would have been most assuredly lost.

This article was not prepared for or in contemplation of any matter in which my firm is or I am counsel. Although I represent almost exclusively creditors (preferably with a thin equity cushion), we have represented parties on various sides of the issues discussed. See Douglas, *Law Reviews and Full Disclosure*, 40 WASH. L. REV. 227, 232 (1965). The views expressed are my own.

** *Hearings on § 976 and § 1912 Before the Senate Comm. on Finance*, 89th Cong., 1st Sess. 23 (1965) (remarks by Sen. Sam J. Ervin).

¹ Setoff is a time-honored creditor's remedy whereby mutual debts may be "netted-out." Setoff generally requires the creditor to take some overt action such as a debit to the debtor's account. The genesis of the doctrine of setoff can be traced to Roman law and, although not a part of early English common law, has been a part of American common law since the middle seventeenth century. See 3 COLLIER ON BANKRUPTCY ¶ 553.01[1] at 553-30 (15th ed. 1988). Setoff has also been a time-honored part of the fabric of Jewish Law. See G. HOROWITZ, *THE SPIRIT OF JEWISH LAW* § 258 at 479-80 (2d ed. 1973). As the Supreme Court of the United States cogently observed, the doctrine of setoff was grounded on the absurdity of making *A* pay *B* when *B* owes *A*. See *Studley v. Boylston Nat'l Bank*, 229 U.S. 523, 528 (1913).

² The administrative freeze means that a creditor has refused to allow a debtor access to the debtor's funds in which the creditor claims a right to setoff permitted by state law and recognized by the Code. Setoff generally requires that the creditor take some overt action in order to evidence, in an objective manner, that a setoff has occurred. The administrative freeze, however, does not require an overt act or even an intent to setoff. While the term "administrative freeze" implies that the creditor has done something, taken some action, the debtor's complaint is truly that the creditor is not doing something; the creditor is refusing to honor attempted withdrawals of the debtor's funds.

Both setoff and the freeze should be distinguished from recoupment. While setoff is a violation of the automatic stay, recoupment is not. Recoupment is essentially unaffected by bankruptcy. See *Waldschmidt v. CBS, Inc.*, 14 Bankr. 309, 313, 314 (M.D. Tenn. 1981). Recoupment is best characterized as a defense to a debtor's claim rather than a mutual obligation. 4 COLLIER ON BANKRUPTCY ¶ 553.03 at 553-13 (15th ed. 1988). Recoupment occurs when the mutuality of obligation arises out of

matic stay in bankruptcy.³ Nowhere are the policies embodied in the Bankruptcy Code⁴ for the protection of rights of debtors and creditors more acutely in conflict. Cases exist holding that an administrative freeze violates the automatic stay while an equal number of cases exist holding that the administrative freeze does not violate the automatic stay. Does a creditor violate the automatic stay by imposing an administrative freeze on the debtor's funds held by that creditor? Should a creditor risk the possibility of violating the stay to protect its right to setoff by effecting an administrative freeze? There is no easy answer to this dilemma.

There are several Code provisions that affect the resolution of the issue of whether the administrative freeze violates the automatic stay. While this question has engendered many opinions, unfortunately, the case law is hopelessly confused. This article explores the provisions of the Code which are implicated when a creditor imposes an administrative freeze on funds subject to setoff. This article discusses the administrative freeze and distinguishes it from setoff. It then explores the analysis of those cases which have permitted a freeze of the debtor's accounts and those cases which have not. Finally, this article discusses the clashing policy rationales permeating the case law, attempting to discern the more compelling logic.

I. AUTOMATIC STAY

Upon the filing of a petition in bankruptcy, a magical event occurs; the omnipresent automatic stay arises.⁵ The stay is one of the fundamental debtor protections provided by the bankruptcy laws. The reach of the automatic stay is virtually limitless. The scope of the stay is extremely broad, proscribing almost any type of formal or informal action against

the same transaction or occurrence. *Ashland Petrol. Co. v. Appel (In re B&L Oil Co.)*, 782 F.2d 155, 157-58 (10th Cir. 1986). When the mutuality of obligation arises out of the same transaction, then a creditor may recoup its debt without fear of violating the automatic stay. *Id.*

³ 11 U.S.C. § 362(a) (1988).

⁴ Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 82 Stat. 2549 (codified at 11 U.S.C. §§ 101-1330), as amended by Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (codified as amended in various sections of 11 U.S.C. and 28 U.S.C.); Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3114 (codified as amended in various sections of 11 U.S.C. and 28 U.S.C.); and, Retiree Benefits Bankruptcy Protection Act of 1988, Pub. L. No. 100-334, 102 Stat. 610 (codified as amended in various sections of 11 U.S.C.) [hereinafter "Code"].

⁵ See 11 U.S.C. § 362(a) (1988). The automatic stay applies to all entities, which includes not only traditional creditors but also governmental units and the United States Trustee. See 11 U.S.C. § 101(14) (1988); see generally 2 COLLIER ON BANKRUPTCY ¶ 362.04 (15th ed. 1988).

the debtor or the property of the estate. Among other actions, the automatic stay prohibits the creditor's setoff of any prepetition claim.⁶ The automatic stay becomes effective upon the filing of a petition under the Code, regardless of whether the debtor would suffer irreparable harm without it.⁷

The scope of the stay is extremely broad. It bars virtually all debt collection efforts. There exist, however, several statutory exceptions to the automatic stay.⁸ For example, criminal actions against the debtor, the collection of alimony or support from property that is not property of the estate, and action by a governmental unit to enforce its police or regulatory policies are excepted from the scope of the stay.⁹ Statutory exceptions to the stay are strictly construed.¹⁰

Section 362(c)(1) provides that the automatic stay automatically terminates as to particular property when that property ceases to be "property of the estate."¹¹ If, for example, the bankruptcy trustee disposes of part of the property of the estate and the sale is not free and clear of liens, a creditor with a lien in the sold property may foreclose its lien. Furthermore, if a trustee abandons the property, it ceases to be property of the estate.¹² The automatic stay also terminates automatically when the bankruptcy case is closed, dismissed, or the debtor receives or is denied a discharge.¹³ A bankruptcy court may also order the earlier end of the automatic stay: the court may terminate the automatic stay on request of a party in interest for cause, or where the debtor has no equity in the property and the property is not necessary to an effective reorganization.¹⁴

⁶ 11 U.S.C. § 362(a)(7) (1988). "Claim" is defined in 11 U.S.C. § 101(4) (1988) to include: (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

⁷ *Minico Group of Cos., Ltd. v. First State Underwriters Agency of New England Reinsurance Corp.* (In re *Minico Group of Cos., Ltd.*), 799 F.2d 517, 520 (9th Cir. 1986).

⁸ See 11 U.S.C. § 362(b) (1988).

⁹ See *id.*

¹⁰ Each of the exceptions to the automatic stay are based on necessity or public policy. See generally 1 NORTON, BANKRUPTCY LAW AND PRACTICE § 20.13 (1987).

¹¹ 11 U.S.C. § 362(c)(1) (1988).

¹² See 11 U.S.C. § 554 (1988). Under §554(a), the trustee may abandon property of the estate that is burdensome to the estate or of inconsequential value. Also, § 554(b) grants standing to a party in interest to move to have the court order the trustee to abandon the property. It must be remembered, however, that even though the property is no longer property of the estate, it nevertheless may be protected by the stay because it may remain property of the debtor. See 11 U.S.C. § 362(c)(2) (1988).

¹³ 11 U.S.C. § 362(c)(2) (1988).

¹⁴ 11 U.S.C. § 362(d) (1988). Section 362(g) imposes the burden of proof on the party opposing

There are several purposes embodied in the automatic stay. A debtor filing a bankruptcy petition needs immediate protection from the collection efforts of his creditors.¹⁵ A bankruptcy trustee or the debtor-in-possession needs time to collect the property of the estate, administer estate assets, and make *pro rata* distributions to creditors.¹⁶ Creditors need protection from other creditors bent on winning the "race to the courthouse" or dismantling the debtor.¹⁷ Accordingly, the filing of a bankruptcy petition automatically stays creditors from taking further action to collect or enforce their claims. The purpose of the automatic stay, however, is not to extinguish the rights of a creditor under state law.¹⁸

II. SETOFF UNDER STATE LAW

The Code preserves any nonbankruptcy right to setoff; it does not, however, create any independent federal right to setoff.¹⁹ Thus, if a state

relief from the stay for all issues other than that of the debtor's equity in the property. See *United Sav. Ass'n v. Timbers of Inwood Forest*, 108 S. Ct. 626, 632 (1988); see generally 2 COLLIER ON BANKRUPTCY ¶ 362.10 (15th ed. 1988).

¹⁵ See generally 2 COLLIER ON BANKRUPTCY ¶ 362.01 (15th ed. 1988).

¹⁶ See *Fidelity Mortgage Investors v. Camelia Builders, Inc. (In re Fidelity Mortgage Investors)*, 550 F.2d 47, 55 (2d Cir. 1976), cert. denied, 429 U.S. 1093 (1977).

¹⁷ See *Barclays Bank v. Saypol (In re Saypol)*, 31 Bankr. 796, 799 (Bankr. S.D.N.Y. 1983).

¹⁸ H.R. REP. NO. 595, 95th Cong., 1st Sess. 342, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6298. The automatic stay does not effect rights of creditors, but simply stays enforcement of those rights pending orderly examination of the debtor's and creditor's rights. Professor Jackson, however, cogently notes that "[i]n a liquidation proceeding, the 'automatic stay' affects a creditor's substantive rights only until the assets are actually disbursed. [Citation omitted]. In a reorganization proceeding, however, the deferral of substantive rights may last longer. [Citation omitted]." Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 872 n.70 (1982). The thrust of Professor Jackson's assertions is that it is rare for a secured creditor to either be paid or be permitted to resort to his collateral at the inception of the bankruptcy proceeding. Bankruptcy takes time. And time is, of course, lost value to the secured creditor. Section 361's purpose is to ensure that the secured creditor receives that for which he had bargained. H.R. REP. NO. 595, 95th Cong., 1st Sess. 339, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6295. But see *Timbers*, 108 S. Ct. at 635 (undersecured creditor is not entitled to lost opportunity cost resulting from the stay of its right to foreclose). Thus, Professor Jackson correctly recognized that a secured creditor's rights may be affected, but not abrogated, by the automatic stay.

Bankruptcy law has never purported to grant absolute recognition to state-created rights. The stated policy of bankruptcy law has been to accord *substantial* respect to state rights unless they conflict with federal policy and equitable principles. See *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161-63 (1946); Hill, *The Erie Doctrine in Bankruptcy*, 66 HARV. L. REV. 1013, 1035 (1953) ("apparent purpose" of the bankruptcy laws is to provide a system for the effectuation of state-created rights); accord Eisenberg, *Bankruptcy Law In Perspective*, 28 UCLA L. REV. 953, 956 (1981).

¹⁹ Passamano, *Setoff in Bankruptcy: An Overview of the Mechanics*, 105 BANKING L.J. 349 (1988); see generally COLLIER ON LENDING INSTITUTIONS AND THE BANKRUPTCY CODE ¶ 3.04[1]

or federal statute prohibits setoff of certain debts, such as consumer debts, the prohibition is carried forward into bankruptcy. The bitter necessarily follows the sweet. Section 553(a) provides that the Code "does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case."²⁰

Because the Code does not create any independent right of setoff, one must review state law to assess whether a right to setoff exists at all. Traditionally, a right to setoff exists when the following four conditions are met: (i) the fund to be set off is the property of the debtor; (ii) the fund is deposited without restrictions; (iii) the existing indebtedness is due and owing; and, (iv) there is a mutuality of obligation between the debtor and the creditor, and between the debt and the fund on deposit.²¹ Setoff is thus a method to net debts, usually arising out of unrelated transactions.

While state law is not uniform as to how one effects a right to setoff, generally, the courts have concluded that a creditor must take three steps to effectuate its setoff right. First, the creditor must decide to exercise the right to setoff. Second, the creditor must take some action which accomplishes the setoff. Third, the creditor must make some record which evidences that the right to setoff has been exercised.²² While under the majority rule, the mere declaration of an intent to setoff is ineffective to accomplish setoff, there are several jurisdictions where no overt act is necessary. For example, in Pennsylvania, a bank's setoff automatically arises once a debt matures.²³ No further action by the bank is required.

A typical example of the right to setoff often arises in the traditional bank/customer relationship. For example, a customer maintains a deposit account at a bank. This relationship is traditionally viewed as a creditor/debtor relationship. The customer then executes a promissory note, promising to pay the bank a sum of money. Upon the execution of the note, an additional customer/bank relationship exists. In this relationship the customer is the debtor, the bank is the creditor. If the customer defaults on

(1986).

²⁰ 11 U.S.C. § 553(a) (1988).

²¹ See *FDIC v. Pioneer State Bank*, 155 N.J. Super. 381, 390, 382 A.2d 958, 962 (1977); see also *Baker v. Nat'l City Bank*, 511 F.2d 1016, 1018 (6th Cir. 1975).

²² See *Baker*, 511 F.2d at 1018; Clark, *Bank Exercise of Setoff: Avoiding the Pitfalls*, 98 BANKING L.J. 196, 255 (1981).

²³ *Pittsburgh Nat'l Bank v. United States*, 657 F.2d 36, 38-39 (3d Cir. 1981) (Pennsylvania recognizes the doctrine of automatic setoff).

the promissory note, the bank's right to setoff arises. The customer is the bank's creditor in relation to the deposit account, but is also a debtor in relation to the promissory note. The bank is a creditor as to the promissory note, but is a debtor as to the deposit account. Mutuality of obligation exists. The conditions necessary for the right to setoff are all present.

III. SETOFF UNDER THE CODE

While the Code does not create any right to setoff, it does delineate the procedure by which a creditor can exercise its nonbankruptcy setoff right.²⁴ Assuming that a right to setoff exists under state law, there remains the question of the extent of the effect that the Code has on that setoff right.

Section 553 of the Code provides:

(a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against the claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that—

- (1) the claim of such creditor against the debtor is disallowed other than under section 502(b)(3) of this title;
- (2) such claim was transferred, by an entity other than the debtor, to

²⁴ See Weintraub & Resnick, *Freezing The Debtor's Account: A Banker's Dilemma Under The Bankruptcy Code*, 100 BANKING L.J. 316, 317 (1983). In recognizing the right to setoff in certain circumstances, § 553 recognizes the possible injustice that may result in compelling a creditor to forego setoff rights, file a proof of claim, and turn over the funds in the creditor's possession. For example, assume that a creditor owes its debtor \$100,000, and the debtor owes the creditor \$100,000. All other factors remaining constant, under state law the creditor can setoff the mutual debts and owe nothing to the debtor. If, however, the Code fails to recognize the creditor's setoff right, then a remarkable injustice occurs. The creditor must turn over the \$100,000 to the debtor's estate. See 11 U.S.C. § 542(b) (1988). The creditor would then be entitled to file a proof of claim. Assuming that the estate pays a dividend of ten percent, the creditor would receive \$10,000. See 4 COLLIER ON BANKRUPTCY ¶ 553.02 at 553-10 (15th ed. 1988). So what says Professor McCoid. See McCoid, *Setoff: Why Bankruptcy Priority?*, 75 VA. L. REV. 15 (1989). After noting that setoff is preferential in effect, Professor McCoid addresses each of the proffered justifications for the special treatment of setoff by the Code. See generally *id.* at 19-41. He quickly dispels the quaint notion that setoff is grounded on "natural justice and equity," see *id.* at 19-26, by recognizing the basis cuts against creditor equality and is unsupported by a creditor *inter se* model. *Id.* at 43. Professor McCoid then turns to the contemporary rationale for setoff's exalted role: security. *Id.* at 29-39. He successfully discounts this justification, especially where the mutuality of indebtedness arises out of entirely different transactions. *Id.* at 37-38. Although Professor McCoid offers no empirical evidence that failure to recognize the secured priority of setoff would not increase the cost of credit, his discussion that it would not is appealing. *Id.* at 41.

such creditor—

- (A) after the commencement of the case; or
- (B)(i) after 90 days before the date of the filing of the petition; and
- (ii) while the debtor was insolvent; or

(3) the debt owed to the debtor by such creditor was incurred by such creditor—

- (A) after 90 days before the date of the filing of the petition;
- (B) while the debtor was insolvent; and
- (C) for the purpose of obtaining the right of setoff against the

debtor.

(b)(1) Except with respect to a setoff of a kind described in sections 362(b)(6), 362(b)(7), 365(h)(2) or 365(i)(2), of this title, if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of—

- (A) 90 days before the date of the filing of the petition; and
- (B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.

(2) In this subsection, “insufficiency” means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

(c) For purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.²⁵

Only mutual debts may be set off under Section 553(a). A debt is considered mutual when it is between the same parties in the same right or capacity.²⁶ The debts need not, and usually do not, arise out of the same

²⁵ Section 553 is the appropriate rubric in which to gauge the right to setoff. Therefore, the trustee cannot attack a prepetition setoff under the general preference provisions of 11 U.S.C. § 547 (1988). See *In re Hinson*, 65 Bankr. 675, 677 (Bankr. W.D. Tenn. 1986). Moreover, setoff was deleted from the term “transfer” as defined in 11 U.S.C. § 101(50) (1988).

²⁶ Under 11 U.S.C. § 553 (1988), the mutuality requirement is strictly construed. *Virginia Block Co. v. Bushong (In re Virginia Block Co.)*, 16 Bankr. 560, 562 (Bankr. W.D. Va. 1981). For example, a debt due an individual general partner cannot be setoff against a claim of the partnership or a debt due a corporation against a claim of its wholly-owned subsidiary. *Id.* Equally true, a creditor of a corporation cannot setoff funds in the personal account of the president of the corporation. *Accord England v. Indus. Comm’n of Utah (In re Visiting Home Servs., Inc.)*, 643 F.2d 1356, 1360 (9th Cir. 1981). It would appear that the question of the existence of mutuality is a matter of state law. *E.g.*, *Straughair v. Palmieri (In re Palmieri)*, 31 Bankr. 111, 112 (Bankr. N.D. Ga. 1983). Moreover, the broad definitions of “claim” and “debt” generally permit setoffs of contract and tort claims because

transaction.²⁷ Section 553 requires that both the funds and the debt arise prior to the filing of the petition.²⁸

Section 553 affects both the prepetition and post-petition exercise of setoff. Under Section 553, a setoff may be attacked if effected on or within ninety-days of the filing of the bankruptcy petition. Therefore, where a creditor effects a setoff more than ninety-days before the petition in bankruptcy is filed, the trustee cannot attack the setoff.²⁹ However, if a creditor effects a setoff within ninety-days of bankruptcy, while the debtor is presumed insolvent, and if it can be proved that the deposit was made for purposes of obtaining a right to setoff, the setoff is voidable by the trustee under Section 553(a)(3).³⁰

The Code modifies prior law dramatically in granting the trustee power to void a setoff exercised within ninety-days of bankruptcy, not only where deposits have been built up with an intent to exercise setoff, but also where there has been an improvement in position by the creditor within the ninety-day period.³¹ Under Section 553(b), the trustee may void a setoff to the extent that an insufficiency existing at the date of setoff

mutuality does not require a similarity of obligations. *See* *Waste Management v. Barry Parker's, Inc. (In re Barry Parker's, Inc.)*, 33 Bankr. 115, 117 (M.D. Tenn. 1983); *see generally* Annotation, *Right to Set Off Tort Claim and Contract Claim Against One Another Under § 68(a) of the Bankruptcy Act*, 34 A.L.R. FED. 579 (1977).

²⁷ This fact distinguishes setoff from recoupment. For an explanation of the distinction between setoff and recoupment, *see supra* note 2. A creditor cannot effect a setoff when it has notice that an account is dedicated to a special use. *See* 4 COLLIER ON BANKRUPTCY ¶ 553.04 at 553-22 (15th ed. 1988). For example, a bank generally cannot exercise a setoff against a debtor's payroll account. *See, e.g., Sisk v. Saugus Bank and Trust Co. (In re Saugus Gen. Hosp., Inc.)*, 698 F.2d 42, 46-47 (1st Cir. 1983). Moreover, under § 553(a)(2), no setoff is allowed against claims transferred to the creditor from a party other than the debtor (i) after the case is commenced or (ii) within ninety-days prior to the filing of the petition, *i.e.*, while the debtor was insolvent. The provision is intended to discourage the purchase of third-party claims at a discount shortly before bankruptcy in order to take undue advantage of the right of setoff. *See generally* CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* ¶ 6.05[2][a] (2d ed. 1988).

²⁸ To be eligible for setoff, both the mutual claim of the creditor and the debt of the debtor must have arisen prior to the commencement of the case. Claims arising after the commencement of the case lack the requisite mutuality for setoff because the post-petition trustee or debtor-in-possession is regarded as a different entity from the prepetition debtor. *See, e.g., Local Unions v. Brada Miller Freight Sys., Inc. (In re Brada Miller Freight Sys., Inc.)*, 702 F.2d 890, 894 (11th Cir. 1983); *In re Springfield Casket Co.*, 21 Bankr. 223, 228 (Bankr. S.D. Ohio 1982). Interestingly, § 553 is silent regarding the setting off of mutual *post-petition* obligations.

²⁹ *See* 11 U.S.C. § 553 (1988). *See also* CLARK, *supra* note 27, ¶ 6.05[2][a].

³⁰ Section 553(a)(3) is a general codification of the case law under § 68 of the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1978). The purpose of this provision is to prevent the creditor from using its common law right to setoff in an unfair manner. *See* CLARK, *supra* note 27, ¶ 6.05[2][a] at 6-62.

³¹ 11 U.S.C. § 553(b) (1988).

is less than an insufficiency existing on the later of: (1) the first day of the ninety-day period; or, (2) the first day within that period on which an insufficiency existed.³² The "insufficiency" relates to the extent to which the amount owed by a debtor exceeds the amount owed to that debtor.³³ Significantly, the power to recover under Section 553(b) is absolute; the power does not hinge on the insolvency of the debtor.³⁴

Of great significance is the fact that the improvement in position rule under Section 553(b) only applies to prepetition setoff. Thus, mere improvement of a creditor's position is not voidable by the trustee when the creditor does not setoff prior to bankruptcy.³⁵ The creditor who rolls the dice and refrains from prepetition setoff can ride the tide of any increase in the debtor's funds. The dual standard between the treatment by the Code of prepetition and post-petition setoff reflects a policy to discourage prepetition setoff, thus maintaining a source of working capital for the debtor's reorganization.³⁶

The Code treats the right to setoff as a secured claim to the extent of the funds subject to setoff on the date the bankruptcy petition is filed.³⁷ For example, if a creditor possesses funds of the debtor of \$1,000 and the debtor owes the creditor \$2,000, the Code treats the creditor as holding a secured claim to the extent of \$1,000 and an unsecured claim to the extent of \$1,000.

³² See 11 U.S.C. § 553(b) (1988). An example may help to clarify this method. Assume that the debtor owes a bank \$100,000 on January 1, and the debtor maintains a deposit account balance of \$50,000 on that date. The bank exercises setoff on March 8, at a time when the debtor's account balance is \$75,000. The debtor files its bankruptcy petition on April 1. *Result*: The bank will be allowed to retain \$50,000 under § 553. However, if the bank refrained from exercising setoff, it would have possessed a secured claim valued at \$75,000. *Accord Exxon Corp. v. Compton Corp. (In re Compton Corp.)*, 22 Bankr. 276, 278 (Bankr. N.D. Tex. 1982).

³³ 11 U.S.C. § 553(b)(2) (1988). The improvement in position test does not apply to setoffs under 11 U.S.C. §§ 362(b)(6), 362(b)(7), 365(h)(2) & 365(i)(2) (1988). The improvement in position rule codified in § 553(b) is similar to that governing security interests in accounts and inventory under § 547(c)(5). See 11 U.S.C. § 547(c)(5) (1988). With setoff, as opposed to the requirements under § 547(c)(5), the trustee need not show that the debtor was insolvent at the time of the improvement of position. See *In re Hinson*, 65 Bankr. 675, 677 (Bankr. W.D. Tenn. 1986). Moreover, unlike § 553, the trustee can only reach back ninety-days; there is no one year insider period like that found in § 547. See CLARK, *supra* note 27, ¶ 6.05[2][a] at 6-63.

³⁴ For a practical exercise in the nuances of § 533, see Passamano, *supra* note 19, at 352-54.

³⁵ See, e.g., *In re Compton Corp.*, 22 Bankr. at 278.

³⁶ See CLARK, *supra* note 27, ¶ 6.05[2][a] at 6-64. "The bank may gain by delaying setoff until after bankruptcy because it may ultimately recover the greater portion of its claim than it would otherwise due to the 'adequate protection' provisions of sections 361 and 361(e) and because the improvement-in-position restrictions of section 553(b) will not apply." 4 COLLIER ON BANKRUPTCY ¶ 553.15 at 553-60 - 553-61 (15th ed. 1988).

³⁷ 11 U.S.C. § 506(a) (1988).

The right to setoff under the Code is fragile and can be easily waived by the creditor. Failure to assert in a timely manner the setoff right,³⁸ failure to stop payment of prepetition checks by a bank claiming a right to setoff,³⁹ or failure to assert any setoff rights in a proof of claim⁴⁰ may result in the court concluding that the creditor has waived any setoff rights it may have had. Moreover, the courts have held that the right to setoff under Section 553 is permissive.⁴¹ Consequently, a court may theoretically deny setoff, even if the elements of Section 553 have been met.⁴²

While Section 553 permits the creditor to exercise its rights to setoff, the right is subject to Section 362, the automatic stay provision of the Code. A creditor must obtain relief from the bankruptcy court before exercising its right to setoff; failure to do so exposes the creditor to the risk that its setoff may be invalidated and that it may be sanctioned for violating the automatic stay.⁴³

IV. CASE LAW ON THE ADMINISTRATIVE FREEZE

Whether the administrative freeze violates the automatic stay is an issue which has engendered much judicial debate. While the cases can be loosely grouped into those cases which permit a creditor to exercise an administrative freeze and those cases which do not, such artificial distinc-

³⁸ See *Holder v. Wilson (In re Wilson)*, 49 Bankr. 19, 21 (Bankr. N.D. Tex. 1985).

³⁹ See *Lowden v. Iowa-Des Moines Nat'l Bank & Trust Co.*, 10 F. Supp. 430, 433-34 (S.D. Iowa 1935), *aff'd*, 84 F.2d 856 (8th Cir.), *cert. denied*, 299 U.S. 584 (1936).

⁴⁰ See 4 COLLIER ON BANKRUPTCY ¶ 553.07 at 553-38 & n.5 (15th ed. 1988).

⁴¹ See, e.g., *Melamed v. Lake County Nat'l Bank*, 727 F.2d 1399, 1404 (6th Cir. 1984) ("[S]etoffs are generally favored, but are not automatically favored. The allowance of a setoff is within the discretion of the trial court and its decision on the matter will not be set aside unless found to constitute a clear abuse of discretion."); *FDIC v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 701 F.2d 831, 836 (9th Cir.), *cert. denied*, 464 U.S. 935 (1983). However, one court has stated:

The rule allowing setoff, both before and after bankruptcy, is not one that courts are free to ignore when they think application would be "unjust." It is a rule that has been embodied in every bankruptcy act the nation has had and creditors, particularly banks, have long acted in reliance upon it.

N.J. Nat'l Bank v. Gutterman (In re Applied Logic Corp.), 576 F.2d 952, 957-58 (2d Cir. 1978).

⁴² *Melamed*, 727 F.2d at 1404. There appears to be little logic in such an approach. The hostilities voiced by courts in this context are hostilities better placed at the foot of state law. It appears that the genesis of this doctrine can be traced to the belief that a setoff right is a windfall. However, this is not so. See *infra* note 173 and accompanying text.

⁴³ 11 U.S.C. § 362(h) (1988). Actions taken in violation of the automatic stay are void. *Kalb v. Feuerstein*, 308 U.S. 433, 443 (1940); *Caribbean Food Products, Inc. v. Banco Credito y Ahorro Ponceno*, 575 F.2d 961 (1st Cir. 1978). Section 362(h) provides for the recovery of damages, costs, and attorneys' fees by an individual damaged by a willful violation of the stay. In the appropriate case, punitive damages may also be recovered. For a general discussion of § 362(h), see 2 COLLIER ON BANKRUPTCY ¶ 362.12 (15th ed. 1988).

tions cannot help but mask many subtle issues. The following is a review of the many cases exploring the issue.

A. Cases Holding that the Freeze Violates the Stay

The cases which have determined that an administrative freeze effected to preserve a creditor's setoff right violates the automatic stay possess a common thread. The common thread is an emphasis on the role that the Code plays in providing a safe haven, often temporary, for debtors to effectuate a plan of reorganization. Typically, these cases discuss in great detail the noble purposes embodied in the automatic stay.

The case generally recognized as the first case to hold that an administrative freeze violates the automatic stay is *In re Kenney's Franchise Corporation*.⁴⁴ The precise issue in *Kenney's Franchise I* was whether the bank's freeze of the debtor's checking account upon learning that a Chapter 11 case had been filed constituted a setoff in violation of the automatic stay.⁴⁵ The debtor argued that the administrative freeze was tantamount to a setoff, thus violating the automatic stay. The bank, however, argued that it possessed a "banker's lien"⁴⁶ upon the account and that it had the right to hold or freeze the funds until the court granted it adequate protection pursuant to Section 362(d). Essentially, the bank argued that the funds were cash collateral⁴⁷ and were thus cloaked with the protections afforded by Section 363(c)(2).⁴⁸

⁴⁴ *Kenney's Franchise Corp. v. Central Fidelity Bank, N.A. (In re Kenney's Franchise Corp.)*, 12 Bankr. 390 (Bankr. W.D. Va. 1981) (hereinafter *Kenney's Franchise I*), *rev'd*, 22 Bankr. 747 (W.D. Va. 1982) (hereinafter *Kenney's Franchise II*). *Kenney's Franchise I* is an anomaly of sorts in that while the case is frequently cited as the first case to hold that an administrative freeze violates the automatic stay, the case was reversed on appeal by the district court.

⁴⁵ *Kenney's Franchise I*, 12 Bankr. at 391.

⁴⁶ While several courts and commentators have scoffed at the term "banker's lien" in reference to setoff, with the expanded definition of the term "lien" in § 101(33), one can advance the argument that a setoff right may be a lien under the Code. *Cf.* 4 COLLIER ON BANKRUPTCY ¶ 553.15 at 553-61 (15th ed. 1988) (posing the proposition, but abandoning it).

⁴⁷ Cash collateral includes:

cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offsprings, rents, or profits of property subject to a security interest as provided in § 552(b) of this title, whether existing before or after the commencement of the case under this title.

11 U.S.C. § 363(a) (1988). The definition of cash collateral is inclusive and will operate without regard to the source of the cash collateral. *See generally* 2 COLLIER ON BANKRUPTCY ¶ 363.02 (15th ed. 1988).

⁴⁸ 11 U.S.C. § 363(c) (1988) provides:

(1) If the business of the debtor is authorized to be operated under section 721, 1108, 1304,

Before reaching its conclusion, the court painstakingly explored the purposes and effect of the automatic stay. The court observed that the automatic stay precluded a creditor from the act of setoff.⁴⁹ The court also observed that the language of the stay provision was broad and all encompassing, admitting of no exceptions other than those explicitly contained in Section 362(b) which, the court observed, did not authorize setoff.⁵⁰ Further, the court correctly noted that the bank's supposed banker's lien was no more than the common law right to setoff.⁵¹ Not leaving well enough alone, the court then concluded that the right to setoff under prior law did not rise to the level of a security interest. Implicit in the court's conclusion is that if the right to setoff is not a security interest, then it cannot be a secured claim. This conclusion was reached without discussion of Section 506(a), which provides secured status to a setoff right to the extent of funds held by the creditor subject to setoff.⁵² Failure to discuss this relevant section must necessarily result in a discounting of the

1203 or 1204 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

(3) Any hearing under paragraph (2)(B) of this subsection may be a preliminary hearing or may be consolidated with a hearing under subsection (c) of this section, but shall be scheduled in accordance with the needs of the debtor. If the hearing under paragraph (2)(B) of this subsection is a preliminary hearing, the court may authorize such use, sale, or lease only if there is a reasonable likelihood that the trustee will prevail at the final hearing under subsection (e) of this section. The court shall act promptly on any request for authorization under paragraph (2)(B) of this subsection.

(4) Except as provided in paragraph (2) of this subsection, the trustee shall segregate and account for any cash collateral in the trustee's possession, custody, or control.

⁴⁹ *Kenney's Franchise I*, 12 Bankr. at 391.

⁵⁰ *Id.* at 391-92.

⁵¹ *Id.* at 392.

⁵² 11 U.S.C. § 506(a) (1988) provides:

An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

persuasiveness of the court's holding.

One cannot help but believe that regardless of what the Code explicitly states or what counsel may have argued, the *Kenney Franchise I* court's position was that the right to setoff was not a secured claim at common law and thus could not be a secured claim under the Code. The court, however, was wrong. Under Section 506(a), a creditor with a claim based on the right to setoff possesses a secured claim. The language of Section 506(a) leaves no room for debate. Nevertheless, the *Kenney's Franchise I* court embraced a generous adherence to the automatic stay provision in reaching its decision that the bank had violated the automatic stay imposed by Section 362(a)(7). This conclusion was, in effect, so generous that it squeezed out the impact of Section 506(a).

A peculiar analysis can be found in *In re Executive Associates, Inc.*,⁵³ where the court held that a freeze on the debtor's funds violated the automatic stay.⁵⁴ The court was impressed with the havoc a freeze could wreak on a debtor's attempt to reorganize its business.⁵⁵ Interestingly, the creditor argued that without the freeze the debtor could use the funds, which constitute cash collateral, without providing adequate protection.⁵⁶ The court dismissed the creditor's contention, observing that it was not ruling on the Section 363 cash collateral issue because the creditor had failed to prove the value of the funds on deposit at the time the petition was filed, *i.e.*, the value of the creditor's secured claim.⁵⁷ A fair reading of the court's opinion leads one to a peculiar observation. While the court would not countenance the freeze, it would allow a creditor to refuse to permit its debtor to use funds subject to setoff under Section 553, unless the debtor provided adequate protection. If this is the case, a creditor in that district can refuse to consent to the use of funds legitimately subject to setoff, but cannot freeze the account. One may ask what distinction can be drawn here. Unfortunately, the use of the term "freeze" implies that the creditor has taken some action beyond merely failing to consent to the use of the funds. While it is true that the creditor typically makes some record that the funds are not to be withdrawn, the debtor's true complaint is that

⁵³ Exec. Assoc., Inc. v. Southern Nat'l Bank (*In re Exec. Assoc., Inc.*), 24 Bankr. 171 (Bankr. S.D. Tex. 1982).

⁵⁴ *Id.* at 172. *Accord* LHG Resources, Inc. v. First Nat'l Bank (*In re LHG Resources, Inc.*), 34 Bankr. 202, 203 (Bankr. W.D. Tex. 1983).

⁵⁵ *In re Exec. Assoc., Inc.*, 24 Bankr. at 172.

⁵⁶ *Id.* at 172-73.

⁵⁷ *Id.*

the creditor is refusing to consent to the use of those funds.⁵⁸ *In re Executive Associates* notwithstanding, a refusal to consent to the use of cash collateral is tantamount to a freeze. If one is suspect, it necessarily follows that the other must be as well. Logic and experience tell one, however, this is not the case.

In *United States v. Norton*,⁵⁹ the Third Circuit concluded that an IRS freeze of a tax refund due a Chapter 13 debtor violated the spirit of the automatic stay. Again, after carefully discussing the purposes of the automatic stay and the goals of bankruptcy, specifically in the Chapter 13 scenario, the court had little difficulty in finding that the automatic stay prevented an IRS freeze. The court was impressed by the fact that if a bank could freeze the debtor's accounts upon the filing of a petition in bankruptcy, the debtor's chances for a successful rehabilitation would be substantially diminished.⁶⁰

Chapter 13 of the Bankruptcy Code . . . is designed to encourage and make possible the payment, rather than the discharge of debts. The automatic stay protects debtors from their creditors and creditors from themselves while a repayment plan is developed. If a creditor could circumvent the automatic stay simply by delaying the entry of a setoff or credit in its books, it could hold the funds until the case was closed and then deposit them into its own bank account. By the unilateral action of one creditor, these funds would become unavailable for distribution to other creditors or for use by the debtor in a Chapter 13 plan, thus making it that much less likely that the debtor could be rehabilitated.⁶¹

The court, moreover, was not persuaded by the IRS' argument that the automatic stay provisions of the Code were not meant to modify a creditor's rights, but simply to stay their enforcement pending an orderly ex-

⁵⁸ As observed in *Stann v. Mid Am. Credit Union*, 39 Bankr. 246, 248 (D. Kan. 1984), "[t]he administrative freeze is not an attempt to collect a debt, [but rather] it is an act to maintain the *status quo* until the rights of the parties can be determined by the bankruptcy court."

⁵⁹ 717 F.2d 767 (3d Cir. 1983). There appears to be an unusual amount of Pennsylvania cases on this issue. *E.g.*, *Cusanno v. Fidelity Bank (In re Cusanno)*, 17 Bankr. 879, 882 (Bankr. E.D. Pa. 1982) (under state law, "administrative hold" on the debtor's account is a setoff, and setoff pursuant to § 553 of the Code is expressly subject to the automatic stay under § 362(a)(7)); *In re Cross Keys Motors, Inc.*, 19 Bankr. 976, 977 (Bankr. M.D. Pa. 1982) ("The setoff of any debt owing to a debtor that arose before the commencement of a case under this title against any claim against the debtor is specifically prohibited"); as well as the cases discussed in this article.

⁶⁰ *Norton*, 717 F.2d at 773.

⁶¹ *Id.*

amination of the debtor's affairs.⁶² The court dismissed this argument, observing that even creditors whose claims are secured under the Code must submit to the risk inherent in the judicial suspension of the rights they normally would have to enforce their claims against property of the debtor.⁶³ Conspicuously absent in the court's discussion was any reference to adequate protection.

The *Norton* case is questionable precedent in light of the emphasis placed by the Third Circuit on the law of setoff in Pennsylvania.⁶⁴ The IRS argued that, because it had not applied the amount of the tax refund withheld, it had not actually setoff the funds; rather, it had merely preserved its right to setoff. Under Pennsylvania law, however, setoff occurs at the time sufficient evidence of intent to setoff is manifested.⁶⁵ There is no requirement that a book entry or some other written evidence be made. The mere fact of denying a debtor access to its funds constitutes setoff.⁶⁶ Consistent with Pennsylvania law then, the court ruled that the IRS withholding of the debtor's refund was sufficient evidence of intent to setoff. In deferring to state law, the court reasoned that the freeze was not merely tantamount to a setoff, but was, in fact, a setoff and a setoff was clearly prohibited by the automatic stay. Nevertheless, two principles that the *Norton* case stands for, which are not tainted by the peculiarities of Pennsylvania law, are the court's adherence to a generous reading of the automatic stay provision, seen earlier in *Kennedy's Franchise I*, and the lauding of the underlying policy provisions relevant to a bankruptcy reorganization case.

A case which closely follows the rationale of the *Norton* case is *United States v. Reynolds*,⁶⁷ which held that the imposition of a freeze by the IRS to protect its right to setoff violated the automatic stay.⁶⁸ The court embraced the *Norton* analysis, noting that the analysis rested on the policies embodied in the Code relating to the reorganization of the

⁶² *Id.*

⁶³ *Id.* See also *supra* note 18.

⁶⁴ See *supra* note 59.

⁶⁵ *Norton*, 717 F.2d at 772.

⁶⁶ Pennsylvania law on setoff states that setoff automatically occurs when the "atmospheric conditions" for setoff arise; no overt act is necessary. *Pittsburgh Nat'l Bank v. United States*, 657 F.2d 36, 38-39 (3d Cir. 1981) (setoff occurs by operation of law). Thus, a freeze appears to be the same thing as a setoff under Pennsylvania law. The Pennsylvania view on what constitutes a setoff is not the majority view. See 4 COLLIER ON BANKRUPTCY ¶ 553.17 at 553-79 n.3 (15th ed. 1988).

⁶⁷ 764 F.2d 1004 (4th Cir. 1985).

⁶⁸ *Id.* at 1006-07.

debtor.⁶⁹ The *Reynolds* court held that in the absence of Virginia law on the issue of what constitutes a setoff, the court should employ the *Norton* reorganization rationale as justification for concluding that a freeze of funds violates the automatic stay.⁷⁰ When the *Reynolds* court stated that there was no Virginia law on the freeze issue,⁷¹ it was mistaken. In *Kenney's Franchise II*,⁷² the court held that the imposition of a freeze to protect a creditor's setoff right was not proscribed by the automatic stay. Central to the holding in *Kenney's Franchise II* was the court's conclusion that setoff in Virginia, unlike in Pennsylvania, requires an application of the debtor's funds to the indebtedness, *i.e.*, some overt act evidencing the setoff.⁷³ Inexplicably, the *Reynolds* court ignored *Kenney's Franchise II*.

In *In re Rio*,⁷⁴ the court held that an administrative freeze imposed by a credit union on a Chapter 13 debtor's checking account after the credit union received notice of the Chapter 13 petition was tantamount to a setoff, thus violating the automatic stay.⁷⁵ In *In re Rio*, the credit union contended that the funds on deposit were cash collateral subject to the restrictions of Section 362(c)(2). Therefore, the credit union argued, it was entitled to deny access to the funds absent a court order granting the debtor the right to use the funds. The court was unpersuaded.

[Section] 363(c)(2) is applicable only where the debtor has been authorized to operate a business. [citation omitted] The debtor in this case is not engaged in operating a business and no authority to engage in business has been requested or granted.⁷⁶

In holding that the administrative freeze was tantamount to a setoff and thus violated the automatic stay, the court embraced the dissenting opinion in *In re Edgins*.⁷⁷ In a cryptic syllogism, the *In re Rio* court stated:

⁶⁹ *Id.* at 1007. The *Reynolds* court also observed that the *Norton* analysis was supported by the peculiarities of Pennsylvania law. *Id.*

⁷⁰ *Id.* In reaching its conclusion that the imposition of a freeze violated the stay, the court was impressed with the fact that the debtor's Chapter 13 plan provided payment in full in addition to adequate protection for the IRS. *Id.* at 1007-1008. I believe another, more accurate way to understand this case is that the debtor purchased the right to use the funds subject to setoff by providing adequate protection to the IRS.

⁷¹ *Id.* at 1007.

⁷² 22 Bankr. 747 (W.D. Va. 1982).

⁷³ *Id.* at 748.

⁷⁴ 55 Bankr. 814 (Bankr. M.D. Ala. 1985).

⁷⁵ *Id.* at 817.

⁷⁶ *Id.*

⁷⁷ Bank of Am. Nat'l Trust & Sav. Ass'n v. Edgins (*In re Edgins*), 36 Bankr. 480 (Bankr. 9th

The dissent in that case [*Edgins*] reasoned that under [Section] 524(b) an entity is required to turn over property of the debtor except to the extent it is subject to being off setoff under [Section] 553. The setoff in [Section] 553 is clearly subject to the automatic stay of [Section] 362(a)(7). The act of freezing an account is tantamount to a setoff and is also stayed by [Section] 362(a)(7). The proper remedy of the bank was to seek relief from the [sic] stay.⁷⁸

The second argument advanced by the credit union was that it was entitled to adequate protection as a prerequisite to being required to release the funds.⁷⁹ The court held that adequate protection under Section 363(e) is available only to an entity having a security interest in property of the estate. The court dodged the question of whether the credit union had a security interest in the funds by stating, without analysis, that where an entity is promised payment in full by the Chapter 13 plan, then its secured or unsecured status is irrelevant.⁸⁰ This result was reached even though the plan provided for full payment over a period of time without adequate protection.⁸¹

In a facially persuasive opinion, the court in *In re Wildcat Construction Co.*,⁸² observed, in *dicta*, that a bank's refusal, prior to a judicial determination of the rights of the parties, to honor checks and permit withdrawals from the bank accounts of the debtor-in-possession violated the automatic stay.⁸³ The court observed that regardless of whether freezing a bank account is a setoff or tantamount to a setoff, it is an unauthorized interference with the property of the Chapter 11 debtor without leave of the court.⁸⁴ The court further rejected the bank's argument based on Section 506(b) as an independent ground for freezing the bank accounts.

Indeed, perhaps the most fundamental problem with countenancing the freezing of the debtor's bank accounts before any judicial determination of the rights of the parties has been made is that it begs the critical question, assuming in advance the precondition for its validity. This position converts

Cir. 1984).

⁷⁸ *In re Rio*, 55 Bankr. at 817-18.

⁷⁹ *Id.* at 817.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² 57 Bankr. 981 (Bankr. D. Vt. 1986).

⁸³ *Id.* at 984.

⁸⁴ *Id.*

a bank's potential right to setoff into an allowed claim at the outset. These courts "seem to assume that the bank has the right to make the initial determination of which bank accounts are cash collateral which the debtor may not use. . . ." [citation omitted] The freeze is essentially an extrajudicial temporary restraining order. We must not delegate to one of the parties the judicial responsibility of deciding whether the funds in the account are cash collateral and of enforcing the statutory prohibition against using such cash collateral.⁸⁵

The court noted that left to its own devices, an interesting result occurs under the Code. Both the bank and the Chapter 11 debtor are frozen in place: the bank by the automatic stay, the debtor by the prohibition against using cash collateral without consent of the creditor or order of the court.⁸⁶

Much like the court in *Kenney's Franchise I*, the *Wildcat* court's analysis relied primarily on a generous interpretation of Section 362(a)(7). Additionally, the *Wildcat* court also relied on the 1984 amendments to Section 362. Section 362(a)(3) provides that the automatic stay prohibits "[a]ny act . . . to exercise control over property of the estate." Property of the estate is defined in Section 541(a)⁸⁷ to include all legal and equitable interests of the debtor. Arguably, Section 362(a)(3) provides support for the proposition that a creditor's freezing of the debtor's account is a violation of the automatic stay. One commentator observed that "[i]n light of the 1984 amendment to Section 362(a)(3), it is extremely difficult to deny that a freeze of a debtor's account does not constitute '[an] act . . . to exercise control over property of the estate.'"⁸⁸

This argument, however, may prove too much. For example, no one

⁸⁵ *Id.* at 986.

⁸⁶ *Id.* at 983. One commentator notes:

If this were Camelot, these provisions of the Bankruptcy Code would, by themselves, impose the "freeze." Bankers would not put administrative holds on debtors' bank accounts, and debtors would not attempt to withdraw funds from the accounts without the bank's permission or a court order obtained upon showing adequate protection.

Groschadl, "Freezing" the Debtor's Bank Account: A Violation of the Automatic Stay?, 57 AM. BANKR. L.J. 75, 77 (1983).

⁸⁷ 11 U.S.C. § 541(a) (1988) states, in pertinent part:

The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

⁸⁸ Comment, *Freeze And Recoupment: Methods For Circumventing The Automatic Stay?*, 5 BANKR. DEV. J. 85, 91-92 (1987).

can reasonably question that a creditor has authority to deny a debtor access to cash collateral, property of the estate which often serves as the lifeblood of a successful reorganization. Section 363 gives the creditor this right even though the right to refuse to consent to the debtor's use of cash collateral may arguably be "[an] act . . . to exercise control over property of the estate."⁸⁹ Furthermore, nowhere is the Section 363 right to refuse consent to use of cash collateral specifically excepted from the automatic stay in Section 362(b).

The criticisms leveled by the *Wildcat* court at the actions of the bank could be equally leveled against any creditor who failed to consent to the debtor's use of cash collateral. In the typical cash collateral situation, the secured creditor makes "the initial determination" of what constitutes cash collateral. One cannot help but embrace the *Wildcat* court's own words at this point: A secured creditor's refusal to consent to the debtor's use of cash collateral "is essentially an extra-judicial temporary restraining order."⁹⁰ Such refusal, however, is undeniably a right granted to the creditor by the Code.

The *Wildcat* court also failed to address the potential liability, implied by Section 542(c), of a creditor who pays prepetition debts from the debtor's account after receiving notice that the debtor has filed a bankruptcy petition.⁹¹ Although Section 542(c) protects a creditor who, without knowledge or notice of commencement of the case, transfers property of the estate, one implication of Section 542(c) is that if the creditor transfers property of the estate after it receives notice of the filing, it does so at its own peril. In order to protect itself from liability to the trustee for the transfer of property of the estate after commencement of the case, the creditor has no other alternative but to freeze the debtor's account. This is true even in situations where the creditor has no right to setoff.

B. Cases Holding that the Freeze Does Not Violate the Stay

The competing line of cases has held that effecting an administrative

⁸⁹ *In re Wildcat Constr. Co.*, 57 Bankr. 981, 986 (Bankr. D. Vt. 1986).

⁹⁰ *Id.*

⁹¹ 11 U.S.C. § 542(c) (1988) provides:

Except as provided in section 362(a)(7) of this title, an entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith and other than in the manner specified in subsection (d) of this section, to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case under this title concerning the debtor had not been commenced.

freeze to protect a creditor's right to setoff does not violate the automatic stay. In *Kenney's Franchise II*,⁹² the district court, in reversing the bankruptcy court, held that the funds in possession of a creditor who has a right to setoff against those funds, but for the automatic stay, are cash collateral as defined in Section 363.⁹³ In *Kenney's Franchise II*, the bank, upon learning of the filing of a Chapter 11 petition, froze the debtor's checking account. The bank did not apply the proceeds of the checking account to satisfy the indebtedness.⁹⁴ At the outset, the court noted that the appropriate resolution of the issue involved consideration of not one, but a number of provisions of the Code.⁹⁵ "Accordingly, while section 553 is the statutory provision dealing with setoff, 'the withholding or freezing of funds subject to a setoff claim is addressed by section 542, the provision governing the turnover of property to the estate.'"⁹⁶

The court relied heavily on *In re Carpenter's*⁹⁷ analysis of Section 542(b). Section 542(b) provides:

Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

The *Carpenter* court, referring to Section 542(b), reasoned:

The use of the phrase *may be offset* clearly contemplates that the setoff right has not been exercised. Obviously, if the debt had been setoff, it could not be considered property of the estate. Thus, Congress has recognized a significant distinction between the withholding of payment and the exercise of the setoff right. . . . [Subsection (c) absolves] banks . . . of liability to trustees for paying checks prior to knowledge of the filing. The statement in the legislative history of that subsection [c] that it does not 'permit bank setoff in violation of the automatic stay' is not applicable to [Section] 542(b) and, in any event, is not inconsistent with this analysis. . . .

This court is of the opinion that in a liquidation case the withholding or "freezing" of funds subject to a valid setoff claim does not violate the

⁹² *Kenney's Franchise Corp. v. Central Fidelity Bank (In re Kenney's Franchise Corp.)*, 22 Bankr. 747 (W.D. Va. 1982) (hereinafter *Kenny's Franchise II*).

⁹³ *Id.* at 749.

⁹⁴ *Id.* at 747.

⁹⁵ *Id.* at 748.

⁹⁶ *Id.* (citation omitted).

⁹⁷ *Third Nat'l Bank v. Carpenter (In re Carpenter)*, 14 Bankr. 405 (Bankr. M.D. Tenn. 1981).

automatic stay of [Section] 362(a)(7), provided that a complaint seeking relief from the stay is filed promptly thereafter. If banks are unable to follow such a procedure, they either must make frantic *ex parte* applications to the bankruptcy courts for relief from the stay or sit by and watch debtors dissipate funds subject to setoff rights recognized in [Section] 553.⁹⁸

The *Kenney's Franchise II* court was further persuaded by the creditor's argument that Section 363 of the Code governed the question at issue. Under the Section 363 analysis, the court initially concluded that Section 363(a) specifically includes deposit accounts within the definition of cash collateral.⁹⁹ Moreover, the court observed that Section 363(c)(2) provides that the trustee may not use cash collateral without the authorization of the bankruptcy court.¹⁰⁰ The deposit account was cash collateral pursuant to Section 363; therefore, the bank acted properly in not allowing the debtor to use the checking account without prior court approval.¹⁰¹

As noted, *Kenney's Franchise II* relied heavily on *In re Carpenter*.¹⁰² *In re Carpenter* was a Chapter 7 case and the *Carpenter* court was careful to note that its holding was limited to a liquidation situation. *Kenney's Franchise II*, however, was a Chapter 11 reorganization case. The sparse legislative history on this precise topic attempts to draw a distinction between setoff in a reorganization case *vis a vis* a liquidation case.¹⁰³

In the typical Chapter 11 situation, reorganization is the paramount goal. From a Chapter 11 debtor's perspective, the goal of reorganization is frustrated when funds are withheld, a situation which achieves the same result as setoff in that it deprives the debtor of the use of the funds for reorganizing.¹⁰⁴ Again, this argument may prove too much. If the creditor possesses a consensual secured claim in the funds in an account, Section 363 gives it the right to withhold consent to use of the funds until the debtor obtains a court order.¹⁰⁵ A creditor's withholding of consent would

⁹⁸ *Id.* at 407 (citations omitted) (emphasis in original).

⁹⁹ *Kenney's Franchise II*, 22 Bankr. at 749; see Freeman, *Setoff Under the New Bankruptcy Code: The Effect on Bankers*, 97 BANKING L.J. 484, 506 (1980).

¹⁰⁰ *Kenny's Franchise II*, 22 Bankr. at 749.

¹⁰¹ *Id.*; see *In re Gazelle, Inc.*, 17 Bankr. 617, 620 (Bankr. W.D. Wis. 1982).

¹⁰² *Third Nat'l Bank v. Carpenter (In re Carpenter)*, 14 Bankr. 405 (Bankr. M.D. Tenn. 1981).

¹⁰³ See H.R. REP. NO. 595, 95th Cong., 1st Sess. 183-84, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6143-6145.

¹⁰⁴ Comment, *supra* note 88, at 96-97.

¹⁰⁵ See 11 U.S.C. § 363(c) (1988).

necessarily frustrate the goal of reorganization; nevertheless, such action is clearly permitted. One cannot help but question why the Section 363 analysis should differ because the genesis of the secured claim is statutory as opposed to consensual.

A similar result was reached in *In re Edgins*.¹⁰⁶ In *In re Edgins*, a Chapter 13 case, the court cogently observed that the resolution of the issue of whether an administrative freeze violates the automatic stay involves an assessment of the interaction of the provisions regarding the automatic stay,¹⁰⁷ setoff,¹⁰⁸ turnover of property of the estate,¹⁰⁹ determination of secured status,¹¹⁰ and use of cash collateral.¹¹¹ After reviewing the relevant sections, the court reached the conclusion that the Code imposes a stalemate as to the use of funds in which a creditor asserts a right to setoff.

When a creditor defers payment pursuant to an asserted right to setoff, the creditor is not entitled to actually setoff the deferred funds, which would be a violation of [Section] 362. In turn, the debtor is not permitted to use cash collateral without first obtaining court authority and after notice and hearing.¹¹²

The court explored the many cases on this particular issue and dismissed the criticisms against the *Kenney's Franchise II*¹¹³ line of cases. The court observed that "[i]n this type of situation, banks are not so much making a determination of ownership as they are giving notice to the debtor that they claim an interest in the funds and intend to prevent dissipation of the bank's claimed interest pending the court's determination of ownership."¹¹⁴ The court further observed that the reasoning of *In re Cusanno*¹¹⁵ as to the effect of Section 362 was *dicta* because the case was decided on the basis that the property was not subject to setoff. Moreover,

¹⁰⁶ Bank of Am. Nat'l Trust & Sav. Ass'n v. Edgins (*In re Edgins*), 36 Bankr. 480 (Bankr. 9th Cir. 1984).

¹⁰⁷ 11 U.S.C. § 362(a) (1988).

¹⁰⁸ 11 U.S.C. § 553 (1988).

¹⁰⁹ 11 U.S.C. § 542(b) (1988).

¹¹⁰ 11 U.S.C. § 506(a) (1988).

¹¹¹ 11 U.S.C. § 363(c) (1988). See Bank of Am. Nat'l Trust & Sav. Ass'n v. Edgins (*In re Edgins*), 36 Bankr. 480, 483 (Bankr. 9th Cir. 1984).

¹¹² *In re Edgins*, 36 Bankr. at 483.

¹¹³ 22 Bankr. 747 (W.D. Va. 1982).

¹¹⁴ *In re Edgins*, 36 Bankr. at 484.

¹¹⁵ *Cusanno v. Fidelity Bank (In re Cusanno)*, 29 Bankr. 810 (E.D. Pa. 1983), *vacated and remanded*, 734 F.2d 3 (3d Cir. 1984).

the court believed that the *Cusanno* line of cases was not persuasive because it placed the burden on the wrong party.¹¹⁶

Creditors with a valid right of setoff under [Section] 553 would be required to turn over to the debtor funds subject to setoff and thereafter attempt to obtain an order from the court to preclude the debtor from improvidently dissipating the funds. This will, all too often, be an attempt to lock the barn door after the horse has been stolen. The shield of [Section] 362, which is procedural and vests no intrinsic interest in property to the estate, should not be used as a sword to divest other parties of legitimate interests in property particularly where the debtor has the knowledge and means to bring whatever claim he may have for use of the funds on for prompt hearing.¹¹⁷

In a cryptic dissent, Judge Ashland concluded that the administrative freeze was tantamount to a setoff and that the bank must either ask for relief from the automatic stay or run the risk of violating it.¹¹⁸

In *In re Owens-Peterson*,¹¹⁹ the court explored the freeze issue in the context of Chapter 13.¹²⁰ After concluding that the funds subject to setoff are indeed cash collateral as defined in Section 363, the court held that the creditor could freeze the funds to protect its setoff right.¹²¹ Dismissing the contention advanced by the debtor that a freeze is inconsistent with the Chapter 11 and 13 goals of reorganization, the court observed:

[t]he conclusion [that the freeze does not violate the stay] . . . potentially imposes a burden on a debtor undergoing reorganization under Chapter 13 or Chapter 11 of the Bankruptcy Code. Yet, this result is inescapable once the Court determines that the bank account in dispute constitutes cash collateral under [Section] 363(a).¹²²

¹¹⁶ *In re Edgins*, 36 Bankr. at 484.

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 485 (Ashland, J., dissenting).

¹¹⁹ Georgia Fed. Bank v. Owens-Peterson (*In re Owens-Peterson*), 39 Bankr. 186 (Bankr. N.D. Ga. 1984).

¹²⁰ A Chapter 13 case concerns itself with the reorganization of an individual with a regular income. See 11 U.S.C. §§ 1301-1330 (1988); 11 U.S.C. § 101(29) (1988) (definition of an "individual with regular income").

¹²¹ *In re Owens-Peterson*, 39 Bankr. at 190.

¹²² *Id.* at 189. The court also stated an obvious, but often overlooked, fact of bankruptcy practice.

The court is optimistic that a majority of the disputes over bank deposits will be resolved by consent of the parties as provided in § 363(c)(2)(A) rather than by the debtor's racing to appear before the court for authorization to use cash collateral under § 363(c)(2)(B).

Id. at 189-90. Experience bears this observation out. One should not, however, come away with the impression that bankruptcy practitioners are benevolent souls. To the contrary, both creditor and

Therefore, the creditor could protect its cash collateral by imposing a freeze without fear of violating the automatic stay.¹²³

In *In re Hoffman*,¹²⁴ the bankruptcy court explored the issue of whether an administrative freeze violated the automatic stay in the context of both a Chapter 7 and a Chapter 11 case. After carefully reviewing the law on the automatic stay, turnover, and setoff, the court decided that the funds on deposit that were subject to setoff were indeed cash collateral.¹²⁵ The court stated:

[t]he term "lien" as used in [Section] 506(a) is defined broadly at [Section] 101(31) to mean "any charge against or interest in property to secure payment of a debt or performance of an obligation." Consequently an allowed claim may be a secured claim regardless of whether the lien was created by agreement, statute, or judicial process. Additionally, under [Section] 506(a) an allowed claim is treated as a secured claim to the extent of the amount of the property in which the estate has an interest subject to setoff under [Section] 553 with respect to such allowed claim, even if the holder of such allowed claim does not have a perfected security interest in property in which the estate has an interest.¹²⁶

Moreover, the court observed that payment of post-petition checks constituted a transfer of property of the estate. If this transfer was not authorized by the Code, it could be set aside pursuant to Section 549(a).¹²⁷ Section 542 protects a bank that transfers property of the estate to third persons if the transfer is made in good faith without notice of the bankruptcy filing. By implication, if a bank transfers property of the estate

debtor attorneys have their clients' interests at heart when they fashion an agreed cash collateral order. Creditor's counsel believes she can usually extract more from the debtor in terms of adequate protection than she can obtain from the court. Moreover, there is no term greater feared by creditor counsel than the term "indubitable equivalent" as a means of adequate protection for the use of cash collateral. See 11 U.S.C. § 361(c) (1988). Of course, debtor's counsel is concerned the court may conclude there is no hope of reorganization and nip any effort in the bud, or worse, fashion an adequate protection order as a precondition to the use of cash collateral that ends the show.

¹²³ See *In re Owens-Peterson*, 39 Bankr. at 190.

¹²⁴ *Hoffman v. Portland Bank (In re Hoffman)*, 51 Bankr. 42 (Bankr. W.D. Ark. 1985).

¹²⁵ *Id.* at 47.

¹²⁶ *Id.* at 45-46 (quoting 3 COLLIER ON BANKRUPTCY ¶ 506.4 (15th ed. 1985)).

¹²⁷ *Id.* at 46. Section 549(a) provides:

(a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate—

(1) that occurs after the commencement of the case; and

(2) (A) that is authorized only under section 303(f) or 542(c) of this title; or

(B) that is not authorized under this title or by the court.

11 U.S.C. § 549(a) (1988).

after it receives notice of the filing of a petition, it does so at its own peril.¹²⁸ The court concluded that these provisions illustrate the extent of a bank's dilemma and the reasonableness of an administrative freeze under the circumstances.¹²⁹ The *Hoffman* court further noted that the substantial effect of a post-petition administrative freeze was to preserve, not alter, the *status quo* and, therefore, was neither a direct nor indirect attempt to improve the bank's right to distribution of estate assets.¹³⁰ The court, however, failed to address the responsibility the Code imposes on a bank to turn over funds to the trustee pursuant to Section 542(a) and (b).

Additionally, the *Hoffman* court concluded that a distinction exists between Chapter 11 and Chapter 7 cases. In a Chapter 11 case, the debtor has a need for the use of its cash collateral. While the debtor should be prohibited from using the funds unless the bank is furnished adequate protection,¹³¹ there is no reason to totally deny access to the funds. Nevertheless, there exists no reason for denying relief from the stay in a Chapter 7 case when the right of setoff does not exist, once the trustee is made a party.¹³²

The seminal case in concluding that an administrative freeze does not violate the automatic stay is *In re Williams*.¹³³ In *Williams*, after observing the conflicting provisions of the Code, Judge McConnell concluded that the bank's effecting an administrative freeze did not violate the automatic stay because funds in a deposit account subject to a bank's right to setoff constitute cash collateral.¹³⁴ Under the *Williams* analysis, a bank which possesses a right to setoff has the authority under Section 363 to withhold consent to the debtor's use of the cash collateral. It then becomes incumbent upon the debtor to seek approval of the bankruptcy court to use the cash collateral, and, in return, provide some approved means of adequate protection of the bank's secured claim.¹³⁵

What is most interesting about the *Williams* opinion is not necessarily its holding, for there already existed a line of cases which held that the imposition of an administrative freeze did not violate the automatic

¹²⁸ *In re Hoffman*, 51 Bankr. at 46; see *In re Smith Corsets Shops, Inc.*, 696 F.2d 971, 976-78 (1st Cir. 1982).

¹²⁹ *In re Hoffman*, 51 Bankr at 46.

¹³⁰ *Id.*

¹³¹ See, e.g., *In re Archer*, 34 Bankr. 28, 30 (Bankr. N.D. Tex. 1983).

¹³² *In re Hoffman*, 51 Bankr. at 47.

¹³³ *Williams v. Am. Bank of the Mid-Cities, N.A. (In re Williams)*, 61 Bankr. 567 (Bankr. N.D. Tex. 1986).

¹³⁴ *Id.* at 571-72.

¹³⁵ *Id.* at 572.

stay, but rather the analysis by which the holding was reached. After reviewing the seemingly conflicting provisions of the Code, the *Williams* court reached its conclusion by employing long-standing statutory rules of construction to attempt to harmonize the provisions. Specifically, the court embraced the statutory canon of construction that "where there is in the same statute a specific provision, and also a general one which in its most comprehensive sense would include matter embraced in the former, the particular provision must control, and the general provision must be taken to affect only such cases within its general language which are not within the provisions of the particular provision."¹³⁶ In this case, the court reasoned that the specific permission granted to a creditor by Section 542(b) to retain funds subject to setoff should prevail over the general restriction found in Section 362(a)(3) and (a)(7) against post-petition setoffs.¹³⁷ To buttress this analysis, the court discounted Section 362(a)(3), which prohibits any act to exercise control over property of the estate. The court stated that Section 362(a)(3) only forbids a creditor's acts to exercise *exclusive* control over property of the estate.¹³⁸ This conclusion is peculiar. "It is unclear from where the court adopts the 'exclusive' restraint on control as the Code clearly does not limit the control to situations where it is exclusive."¹³⁹

The court in *In re Air Atlanta, Inc.*¹⁴⁰ embraced the *Williams* reasoning that the more specific provision of Section 542(b), which allows a creditor to retain funds subject to setoff, should control over the more general restrictions of Section 362(a)(7), prohibiting setoffs, and subsection (a)(3), prohibiting acts to exercise control.¹⁴¹ The court further embraced the *Williams* holding that the burden should be on the debtor to obtain permission to use cash collateral, and that the bank should not have to turn over funds to the debtor and thereafter request the court to prohibit the debtor from dissipating the funds.¹⁴²

In a break with a long line of tradition, the court in *In re New York City Shoes*,¹⁴³ recognizing that in Pennsylvania a freeze is a setoff, never-

¹³⁶ *Id.* at 573 (quoting 73 AM. JUR. 2D *Statutes* § 257 (1974)).

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ Comment, *supra* note 88, at 99.

¹⁴⁰ Nat'l Bank v. Air Atlanta, Inc. (*In re Air Atlanta, Inc.*), 74 Bankr. 426 (Bankr. N.D. Ga.), *aff'd*, 81 Bankr. 724 (N.D. Ga. 1987).

¹⁴¹ *Id.* at 427.

¹⁴² *Id.* Accord *Craddock-Terry Shoe Corp. v. Crestar Bank (In re Craddock-Terry Shoe Corp.)*, 91 Bankr. 392, 394 (Bankr. N.D. Va. 1988).

¹⁴³ 78 Bankr. 426 (Bankr. E.D. Pa. 1987).

theless concluded that where the debtor is authorized to operate a business, the creditor may freeze the account.¹⁴⁴ While paying homage to Pennsylvania law, including a long line of bankruptcy precedent peculiar to Pennsylvania, the court nevertheless held:

The *Cusanno* holding that an "administrative freeze" constitutes a setoff is correct, given the status of Pennsylvania law regarding bank setoffs. Hence, a bank must obtain relief from the automatic stay pursuant to [Section] 362(a)(7) to consummate a setoff or to proceed to "administratively freeze" all funds except those pertinent to which it has a security or quasi-security interest which would prevent a business debtor from utilizing cash collateral.¹⁴⁵

The court distinguished between cases involving business debtors and cases involving consumer debtors.¹⁴⁶ In the former case, a freeze is appropriate until the debtor can provide adequate protection to the creditor or the creditor establishes its setoff right.¹⁴⁷ In the consumer debtor situation, a freeze is inappropriate and the creditor violates the stay even if the creditor possesses a valid right to setoff pursuant to Section 553.¹⁴⁸ The court failed to discuss why the creditor of a consumer debtor is not entitled to adequate protection of its secured claim.¹⁴⁹

There exists a subset of the second line of cases which embraces a middle of the road view as to the resolution of this issue. These cases essentially conclude that an administrative freeze does not violate the auto-

¹⁴⁴ *Id.* at 432, 433.

¹⁴⁵ *Id.* at 432.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* Apparently, the court imposed on the debtor the duty to provide adequate protection to dissolve the freeze, but seemed to suggest that it is incumbent upon the creditor with a setoff right to move to determine the status of the funds. *Id.* at 431-32. A more troubling aspect of the court's opinion is the *dictum* that the burden on the debtor to establish adequate protection "might be diminished in relation to that imposed upon a debtor attempting to utilize the cash collateral of a classic, heavily-secured creditor." *Id.* at 433. While there is some support for this proposition in the legislative history, see H.R. REP. NO. 595, 95th Cong., 1st Sess. 430, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6385-6386, there is no support in the Code itself.

¹⁴⁸ *In re New York City Shoes*, 78 Bankr. at 432. The court employed a literal reading of § 363(c) which limits itself to cases in which the debtor is authorized by the court or the Code to engage in business. See 11 U.S.C. § 363(c) (1988).

¹⁴⁹ While § 363(c) may support a distinction between business debtors and consumer debtors, there is no such distinction made in § 506(a). The setoff right is classified as a matter of federal law as a secured claim to the extent of funds legitimately subject to setoff, regardless of whether the debtor is engaging in a business or not. It follows that if the claim is secured, the creditor is entitled to adequate protection of its interest. See 11 U.S.C. § 361 (1988). Nothing in the Code suggests otherwise.

matic stay if, shortly after the administrative freeze is effected, the creditor files a motion to terminate the stay under Section 362(d).¹⁵⁰

In *In re Crispell*,¹⁵¹ the court concluded that while the imposition of an administrative freeze does not in itself violate the stay, the continuation of that freeze for any extended period of time would constitute a setoff in violation of Section 362(a)(7).¹⁵² The court reached that conclusion because of its belief that a continuation would have the same substantive effect as a setoff.¹⁵³ The court agreed with the bank's claim that the funds on deposit on the date of bankruptcy were cash collateral against which the bank clearly had a right to setoff. However, the court noted that the setoff right was waived when the bank released the funds.¹⁵⁴ Nonetheless, the court inexplicably failed to recognize that if funds in a deposit account are indeed cash collateral, then the impetus is on the debtor to gain access to those funds, absent consent from the creditor. The court failed to appreciate the subtle yet significant distinction it had drawn.

V. APPLICATION OF THE CASH COLLATERAL PARADIGM

For a thorough resolution of the issue presented in this article, no less than six substantive provisions of the Code must be carefully considered. The first provision is the automatic stay provision found in Section 362. Specifically, Section 362 prohibits the act of setoff and any act to exercise control over the debtor's property.¹⁵⁵ The second provision is Section 553. That provision recognizes a creditor's state-created right to setoff and delineates procedures whereby the right may be exercised.¹⁵⁶ The third provision is Section 506(a), which defines a creditor's right to setoff as a secured claim to the extent of the value of the collateral, *i.e.*, the total amount of funds subject to setoff.¹⁵⁷ The fourth section which is relevant is Section 363(c), which delineates the rights and duties of both a creditor and a debtor to the use of cash collateral.¹⁵⁸ The fifth provision is Section 542(b).¹⁵⁹ That provision directs parties to turn over to the trustee funds

¹⁵⁰ See, e.g., *Third Nat'l Bank v. Carpenter (In re Carpenter)*, 14 Bankr. 405 (Bankr. M.D. Tenn. 1981).

¹⁵¹ *Crispell v. Landmark Bank (In re Crispell)*, 73 Bankr. 375 (Bankr. E.D. Mo. 1987).

¹⁵² *Id.* at 379-80.

¹⁵³ *Id.* at 379.

¹⁵⁴ *Id.* at 380.

¹⁵⁵ 11 U.S.C. § 362(a)(3) & (a)(7) (1988).

¹⁵⁶ 11 U.S.C. § 553 (1988).

¹⁵⁷ 11 U.S.C. § 506(a) (1988).

¹⁵⁸ 11 U.S.C. § 363(c) (1988).

¹⁵⁹ 11 U.S.C. § 542(b) (1988).

that are property of the estate except to the extent such funds may be offset. Finally, Section 542(c) implicitly makes a creditor liable for making any post-petition transfer of the debtor's property without consent of the bankruptcy court.¹⁶⁰ All of these provisions must be analyzed before a proper resolution of the issue can be reached.

The issue of whether the administrative freeze violates the automatic stay thrusts the bankruptcy courts into a maelstrom involving state and federal law and several provisions of the Code which honestly cannot be harmonized. Attempts to read the various statutes consistently conjure up Emerson's caution that foolish consistencies are the hobgoblin of simple minds.

One must first decide that the statutes are, in fact, in conflict. Regrettably, that is an all too simple task. One need only read a smattering of cases to reach the conclusion that the system as it exists today is "broken." Moreover, while the *In re Williams* analysis is sound, its use of the statutory canon of construction may not be. The court in *In re Williams*¹⁶¹ employed the statutory canon of construction that a specific provision of a statute overrides a general provision of a statute. Employing a different, although equally applicable canon of construction than that employed in *In re Williams*, would have indicated the opposite result. That is, the canon that when two provisions are inconsistent the more recent provision controls the resolution of an issue. This canon would direct the court to reach the conclusion that the administrative freeze does violate the automatic stay.

The easy answer is to amend the Code to fix the problem of inconsistent provisions. Until that day, judges must grapple with the issue. The answer to the problem must rest on a judge's assessment and ranking of the underlying goals of bankruptcy.

The line of cases which hold that the imposition of an administrative freeze violates the automatic stay promotes the sound policies embodied in the automatic stay provision of the Code, even at the expense of disregarding the rights created by state law and recognized by the Code. This line of cases, however, is indefensible. Disregarding a creditor's state-created interest is not a legitimate goal of the automatic stay.¹⁶² The automatic stay does not eviscerate the rights of creditors, but instead, simply stays enforcement of those rights pending an orderly examination of the debtor's

¹⁶⁰ 11 U.S.C. § 542(c) (1988).

¹⁶¹ 61 Bankr. 567 (Bankr. N.D. Tex. 1986).

¹⁶² See *supra* note 18.

and the creditor's rights.¹⁶³ The purposes of the automatic stay have generally been to protect the debtor from acts taken by its creditors and to protect a creditor from another creditor's acts without court approval. Neither of these purposes is furthered by the application of the automatic stay provision to the administrative freeze situation. Moreover, this line of cases completely ignores the Code's undeniable policy of rewarding a creditor who declines to setoff before the bankruptcy petition is filed. The Code holds out a carrot to such a creditor by permitting him a secured claim to the extent of the funds subject to setoff, disregarding any *bona fide* prepetition increase in the account. It is foolish to hold out a carrot to a creditor and then penalize him when he bites. Furthermore, this line of cases promotes prepetition setoff; there is an incentive for creditors with a right to setoff to exercise that right during a period of financial difficulty of the debtor rather than continue to carry the debtor in hopes that matters will improve.¹⁶⁴ Thus, these cases promote an atmosphere in conflict with the technical complexities and conceptual underpinnings of modern bankruptcy law on setoff.

The middle ground approach to the issue, while laudable and enticing, is no more supported by the Code than the former approach.¹⁶⁵ If funds on hand are truly cash collateral, then the Code has already provided, pursuant to Section 363(c), that the impetus is on the debtor to obtain access to those funds. The attempt by the courts, and the commentators, to rewrite that provision in a backhanded manner is unconvincing. After all, it is undeniable that failure to consent to the use of cash collateral, other than in the context of an administrative freeze, is not a violation of the automatic stay. A setoff right is a non-consensual claim created by state law. The Code makes the claim a secured claim as a matter of federal law. It makes no sense, and it is unsupported in the Code, to craft a distinction concerning who has the burden of determining the status of funds on whether a claim is created by statute, judicial process, or consent. The legislative history contemplates that a right to setoff is to be treated essentially the same as any other security interest. "[A]n amount that may be offset is tantamount to a security interest for the benefit of the credi-

¹⁶³ H.R. REP. NO. 595, 95th Cong., 1st Sess. 342, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6298.

¹⁶⁴ See CLARK, *supra* note 27, ¶ 6.05[2][a] at 6-64; see also H.R. REP. NO. 595, 95th Cong., 1st Sess. 183, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6143-44.

¹⁶⁵ "Omne ignotum pro magnifico." A. Conan Doyle, *The Red-Headed League*, ANNOTATED SHERLOCK HOLMES 418, 421 (W.S. Baring-Gould ed. 1967) (Sherlock Holmes' only full Latin quotation to be found in the Canons is singularly appropriate).

tor.”¹⁶⁶ Requiring the debtor to seek relief merely forces the debtor to do what it is required to do by Section 363.

Therefore, the resolution of the issue of whether an administrative freeze is a violation of the automatic stay is left to the third line of cases which has held that the Section 363 cash collateral analysis is the controlling paradigm. That paradigm recognizes that a setoff is a violation of the automatic stay. The paradigm also recognizes that the right to setoff is a secured claim to the extent of the value of the funds subject to the setoff. The paradigm further recognizes that there must be some means to protect the secured claim created by state law while permitting a method by which the debtor, in appropriate circumstances, may gain access to the cash collateral. Section 363 neatly provides the answers and the appropriate allocation of the rights and duties of the debtor and its creditors.

The application of the cash collateral paradigm to the administrative freeze makes sense. The funds are property of the estate. The funds are also cash collateral as defined by Section 363. The creditor with a right to setoff against those funds has a secured claim to the extent of those funds under Section 506(a). The debtor has two means by which to obtain access to the funds. The debtor can obtain consent of the creditor holding a right to setoff in those funds. Absent consent, the debtor must obtain a court order to gain access to those funds. The approval of access to those funds by the court will rest necessarily on the debtor's providing adequate protection to the creditor's secured claim. This adequate protection is defined by Section 361 of the Code and may include periodic payments from another source or a replacement lien equal to the value of the right to setoff.¹⁶⁷

The administrative freeze does not generate a new problem. The

¹⁶⁶ H.R. REP. NO. 595, 95th Cong., 1st Sess. 183, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6143-44. While recognizing the obvious differences between a right to setoff and an Article 9 security interest, the legislative history nevertheless observes that the analogy “is adequate to justify giving an offsetting creditor the same protection as the bill gives to secured creditors generally.” *Id.* See CLARK, *supra* note 27, ¶ 6.05(2)(a) at 6-61.

¹⁶⁷ 11 U.S.C. § 361 (1988). Adequate protection is purposefully vague. Section 361 consists of examples of adequate protection given to illustrate possible alternatives. Chief among these examples are the replacement lien, periodic cash payments, or the “indubitable equivalent” of the secured creditor's interest in the property. Case law and experience strongly suggest that valuation problems will frequently result in protection that is less than adequate. See *e.g.*, *In re Bermec Corp.*, 445 F.2d 367 (2d Cir. 1971); *In re Yale Express Sys.*, 38 F.2d 990 (2d Cir. 1967). The legislative history clearly contemplates that a creditor entitled to setoff mutual prepetition debts is entitled to adequate protection like any other creditor holding a secured claim. See H.R. REP. NO. 595, 95th Cong., 1st Sess. 183, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6143-44; 2 COLLIER ON BANKRUPTCY ¶ 361.01[4] at 361-15 (15th ed. 1988).

problem has existed since the beginning of contests between debtors and creditors over the use of cash collateral. The Code has attempted to resolve those tensions by striking a balance between the creditor's interest on the one hand, and the debtor's interest on the other. That balance applies equally to the administrative freeze situation. Moreover, the cash collateral paradigm is consistent with the powerful creditor's bargain heuristic.¹⁶⁸ The cash collateral paradigm accords substantial respect to state-created rights while accommodating conflicting Code provisions. The paradigm recognizes that it need not necessarily be an all or nothing game.

The cornerstone of the creditors' bargain heuristic is that pre-bankruptcy state created rights should not be impaired purely for distributional goals. Rather, impairment of pre-bankruptcy state-created rights is legitimate only when it is necessary to maximize the pool of assets available to satisfy the claims of the creditors as a group.¹⁶⁹ The heuristic recognizes that bankruptcy is a foreseeable risk, borne by each creditor of the debtor. Each individual creditor assesses its own risks in case of its debtor's bankruptcy. The assessment of the risk of bankruptcy necessarily influences each creditor's decision to require security and to set the terms of financing.¹⁷⁰ Unsecured creditors forego security and assume a higher risk than secured creditors, but are theoretically compensated by a higher return and shorter terms of repayment. Secured creditors purchase pre-bankruptcy rights as a hedge against the risk of bankruptcy by accepting a lower rate of return in exchange for security.¹⁷¹ The central premise of the creditors' bargain heuristic is that state law differences in treatment of secured and unsecured creditors should be honored by modern bankruptcy

¹⁶⁸ See generally Jackson, *supra* note 18.

¹⁶⁹ See Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 727-31 (1984); Jackson, *supra* note 18, at 868-71. Professor Jackson observes that because of the increased aggregate pool of assets when the reorganization value of the debtor's estate exceeds its liquidation value, unsecured creditors should receive a greater return without harm to the secured creditors. Jackson, *supra* note 18, at 861-64; see Note, *The Proper Discount Rate Under The Chapter 11 Cram Down Provision: Should Secured Creditors Retain Their State Law Entitlements?*, 72 VA. L. REV. 1499, 1503 (1986).

¹⁷⁰ In this context, security is recognized not only as a monitoring device that allows secured creditors to police a debtor's activities to detect misbehavior, see Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143, 1153 (1979), but also as a means of establishing priority over other creditors. *Accord* Note, *supra* note 169, at 1502.

¹⁷¹ See Baird & Jackson, *Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 112 (1984). State law recognizes that a secured party's claim has priority over an unsecured party's claim. See U.C.C. § 9-301(1)(a) (1987). All creditors, at least those who choose to deal with a debtor, are intimately aware of these ground rules. See Eisenberg, *supra* note 18, at 965.

law.¹⁷² The creditor with a setoff right possesses a cognizable pre-bankruptcy state law right similar to the Article 9 secured party. Moreover, the ability to setoff in the future is often a bargained for right of the creditor at the inception or reworking of the debt. It may serve as a form of security, warranting a creditor's concession on loan terms. Typically, setoff rights do not arise accidentally; they are not a windfall. Instead, setoff rights often comprise part of the loan package.¹⁷³

The creditors' bargain heuristic is defensible on two related, though independent, grounds. First, the heuristic dissuades the strategic use of bankruptcy by certain creditors.¹⁷⁴ When bankruptcy law recognizes a different method of the distribution of entitlements than state law, bankruptcy law creates perverse incentives that motivate parties to use the bankruptcy process strategically.¹⁷⁵ Some creditors will, therefore, opt for bankruptcy because their return is greater under bankruptcy law than under state law.¹⁷⁶ This maneuvering leads to inefficiency and generates unnecessary costs.¹⁷⁷ Uniformity between state law and bankruptcy law minimizes the strategic use, or threat of use, of the bankruptcy forum, alleviating these concerns.

Second, secured parties must generally participate in the bankruptcy process for it to have maximum utility.¹⁷⁸ With perversions in the credit

¹⁷² Almost all bankruptcy law to date accords substantial respect to non-bankruptcy state-created rights. See Jackson, *supra* note 18, at 859 & n.15. *But see* United Sav. Ass'n v. Timbers of Inwood Forest, 108 S. Ct. 626 (1988) (undersecured creditor not entitled to lost opportunity cost arising from a stay of its right to foreclose).

¹⁷³ Typically, a bank may demand that in return for providing funds, the debtor agree to maintain its operating account at the bank. This situation allows for setoff rights and the creditor's ability to monitor its debtor. There is nothing inherently unfair about recognizing bargained for rights. See Baird & Jackson, *supra* note 171, at 112; Eisenberg, *supra* note 18, at 965. *But see* McCoid, *supra* note 24, at 37-43. (Professor McCoid questions setoff as a bargained-for right).

¹⁷⁴ Note, *supra* note 169, at 1503.

¹⁷⁵ See Eisenberg, *supra* note 18, at 958.

¹⁷⁶ An illuminating example of this situation can be found in Texas. Under Texas state fraudulent transfer law, the bid price at a noncollusive, nonjudicial, regularly conducted foreclosure sale establishes reasonably equivalent value as a matter of law. See TEX. BUS. & COM. CODE ANN. § 24.004(b) (Vernon 1988). Therefore, the foreclosure sale is immune from attack as a constructive fraudulent conveyance. A different result may be reached under bankruptcy law. If the bid price at a foreclosure sale is not greater than seventy percent of the fair market value of the property, and the debtor was also insolvent at the time of the transfer, then the foreclosure sale which is lawful under state law can be avoided under the Code. 11 U.S.C. § 548(a)(2) (1988); see Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980); see also Abramson v. Lakewood Bank & Trust Co., 647 F.2d 547 (5th Cir. 1981) (*per curiam*), *cert. denied*, 454 U.S. 1164 (1982).

¹⁷⁷ See Note, *supra* note 169, at 1502-03.

¹⁷⁸ This does not necessarily mean that secured creditors must benefit from a bankruptcy. They usually do not. Rather, this proposition requires only that the secured creditor remain indifferent to

system traceable to interpretations of the Code, secured creditors will not willfully participate in bankruptcy. At the first sign of financial distress, the dismantling of the debtor would begin. The utility of bankruptcy is measured by the fruits of a collective process. Bankruptcy is a collective forum. Its goal must be to increase total creditor wealth generally by forcibly keeping intact the debtor's going concern value and by invalidating certain pre-bankruptcy transfers and other individual collection efforts.¹⁷⁹

The cash collateral paradigm addresses these concerns. Unlike the *Kenney's Franchise I*¹⁸⁰ line of cases, the paradigm does not generate perverse consequences. The creditor's right to setoff remains intact to the extent permitted under state law and the Code. The strategic use of bankruptcy law is dissuaded. Moreover, the cash collateral paradigm makes the creditor with setoff rights at least indifferent to the use of the collective efforts embodied in the Code. However, in a jurisdiction where the freeze is proscribed, the creditor with setoff rights is harmed by resort to the bankruptcy process. It may lose its right to setoff. The unintended result is that the creditor with setoff rights in those jurisdictions would setoff at the first signs of the debtor's serious financial distress—a result completely at odds with the stated purposes of Section 553.

The use of the cash collateral paradigm may be attacked on two fronts. First, one can attack the paradigm because Section 363 by its terms is limited to business reorganization situations. Thus, the paradigm breaks down in a Chapter 7 or 13 case because generally no business reorganization is involved. Second, the paradigm may be susceptible to an attack built on Section 362(a)(3). Section 362(a)(3) proscribes any act to exercise control over the debtor's property. In defending the paradigm, it is difficult to argue that effecting an administrative freeze is not an act to exercise control over the debtor's property. Each perceived chink in the cash collateral paradigm's armor will be addressed in turn.

By its terms, Section 363(c) is limited to business reorganization situations. Thus, it appears that the paradigm does not apply to Chapter 7 or 13 cases. Nonetheless, the paradigm implicitly covers the Chapter 7 situation. The Code strikes a balance between the debtor's interest in reorga-

the bankruptcy process. See Note, *supra* note 169, at 1503-06.

¹⁷⁹ Of course, it is generally the unsecured creditors, and possibly the owners, who most dramatically benefit from the collective process.

¹⁸⁰ 12 Bankr. 390 (W.D. Va. 1981). An unsecured creditor will prefer bankruptcy in jurisdictions which follow the *Kenney's Franchise I* rule where a creditor possesses a substantial setoff right because a creditor who is unable to freeze the account may forever lose its setoff right while the debtor attempts to make a go of the enterprise.

nizing and the creditor's interest in specific collateral. The result struck is the allocation of the rights and duties embodied in Section 363(c). Why, then, would the procedure be more favorable to a debtor in a Chapter 7 case when the debtor's interest in reorganizing is nonexistent, leaving only the creditor's interest as the remaining legitimate factor? The legislative history recognizes this result, stating that "[i]n a liquidation case, any set-off that occurs after the commencement of the case has no effect on the debtor . . . [i]t will not interfere with the debtor's operation or business in any way, because the debtor has already gone out of business."¹⁸¹ Thus, the paradigm survives this attack largely because it is superficial.

There is, however, merit to the argument that the cash collateral paradigm weakens in the Chapter 13 scenario. There, one confronts the reorganization goal in a different context; instead of the reorganization of a business, Chapter 13 concerns itself with the reorganization of an individual's debts. While the paradigm is still persuasive in that it strikes a balance between legitimate debtor and creditor interests, one cannot deny that Section 363(c) limits itself to business reorganizations. Thus, a court cannot blindly apply the paradigm because of this apparent glitch. The court, nevertheless, should analogize to the Chapter 11 cases, embracing the cash collateral paradigm even though it may not neatly fit into the Chapter 13 scenario. The reason for this approach rests on the role that adequate protection plays in the contest over the use of cash collateral.

The linchpin of the cash collateral paradigm is that for the debtor to gain access to certain funds in which a creditor asserts a secured claim, it must generally provide to the creditor some form of adequate protection. Absent consent, a debtor is not entitled to use cash collateral without providing adequate protection to the creditor who claims an interest in the cash collateral. Why should this creditor protection be unavailable in the Chapter 13 case? In the Chapter 13 case, the cash collateral paradigm permits the debtor to use cash collateral, but he must pay a price to do so; the price the Code extracts from the debtor is adequate protection.

The second method by which the cash collateral paradigm may be attacked rests on the 1984 amendments to Section 362. These amendments prohibit any act to exercise control over the debtor's property.¹⁸² The

¹⁸¹ H.R. REP. NO. 595, 95th Cong., 1st Sess. 183, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6143-44.

¹⁸² *See* 11 U.S.C. § 362(a)(3) (1988). Section 362(a)(3) is a logical counterpart to §§ 542 (turnover of property to the estate) and 543 (turnover of property by a custodian) which aid the trustee in obtaining property of the estate from third parties. *COLLIER ON BANKRUPTCY* ¶ 362.04[3] at 362-35 (15th ed. 1988).

court in *In re Williams*¹⁸³ grappled with this issue but unfortunately dodged the import of the amendments by employing a convenient canon of construction. One author invokes the 1984 amendments to support his conclusion that the freeze may violate the automatic stay in appropriate circumstances.¹⁸⁴

The problem with reading Section 362(a)(3) broadly is that the section can swallow whole many provisions in the Code that protect creditors. For example, a creditor's failure to consent to the use of cash collateral under Section 363 in the typical cash collateral situation may be viewed as exercising control over the debtor's property.¹⁸⁵ Such a result was certainly not intended by Congress. Congress was well aware of the conflicting cases on the freeze issue before it enacted the 1984 amendments. It should have spoken with a clear voice if it meant to proscribe the use of the freeze. Its failure to do so highlights the fact that the purpose of Section 362(a)(3) was not to proscribe the use of the freeze, but rather to aid the bankruptcy trustee in obtaining property of the estate from third parties under Sections 542 and 543 and to prevent the dismemberment of the estate.¹⁸⁶

CONCLUSION

Greek legend tells of a bandit named Procutus who guarded a mountain pass, stopping all travelers on their way. He had a bed and would force the traveler to lie on it. If the traveler was too tall for the bed, Procutus cut off his legs; if the traveler was too short, Procutus stretched the traveler out, pulling out his legs and arms until he fit. The administrative freeze is a Procutus bed; each relevant Code section is like the unwary traveler in Procutus' day. None seem to fit the bed just right.

The Code contains a mechanism by which the contest between a creditor possessing a right to setoff and the debtor whose funds are subject to setoff can be resolved. Section 363(c) of the Code provides the appropriate paradigm. Furthermore, the policies of the Code embodied in Sections 363(c), 506(a), 542, and 553 are furthered by the application of the cash collateral paradigm. While furthering the policies embodied in those sec-

¹⁸³ 61 Bankr. 567 (Bankr. N.D. Tex. 1986).

¹⁸⁴ See Comment, *supra* note 88, at 106.

¹⁸⁵ Accord 2 COLLIER ON BANKRUPTCY ¶ 362.04 at 362-41 - 362-42 & n.30(a) (15th ed. 1988). See H.R. REP. NO. 595, 95th Cong., 1st Sess. 341, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6297-98.

¹⁸⁶ See 2 COLLIER ON BANKRUPTCY ¶ 362.04 at 362-35 (15th ed. 1988).

tions, the cash collateral paradigm does not hamper the policies embodied in Section 362 of the Code. The creditor cannot setoff its claim without relief from the automatic stay. The debtor is not denied access to the funds without recourse. Rather, the debtor has the two alternatives provided for in Section 363(c). The paradigm does not lock out the debtor from access to its funds. The cash collateral paradigm does not compromise the automatic stay principle by balancing it with the setoff, turnover, and cash collateral principles. The paradigm accommodates it.

The issue of whether the administrative freeze violates the automatic stay has engendered considerable judicial debate. What many of the cases have failed to recognize is that the resolution of the issue calls into question the essence of the tension between a debtor and its creditors in bankruptcy. In a Chapter 11 or 13 case, and to some extent in a Chapter 7 case, the debtor must be able to tap as many resources as possible. Cash collateral is the lifeblood of a successful reorganization. However, the arguments that may be advanced by a debtor in attempting to persuade a court that an administrative freeze violates the automatic stay are arguments that apply equally to any form of cash collateral contest. The Code provides a mechanism by which the debtor can attempt to alleviate the harm of the denial of the use of its funds in which a creditor has a secured interest. It is this avenue of redress to which the debtor must turn.

