

The Creditor in Possession Under the Bankruptcy Code: History, Text, and Policy

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Articles

THE CREDITOR IN POSSESSION UNDER THE BANKRUPTCY CODE: HISTORY, TEXT, AND POLICY

THOMAS E. PLANK*

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INTRODUCTION

A creditor often takes possession¹ of property items owned by its borrower. Sometimes a creditor takes possession to create or to perfect a security interest in the property items.² At other times, a creditor obtains possession of the property items after the borrower's default to sell them and to collect the debt.³ If a borrower becomes a debtor under the Bankruptcy Code,⁴ the bankruptcy trustee or the

1. A creditor cannot "possess" intangible property items, like an account, but it can exercise control through various means, such as by giving notice to the account debtor of its interest in an account. To avoid repeating "possession or control" throughout this Article, I use "possession" to include "control" of these intangible property items when speaking generally. In some contexts, however, such as the perfection of a security interest in tangible property items by possession, "possession" does not include the concept of control of an intangible property.

2. See U.C.C. § 9-203(1)(a) (1995) (the prior official text previously adopted in all 50 states) [hereinafter 1995 U.C.C.] (attachment); *id.* §§ 9-304, 9-305 (perfection); see also U.C.C. §§ 9-203, 9-312(b), 9-313, 9-314 (1999) (current official text, to be effective July 1, 2001) [hereinafter 1999 U.C.C.] (allowing or requiring possession for attachment or for perfection).

Formerly, possession was necessary to perfect a security interest in certificated securities, but now filing a financing statement will perfect. See 1995 U.C.C. § 9-115(4)(b) (amending U.C.C. § 9-304(1) (1990)); 1999 U.C.C. § 9-312(a). Under the 1999 U.C.C., a security interest in instruments may also be perfected by filing. 1999 U.C.C. § 9-312(a). For security interests in deposit accounts (1999 U.C.C. § 9-327(1)), investment property (1995 U.C.C. § 9-115(5)(a); 1999 U.C.C. § 9-328(1)), chattel paper (1995 U.C.C. § 9-308; 1999 U.C.C. 9-330(a), (b)), letter of credit rights (1999 U.C.C. § 9-329(1)), and instruments (1995 U.C.C. § 9-308; 1999 U.C.C. § 9-330(d)), a secured creditor in possession or control can have priority over a secured creditor perfected only by filing.

For assignments of rights to payment excluded from Article 9 of the U.C.C., *e.g.*, 1995 U.C.C. §§ 9-104(f), (g); 1999 U.C.C. § 9-109(d)(8), notice of the assignment may be necessary to perfect a security interest. See *In re Expressco, Inc.*, 99 B.R. 395, 396 (Bankr. M.D. Tenn. 1989) (holding that a security interest in the borrower's right to a refund of unearned insurance premiums is excluded from Article 9 and Tennessee statutory law and must be perfected by notice to the insurance company under Tennessee common law); *Tifco, Inc. v. U.S. Repeating Arms Co.* (*In re U.S. Repeating Arms Co.*), 67 B.R. 990, 997 (Bankr. D. Conn. 1986) (reaching the same conclusion that notice is required, but under a Maryland insurance premium financing statute); see also Dan T. Coenen, *Priorities in Accounts: The Crazy Quilt of Current Law and a Proposal for Reform*, 45 VAND. L. REV. 1061, 1069-70, 1124-28 (1992) (explaining that notice of assignment must be given to a debtor in many jurisdictions).

3. See 1995 U.C.C. § 9-502(1) (allowing a secured party to collect any accounts assigned as security upon default); *id.* § 9-503 (allowing a secured party to take possession after default). An unsecured creditor may also obtain possession or cause a state official to obtain possession of the property items to enforce a judgment. See, *e.g.*, CAL. CIV. PROC. CODE §§ 700.030-200 (West 1987 & Supp. 1999); NEW YORK C.P.L.R. § 5232 (McKinney 1997).

4. 11 U.S.C. §§ 101-1330 (1994), enacted by the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

borrower, as debtor in possession, often tries to retrieve the property items from the creditor in possession.⁵

Despite the absence of any express statutory authority, in 1983, the Supreme Court ruled that a reorganizing⁶ debtor could recapture property items from a creditor who was rightfully in possession. In *United States v. Whiting Pools, Inc.*,⁷ the Court held that section 542(a) of the Code authorized a bankruptcy court to direct the Internal Revenue Service, which had seized all the goods of Whiting Pools to obtain repayment of past due taxes, to return the seized goods to Whiting Pools after it filed a chapter 11 bankruptcy petition.⁸ Courts have generally followed and extended this decision.⁹ Moreover, some scholars believe that Congress really intended that creditors who have

5. In this Article, a "creditor in possession" is a creditor who has possession before the filing of the bankruptcy petition of property items owned by the debtor. The term does not refer to a creditor who obtains possession after the commencement of the case.

6. There is explicit language requiring the return of property items to a debtor for the purpose of liquidating the item under some circumstances. See *infra* Part III.B.2. I exclude from this scenario a reorganizing debtor's attempt to obtain possession through one of the explicit avoidance powers. The most common example is avoiding the transfer of possession of tangible property items as a preference. See 11 U.S.C. § 547(b) (1994). Transfer of possession to a previously unsecured judgment creditor as the result of a levy or garnishment would be a preference unless the transfer occurred more than 90 days (or one year if the creditor were an insider) before the filing of the petition. *Id.* § 547(b)(4)(A), (B). If, however, a previously secured creditor has foreclosed on property items, then the transfer of possession would not be a preference because it would not meet the element of section 547(b)(5) that the transfer enable the creditor to receive more than it would have received in a chapter 7 liquidation if the transfer had not been made. In addition, if the creditor has failed to perfect its interest in certain intangible property items by filing a financing statement, the transfer of control could be avoided under the strong arm power. See 1995 U.C.C. § 9-302; 1999 U.C.C. § 9-310(a) (generally requiring filing to perfect a security interest); 11 U.S.C. § 544(a) (authorizing the trustee's strong arm powers). The transfer of control of an intangible property item—such as by notifying an account debtor on an account to pay the secured creditor—would not perfect the security interest. Transfer of possession of tangible property items would in most cases perfect the security interest. See 1995 U.C.C. §§ 9-304, 9-305; 1999 U.C.C. § 9-313(a) (allowing or requiring perfection by possession).

7. 462 U.S. 198 (1983).

8. *Id.* at 209. After Whiting Pools, Inc., failed to pay approximately \$92,000 in federal income taxes and Federal Insurance Contribution Act taxes withheld from employees, the Internal Revenue Service seized all of Whiting Pools's personal property pursuant to the Federal Tax Lien Act, 26 U.S.C. §§ 6321-6334 (1976), to collect the unpaid taxes. See *Whiting Pools*, 462 U.S. at 200-01. The next day Whiting Pools filed a chapter 11 petition in bankruptcy and as debtor in possession sought an order pursuant to section 542(a) of the Bankruptcy Code requiring the IRS to return the seized goods to the debtor in possession to enable it to reorganize. See *id.*

9. See Thomas E. Plank, *The Outer Boundaries of the Bankruptcy Estate*, 47 EMORY L. REV. 1193, 1263-86 (1998) [hereinafter *Bankruptcy Estate*] (surveying post-*Whiting Pools* decisions and explaining how those cases have followed and expanded the ruling).

repossessed property items owned by a debtor should return them to the bankruptcy trustee or debtor in possession.¹⁰

Nevertheless, *Whiting Pools* is dead wrong.¹¹ The United States Bankruptcy Code provides absolutely no support for its conclusion. Section 542(a) requires, in effect, that an entity in possession or control of property of the estate must deliver that property to a reorganizing debtor.¹² Under section 541(a)(1) "property of the estate" consists primarily of "all the legal or equitable interests of the debtor in property as of the commencement of the case."¹³ Thus the property of *Whiting Pools*'s estate consisted not of the goods possessed by the IRS but of the *interests* of *Whiting Pools* in the goods, its equity interests. These interests were only its right to any surplus from the sale of the goods, its right to redeem the IRS's lien on the goods by paying the amount of taxes due, and its right to notice of the foreclosure sale.¹⁴ The IRS did not have custody or control over these interests, and thus section 542(a) did not apply to the IRS.

The Court acknowledged that, under the plain meaning of the definition of property of the estate, section 542(a) would not require the turnover of the goods in the creditor's possession.¹⁵ To avoid the import of the statute, the Court asserted, without analysis, that the definition of property of the estate was not exclusive.¹⁶ Freed from

10. See, e.g., Charles Jordan Tabb, *The Bankruptcy Reform Act in the Supreme Court*, 49 U. PITT. L. REV. 477, 507-14, 510 n.219 (1988) (acknowledging the weakness of the Court's statutory analysis in the *Whiting Pools* decision but contending that the legislative history and policy of 11 U.S.C. § 542(a) supported the decision).

11. See Plank, *Bankruptcy Estate*, *supra* note 9, at 1196-97, 1234-63 (critiquing the Court's analysis in *Whiting Pools*, and explaining why it should no longer be considered good law).

12. 11 U.S.C. § 542(a) (1994), *quoted infra* note 252. Section 542(a) requires an entity "in possession, custody, or control . . . of property that the trustee may use, sell, or lease under section 363" to deliver that property to the trustee. *Id.* Pursuant to the relevant subsections of section 363, the trustee "may use, sell, or lease property of the estate." *Id.* § 363(b), (c), *quoted infra* note 222. Section 363(f) also authorizes a trustee under certain circumstances to sell property items in which the estate and another entity have an interest. See *infra* Part III.B.2. This subsection did not apply in *Whiting Pools* because the debtor in possession did not want possession to sell the goods. *Whiting Pools*, 462 U.S. at 203-04.

13. 11 U.S.C. § 541(a)(1) (1994). The section reads, in part:

(a) 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.

14. See *infra* notes 267, 282-284 and accompanying text (discussing an owner's interests in property items subject to a security interest and in the possession of a creditor).

15. See *Whiting Pools*, 462 U.S. at 203, *discussed infra* notes 278-284 and accompanying text; see also *infra* notes 232-234, 321-323 and accompanying text.

16. See *Whiting Pools*, 462 U.S. at 203, *quoted infra* in text accompanying note 285.

the constraint of the statute, the Court relied on legislative history and policy to conclude that the debtor in possession, *Whiting Pools*, could regain possession of the goods.¹⁷

The Court's reliance on legislative history is particularly weak. The legislative history that it cited consists solely of (1) the testimony of witnesses before Congress urging that the Code contain such a turnover power and (2) the later appearance of section 542, which, by its terms, does not explicitly implement the witnesses' suggestion.¹⁸ Moreover, the Court missed the statement of the Code's sponsors that Congress intended section 542(a) to apply to property items acquired by the estate *after* the filing of the petition.¹⁹ Because the IRS, as the creditor in possession, obtained possession before the commencement of the case, this direct legislative history would dictate a different result.

The Court also relied on the general congressional policy favoring reorganization.²⁰ Because the Court did not focus specifically on the creditor in possession, the Court's policy analysis is insufficient. Indeed, a strong case can be made that *Whiting Pools* is wrong as a matter of policy. *Whiting Pools* gives inordinate power to an inept debtor who not only has failed, but who has waited until after a creditor has repossessed its property items to file for reorganization. Few chapter 11 petitions end in a reorganized debtor, and most do not even result in confirmed plans.²¹ The Code gives to debtors in reorganization the power to continue to use the assets in their possession that would otherwise be available to unsecured and undersecured creditors, who receive no interest on their claims during the bankruptcy case.²² The policy implemented by the Code's specific language that supports this state of affairs does not, however, in and of

17. See *Whiting Pools*, 462 U.S. at 203-04, 207-09.

18. See *id.* at 204; *infra* notes 224-229, 236-243, 287 and accompanying text (discussing in detail the legislative history on which the Court relied and criticizing the Court's use of this legislative history); *infra* notes 232-234, 321-323 and accompanying text (explaining why the language of section 542(a) does not implement the witnesses' suggestions).

19. See *infra* note 254 and accompanying text; see also note 252 and accompanying text (describing the amendments to section 542(a) during the legislative process that the Court in *Whiting Pools* missed).

20. *Whiting Pools*, 462 U.S. at 203-04, discussed *infra* note 430 (discussing the Court's understanding of why Congress favors reorganization).

21. See *infra* note 422 and accompanying text (discussing the likelihood of reorganization under chapter 11).

22. See 11 U.S.C. § 502(b)(2) (1994) (disallowing unmaturing interest on claims); *United Sav. Ass'n v. Timbers of Inwood Forest Assoc.*, 484 U.S. 365, 370 (1988) (holding that the right of an undersecured creditor to adequate protection does not include interest payments to compensate the creditor for the delay of foreclosure caused by the bankruptcy case).

itself justify requiring creditors in possession to return property items to a debtor who has filed a chapter 11 petition. If an undersecured creditor in possession, like the IRS in *Whiting Pools*, can retain possession, it can force the debtor either to liquidate or, if there is a realistic prospect for reorganization, to act quickly to propose and to confirm a plan.²³

In later decisions, and in particular the 1995 decision of *Citizens Bank of Maryland v. Strumpf*,²⁴ the Court removed the logical underpinnings for the rationale of *Whiting Pools*. In a situation analogous to *Whiting Pools*,²⁵ the Court limited the meaning of “property of the estate” to the specific definition in the Code.²⁶ If the definition of property of the estate is so confined, section 542(a) cannot be read to give a reorganizing debtor in possession a right to turnover.

Accordingly, as I have argued in greater detail elsewhere,²⁷ the combination of *Whiting Pools*’s inherent flaws—in particular its ignorance of direct contradictory legislative history—and the Court’s later decision in *Strumpf* require that *Whiting Pools* no longer be considered good law. Although this position is not yet widely recognized, the predominant view of *Whiting Pools* should change.²⁸ Courts and scholars have not yet appreciated the analytical significance of *Strumpf*. In addition, the Court’s failure to notice the direct legislative history that

23. See *infra* notes 343-357, 419-427 and accompanying text.

24. 516 U.S. 16 (1996).

25. In *Strumpf*, a bank had put an administrative hold on a checking account of the debtor to preserve its right to set-off a debt owed by the debtor. The Court held that such an administrative hold was not exercising control over “property of the estate” since the property of the estate was not the money in the debtor’s account, but the debtor’s contract right to withdraw money, subject to the bank’s right of set-off. *Id.* at 20. The creditor in *Strumpf* with a right of set-off in intangible property, the debtor’s account, and the creditor in *Whiting Pools* with possession of goods pursuant to a lien were both creditors holding a secured claim in a property item in which the debtor claimed an interest. In both cases, the creditor had gained control of the property item before bankruptcy. Yet, the creditor in *Strumpf* was able to retain control over the debtor’s account and was not required to release the debtor’s account to the debtor, while the IRS in *Whiting Pools* was required to relinquish possession of the goods it rightfully held.

26. See *id.*

27. See Plank, *Bankruptcy Estate*, *supra* note 9, at 1259-63.

28. The United States Court of Appeals for the Eleventh Circuit took a step in the right direction in *Charles R. Hall Motors, Inc., v. Lewis (In re Lewis)*, 137 F.2d 1280 (11th Cir. 1998). The court of appeals ruled that the only interest of a debtor in a car repossessed by a creditor prepetition was the debtor’s right to redeem the car by paying the full amount of the secured debt, and not the car itself, and therefore the car was not subject to turnover under section 542(a). *Id.* at 1285. The import of the case is lessened, however, because the court distinguished *Whiting Pools* on the questionable ground that under state law—Alabama law—repossession by a secured creditor transferred ownership as well as the right to possession to the creditor. *Id.* at 1283-84, 1285 n.8.

destroys its remaining rationale has only recently become publicly noted.²⁹

Therefore, it is worth contemplating to what extent the Code requires a creditor in possession of property items owned by the debtor to return them to the trustee or to the debtor in possession. A repudiation of *Whiting Pools* does not necessarily give every creditor in possession freedom to retain or to sell the property items in satisfaction of its claim. Instead, an analysis of several provisions of the Code provides comprehensive guidance on when and under what circumstances the creditor in possession may sell the property items, may retain them, or must return them.

Judges and scholars have debated whether a pure textualist analysis that eschews legislative history and speculation about policy is a useful method of statutory interpretation.³⁰ Whatever the general merits of each side in that debate, in the case of the creditor in possession, a pure textualist analysis produces a coherent resolution of the competing interests between the creditor in possession and a liquidating or reorganizing debtor—or more precisely, the debtor's unsecured creditors, since a debtor is generally insolvent. It also more probably reflects the actual intention of Congress than the most direct

29. I discussed this legislative history in Plank, *Bankruptcy Estate*, *supra* note 9, at 1251-52. As far as I know, no one else has publicly discussed the Court's failure to find the direct legislative history explaining a last minute change to section 542(a), discussed *infra* notes 252-254 and accompanying text. The United States in its brief also did not cite this legislative history. This omission is somewhat surprising in view of the advice of Kenneth Klee that scholars and courts should first consult the latest statements of the floor managers about the final changes in the Code before looking at the House and Senate reports. See Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941, 957-58 (1979). Kenneth Klee was an associate counsel to the House Committee on the Judiciary and one of the drafters of the Code.

30. See, e.g., William N. Eskridge, *The New Textualism*, 37 UCLA L. REV. 621 (1990) (examining the shortcomings of a pure textualist approach but arguing for greater judicial restraint in resorting to legislative history); Roger Colinvaux, Note, *What Is Law? A Search for Legal Meaning and Good Judging Under a Textualist Lens*, 72 IND. L. REV. 1133 (1997) (analyzing the advantages and flaws of textualism); Adam James Wiensch, Note, *The Supreme Court, Textualism, and the Treatment of Pre-Bankruptcy Code Law*, 79 GEO. L.J. 1831, 1836-38, 1854-62 (1991) (noting the debate over the Court's use of textualism in bankruptcy cases and offering several reasons for such use). Some scholars have criticized the "textualist" approach taken by some members of the Court in interpreting the Code. See Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases*, 47 SYRACUSE L. REV. 1, 101-06 (1996) (arguing that the Court's use of textualism fails to advance its stated goals of constraining a federal judiciary and also that it creates uncertainty in applying the Code); Charles Jordan Tabb & Robert M. Lawless, *Of Commas, Gerunds, and Conjunctions: The Bankruptcy Jurisprudence of the Rehnquist Court*, 42 SYRACUSE L. REV. 823, 826-27, 879-85, 891 (1991) (arguing that the Court's reliance on textualism has prevented the development of a coherent bankruptcy jurisprudence and has created uncertainty in the bankruptcy community).

legislative history, which not only nullifies *Whiting Pools* but also ignores those provisions of the Code that do authorize a turnover order against a creditor in possession. Further, an analysis of the pre-Code practice and the relevant policy considerations shows that a textualist analysis is as reasonable a resolution of the competing interests as the current anti-textual result of *Whiting Pools*.

I address these points as follows: Part I reviews the rights of and limitations on the creditor in possession under the Bankruptcy Act of 1898. Under the 1898 Act, when a debtor was liquidating, the creditor in possession had a free hand to sell the property items to collect the secured debt. When a debtor was reorganizing, however, the creditor in possession could be prevented from liquidating the property items and in some cases could be required to return them. Courts, however, would generally interfere with the creditor's right to sell or to retain the property items only if the debtor had positive equity in them and there was a reasonable prospect of reorganization.

Part II discusses the drafting history of the provisions of the Code affecting the creditor in possession. As this part shows, Congress expressly expanded the automatic stay of creditor foreclosure action but eliminated some of the express provisions of the 1898 Act that authorized a turnover order. Congress also rejected several suggestions that the Code expressly require a repossessing creditor to return property items to a reorganizing debtor. The complete legislative history refutes any general right of a reorganizing debtor to require the return of property items held by a creditor.

Part III analyzes the Code sections that govern a creditor in possession. This analysis produces the following results:

- (1) *Automatic stay*. The automatic stay prevents a creditor in possession from foreclosing its security interest (as an act to collect a claim, and not, as many think, as an act to control property of the estate). The creditor may get relief from the stay if the debtor has no positive equity in those items—that is, the value of the items exceeds the amount of

the creditor's claim³¹—and the property items are not necessary for reorganization.³²

(2) *Turnover*. The trustee (including, as applicable, the debtor in possession under chapters 11 and 12, and the debtor under chapter 13) may regain possession of property items held by a creditor in possession under the following circumstances:

(a) The trustee redeems the creditor's security interest.

(b) The estate has a positive equity in the property items and the trustee seeks possession to sell them and to pay the creditor's claim.

(c) In reorganizations under chapter 11 or adjustment of debts under chapters 12 or 13, the confirmed plan requires the return of the property items.

In all cases, until the trustee has the right to possession, the creditor may retain possession of the property items. Until the creditor gets relief from the stay, however, the creditor may not liquidate them.

Part IV describes how the results of the textualist analysis harmonize the nonbankruptcy and bankruptcy policies. The nonbankruptcy right of a creditor to liquidate the property items in its possession and the right of the borrower to redeem a security interest follow the long-standing policies of freedom of alienation and freedom of contract. More specifically, these rights facilitate the transfer of assets from less productive users to more productive users or, if appropriate, the retention of assets by a productive user. In addition, redemption of the creditor's possessory interests or liquidation by the trustee honors the bankruptcy policy of having the trustee, who has a greater incentive than an oversecured creditor, maximize the debtor's assets for distribution to unsecured creditors.

When redemption or liquidation is not desirable, requiring creditors to return possession to a reorganizing debtor only if the plan so provides and allowing the creditor to retain possession until confirmation balances the nonbankruptcy policy favoring the most efficient allocation of resources and the bankruptcy policy favoring the cost-

31. I distinguish between "equity" or "positive equity" and a debtor's "equity interest." An owner of property subject to a security interest by definition has a property interest (i.e., equity interest) that embodies at the least the right of redemption, and any ancillary rights, like the right of notice of a foreclosure sale, and the right to receive any surplus. See Plank, *Bankruptcy Estate*, *supra* note 9, at 1202-03 (discussing the property rights comprising a debtor's equity interest); see also *infra* notes 267, 282-284 and accompanying text. If the value of the property is less than the amount of the secured claim, these rights may have no economic value, but they nevertheless constitute a property interest.

32. The creditor may also get relief from the automatic stay for cause under 11 U.S.C. § 361(d)(1) (1994), *discussed infra* notes 311-314 and accompanying text.

effective administration of bankruptcy cases. Retention of possession by the creditor until confirmation of a plan or a negotiated settlement would eliminate the incentives of the debtor to delay resolving the best use of the assets. It would drive unsalvageable businesses more quickly into liquidation and encourage debtors with a realistic prospect of reorganization to move faster toward a feasible reorganization. In the case of wage earners who seek an arrangement under chapter 13,³³ which requires a quicker proposal of a plan and allows for quicker confirmation, it would also honor the separate bankruptcy policy of providing a fresh start to individual debtors.

The textualist analysis does strengthen somewhat the hand of creditors who obtain possession of property items. Nevertheless, the textualist analysis is generally consistent with the bankruptcy policy of allowing a debtor or its unsecured creditors to stop the race of creditors to the courthouse or to the debtor's assets. Three facts temper whatever advantage that the creditor may obtain from prepetition possession. First, the automatic stay prevents the creditor from liquidating the property items. Second, oversecured creditors in possession may be forced to return the property items either by redemption or for liquidation. Third, undersecured creditors in possession will be forced to return the property items to a reorganizing debtor who has a real prospect of reorganization.

Because the creditor in possession may retain possession until the requirements for turnover are met, those who question the utility of secured credit³⁴ will object to the textualist analysis on more general policy grounds. Whatever one's views on the utility of secured credit,³⁵ there are two responses to this objection. First, to the extent that secured creditors have an "unfair" advantage over unsecured

33. 11 U.S.C. §§ 1300-1330 (1994).

34. See, e.g., Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1891 (1994) (arguing that "[s]ecurity tends to misallocate resources by imposing on unsecured creditors a bargain to which many, if not most, of them have given no meaningful consent").

35. Those who have challenged the efficiency of secured credit have not, in my view, sustained their burden. See David Gray Carlson, *Secured Lending as a Zero Sum Game*, 19 CARDOZO L. REV. 1635, 1639 (1998) (explaining why security interests may be efficient); David Gray Carlson, *On the Efficiency of Secured Lending*, 80 VA. L. REV. 2179, 2180 (1994) (same). I think that secured credit enhances social welfare generally, and in particular, enhances unsecured creditors, regardless of how much secured credit may hurt unsecured creditors in any one particular failed business enterprise. See also Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021, 2024-28 (1994) (arguing that, although the efficiency of security interests is an empirical question, the general policies favoring freedom of contract and freedom of alienation of property suggest that security interests are presumptively efficient); Homer Kripke, *Law and Economics: Measuring the Economic Efficiency of*

creditors, the appropriate balance should be addressed in nonbankruptcy secured credit law.³⁶ Second, even if bankruptcy law were the appropriate place for such adjustment, in a democratic society in which federal judges have life tenure³⁷ and bankruptcy judges are appointed by federal judges,³⁸ Congress, and not the courts, should make the adjustment.

I. THE CREDITOR IN POSSESSION UNDER THE 1898 BANKRUPTCY ACT

An understanding of the rights of a creditor in possession under the Bankruptcy Act of 1898,³⁹ the immediate predecessor to the current Bankruptcy Code,⁴⁰ is a necessary starting point for understanding the treatment that creditors in possession should receive under the Bankruptcy Code. Generally, in liquidations under the Bankruptcy Act, bankruptcy courts did not interfere with the rights of the creditor in possession. In reorganizations under the Act, however, creditors in possession of property items could be prevented from liquidating them and, in some cases, could be required to return them to the trustee. Significantly, the authority to interfere with the rights of the creditor in possession derived either from express statutory provisions or from judicial extrapolation of the equity jurisdiction of the district court (sitting as the bankruptcy court) over the debtor's "property." Moreover, courts generally allowed such interference only when the debtor had equity in the property items in the creditor's possession and when there was a reasonable possibility of a successful reorganization.

Commercial Law in a Vacuum of Fact, 133 U. PA. L. REV. 929, 941-55, 971-79 (1985) (explaining the benefits of and necessity for secured credit in different lines of business).

36. See, e.g., Elizabeth Warren, *An Article 9 Set-Aside for Unsecured Creditors*, 51 CONSUMER FIN. L.Q. REP. 323, 323, 325 (1997) (proposing that the U.C.C., and not the Bankruptcy Code, be revised to provide that twenty percent of a borrower's assets be available for lien creditors without regard to the existence of prior security interests). See generally Douglas Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 816-18, 822-34 (1987) (arguing for consistency between loss distribution that occurs outside of bankruptcy and loss distribution that occurs within bankruptcy).

37. See U.S. CONST. art. III, § 1.

38. See 28 U.S.C. § 152(a)(1) (1994).

39. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898) (codified as amended at 11 U.S.C. §§ 101-1103 (1976 & Supp. II 1978) (repealed 1978)).

40. 11 U.S.C. §§ 101-1330 (1994).

A. Debtor Liquidation

The original Bankruptcy Act of 1898 provided a procedure for the liquidation of an insolvent bankrupt.⁴¹ This Act did not directly regulate creditors in possession. Most of the law concerning creditors in possession⁴² was case law analyzing the jurisdiction and powers of the United States district court sitting as a bankruptcy court.⁴³

Under the Act, the bankruptcy court initially had jurisdiction in law or in equity to carry out nineteen enumerated powers.⁴⁴ This jurisdiction was known as "summary jurisdiction."⁴⁵ If a trustee in bankruptcy sought relief outside of the bankruptcy court's summary jurisdiction, she had to bring a "plenary" action in the appropriate state or federal court.⁴⁶

Under the judicial interpretations of the Act, the bankruptcy court had summary jurisdiction only over property items in the actual or constructive possession of the bankruptcy trustee.⁴⁷ The trustee

41. A bankrupt could propose to his creditors a plan for the composition of his debts, and the composition could be confirmed only with the consent of a majority of the creditors whose claims had been allowed (measured by both the number of creditors and the amount of allowed claims). See Bankruptcy Act, ch. 541, § 12, 30 Stat. 544, 549-50 (1898) (codified as amended at 11 U.S.C. § 30 (1926) (repealed 1933)). Corporations seeking to reorganize used the equity receivership, discussed *infra* note 67, more often than they used section 12. See 6 COLLIER ON BANKRUPTCY ¶ 0.01, at 5-6 (James Wm. Moore ed., 14th ed. 1978). Congress added provisions for the reorganization of debtors beginning in 1933. See *infra* Part I.B.

42. The exceptions were specific provisions dealing with an unsecured creditor who obtained a lien on property items of the debtor within four months of the filing of the petition. See *infra* note 56.

43. See *infra* note 47 (citing cases and other authorities analyzing the powers of bankruptcy courts); see also Bankruptcy Act, ch. 541, §§ 1(8), 2, 30 Stat. 544, 544 (1898) (codified as amended at 11 U.S.C. §§ 1(10), 11 (1976) (repealed 1978)) (delineating the jurisdiction of the bankruptcy courts). Much of the jurisdiction of the bankruptcy court was delegated to referees, the precursors of the bankruptcy judge, under Bankruptcy Act, ch. 541, § 38, 30 Stat. 544, (1898) (codified as amended at 11 U.S.C. § 66 (1976) (repealed 1978)) (prescribing the powers and responsibilities of referees).

44. Bankruptcy Act, ch. 541, § 2, 30 Stat. 544, 544 (1898) (codified as amended at 11 U.S.C. § 11(a) (1976) (repealed 1978)). This list was later expanded to 23 enumerated powers. See Bankruptcy Act, § 2(a) (20), added by Act of June 25, 1910, ch. 412, 36 Stat. 838, 838; *id.* § 2(a) (21), added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 844; *id.* § 2(a) (22), added by Pub. L. No. 87-681, § 2, 76 Stat. 570, 570 (1962); *id.* § 2(a) (2A), added by Pub. L. No. 89-496, 80 Stat. 270, 270 (1966).

45. See 1 COLLIER, *supra* note 41, ¶ 2.06, at 152-58 (discussing the scope of summary jurisdiction).

46. See Bankruptcy Act, ch. 541, § 23, 30 Stat. 544, 552-53 (1898) (codified as amended at 11 U.S.C. § 46 (1976) (repealed 1978)).

47. See *Phelps v. United States*, 421 U.S. 330, 335-36 (1975) (holding that a referee, the predecessor of today's bankruptcy judge, could not use summary proceedings under the Bankruptcy Act to compel a creditor, the Internal Revenue Service, in possession of property items owned by the bankrupt, to return them to the referee); *Cline v. Kaplan*, 323 U.S.

had constructive possession, among other things, when the bankrupt had possession at the time of filing the petition, but failed to deliver the property items to the trustee; when the property items were removed from the possession of the trustee; or when the property items were in the possession of a bailee or agent of the bankrupt.⁴⁸ Further, the bankruptcy court had summary jurisdiction to adjudicate attempts by a trustee in bankruptcy to obtain property items in the possession of third parties who had no right to possess them,⁴⁹ such as a property item in the possession of officers of a corporate debtor.⁵⁰

These proceedings, which were known as "turnover proceedings" or proceedings for a "turnover order," did not apply to those who had a lawful adverse claim to possession of the property items, such as a creditor in possession.⁵¹ If a bankruptcy trustee had grounds to recover property items in the rightful possession of another person, including a creditor in possession, she had to institute a plenary

97, 98-99 (1944) (holding that the bankruptcy court did not have summary jurisdiction for a turnover order against persons in possession for 15 months before the filing of petition of property items alleged to belong to bankrupt); *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478, 481-83 (1940) (holding that the bankruptcy court in a section 77 railroad reorganization had summary jurisdiction to decide the extent of the trustee's title to land possessed by the trustee, but ordering that the issue be decided by plenary suit in state court); *White v. Schloerb*, 178 U.S. 542, 546-48 (1900) (holding that the bankruptcy court had power to compel a sheriff to return to the bankruptcy trustee property items owned by the estate that the sheriff had seized after the filing of the bankruptcy petition); see also 2 COLLIER, *supra* note 41, ¶ 23.04[2], at 453-63, ¶ 23.05, at 469-93 (analyzing summary jurisdiction); Jerrold L. Strasheim, *Fundamentals of Summary Jurisdiction in Straight Bankruptcy over Controversies Between Trustees and Third Persons*, 51 NEB. L. REV. 505, 505 (1972) (same); Morton P. Hyman, Note, *Bankruptcy: Jurisdiction Over Controversies: Summary and Plenary: Sections 2a and 23 of the Bankruptcy Act*, 44 CORNELL L.Q. 107, 112-14 (1958) (analyzing possession as a requirement for summary jurisdiction under the Bankruptcy Act).

48. See *Taubel-Scott-Kitzmilller Co., Inc. v. Fox (In re Cowen Hosiery Co.)*, 264 U.S. 426, 432-33 (1924) (describing when there is constructive possession of property items); 2 COLLIER, *supra* note 41, ¶ 23.05, at 480-83 (same).

49. See *Taubel-Scott-Kitzmilller*, 264 U.S. at 432-33 (1924); *White v. Schloerb*, 178 U.S. 542, 548 (1900).

50. See Joseph W. McGovern, *Aspects of the Turnover Proceeding in Bankruptcy*, 9 FORDHAM L. REV. 313, 315-32 (1940); 2 COLLIER, *supra* note 41, ¶ 23.06[3], at 506 & n.27.

51. See *A.J. Armstrong Co., Inc. v. Limperis (In re Process-Manz Press, Inc.)*, 369 F.2d 513, 515-17, 519 (7th Cir. 1966) (holding that the bankruptcy court did not have summary jurisdiction to adjudicate the validity of the security interest of a creditor in possession of real and personal property items); *Atlanta Flooring & Installation Co., Inc. v. Russell*, 146 F.2d 884, 885 (5th Cir. 1945) (stating that "[s]ummary jurisdiction may not be exercised to determine adverse claims to property not in the actual or constructive possession of the bankrupt at the time the petition in bankruptcy was filed"); *Marcell v. Engebretson*, 74 F.2d 93, 97-99 (8th Cir. 1934), *aff'd on reh'g*, 76 F.2d 876 (8th Cir. 1935) (*per curiam*) (finding that the bankruptcy court had no jurisdiction over property items in constructive possession of trustees appointed by state court to liquidate corporation); see also 2 COLLIER, *supra* note 41, ¶ 23.04, at 461 & n.30, ¶ 23.10, at 560-88 (analyzing the elements of turnover orders).

proceeding in the appropriate state or federal court.⁵² Accordingly, a bankruptcy trustee could not get a "turnover order" against creditors in possession.⁵³

Generally, a creditor in possession of collateral could liquidate the collateral without interference from the bankruptcy trustee.⁵⁴

52. Bankruptcy Act, ch. 541, § 23, 30 Stat. 544, 549-50 (1898) (codified as amended at 11 U.S.C. § 46 (1976) (repealed 1978)); see *Phelps*, 421 U.S. at 335-36 (observing that "where possession is held not for the bankrupt, but for others prior to bankruptcy . . . the holder is not subject to summary jurisdiction," and as such, "recourse is limited to a plenary suit" (internal quotation marks omitted) (quoting 2 COLLIER, *supra* note 41, ¶ 23.06, at 506)); 2 COLLIER, *supra* note 41, ¶ 23.04, at 464, ¶ 23.06, at 494-520 (analyzing adverse claims that must be adjudicated in plenary proceedings). The difference between summary jurisdiction and plenary jurisdiction made a substantive difference in the ability of the trustee to recover assets owned by the bankrupt but subject to a lien. See, e.g., *Phelps*, 421 U.S. at 333 n.2 (explaining that if property items subject to a tax lien are within the summary jurisdiction of the bankruptcy court, the tax lien would be subordinate to the expenses of administration and to priority wage claims, but that if the property items are not subject to summary turnover, they may be brought into the bankrupt estate only if the receiver is able to defeat the government's underlying tax claim in a plenary suit for refund); see also *Carney v. Sanders*, 381 F.2d 300, 302-03 (5th Cir. 1967) (holding that a trustee in bankruptcy for a debtor who had filed a state court action to repudiate a \$25,000 escrow agreement for the benefit of an employee was required to litigate the right to the escrow fund in the state court proceeding); *Schmitt v. Blackwelder*, 379 F.2d 278, 280-81 (2d Cir. 1967) (finding that the bankruptcy court did not have summary jurisdiction to determine the lienholder's and the bankruptcy trustee's rights to condemnation proceeds of real property in possession of receiver appointed to foreclose mortgage).

53. See *Dexter v. Gilbert (In re Kirchoff Frozen Foods, Inc.)*, 375 F. Supp. 156, 160, 163-65 (D. Ariz. 1972), *aff'd*, 496 F.2d 84, 86 (9th Cir. 1974) (holding that the bankruptcy court did not have summary jurisdiction to order an officer of the debtor to return the proceeds of accounts receivable owned by the debtor and retained by the officer when the officer had a substantial adverse claim as a secured creditor with a security interest in the accounts receivable); 2 COLLIER, *supra* note 41, ¶ 23.06[2], at 501-04 (recognizing that "if property is in the possession of the claimant, his claim is adverse," and is thus "subject only to a plenary suit to determine . . . [the claimant's] interest").

54. See, e.g., *Emil v. Hanley (In re John M. Russell, Inc.)*, 318 U.S. 515, 519-20 (1943) (holding that a state court receiver appointed to collect rents from real property pending foreclosure of a mortgage in default did not have to account to a bankruptcy trustee appointed pursuant to a bankruptcy petition filed two weeks after the appointment of the receiver); *Straton v. New*, 283 U.S. 318, 326 & n.6 (1931) (holding that the bankruptcy court could not enjoin a proceeding to foreclose a judicial lien obtained more than four months before filing a petition in bankruptcy for liquidation); *Kerr v. Southwestern Lumber Co.*, 78 F. 2d 348, 349 (5th Cir. 1935) (affirming an order enjoining a bankruptcy trustee from selling stock pledged to a creditor and not in the actual or constructive possession of the trustee and permitting the creditor, who had possession, to sell the stock to repay its debt); *Larry Peitzman & Margaret S. Smith, The Secured Creditor's Complaint: Relief from the Automatic Stays in Bankruptcy Proceedings*, 65 CAL. L. REV. 1216, 1218-19 (1977) (explaining that if a creditor were in possession of collateral, "then the bankruptcy may be disregarded and enforcement proceedings commenced"); Note, *The Enforcement of Collateral Agreements Between the Secured Creditor and the Bankrupt*, 36 VA. L. REV. 654, 659-62 (1950) (discussing the ability of a creditor in possession to sell pledged collateral).

There were a few exceptions. Some presented exceptional circumstances. See *Mann v. Peoples First Nat'l Bank & Tr. Co.*, 209 F.2d 570, 574-75 (4th Cir. 1954) (authorizing in-

The bankruptcy trustee could not prevent the liquidation or obtain possession of the collateral simply because the debtor had been adjudicated a bankrupt.⁵⁵ The trustee could prevent liquidation or obtain possession only if she had some independent basis, such as her ability to avoid a preferential lien.⁵⁶ These rules also applied to creditors who had obtained control over intangible property items, like an account.⁵⁷

junction, "until the petitions for adjudication in bankruptcy have been passed upon," against the pledgee holding stock of the corporation from selling stock when the pledgee, who had filed an involuntary bankruptcy petition against the corporation, admitted that he intended to purchase the stock and to cause the corporation to consent to an adjudication of bankruptcy); *Grabosky v. Kephart*, 72 F.2d 542, 542 (3d Cir. 1934) (upholding an injunction against the sale of assets pledged to a friendly creditor by a debtor seeking "to carry out a plan evilly conceived . . . to rob his real creditors"). A few other courts also enjoined creditors in possession from foreclosing their interests, but these decisions were not followed by later courts. See *In re Henry*, 50 F.2d 453, 455 (E.D. Pa. 1931) (affirming the referee's order enjoining the creditor's sale of pledged investment securities); *In re Purkett, Douglas & Co.*, 50 F.2d 435, 439 (S.D. Cal. 1931) (enjoining the sale of a debtor's property items held by a secured creditor as collateral).

55. See, e.g., *In re Hardman*, 189 F. Supp. 804, 808 (S.D. Ind. 1960) (holding that a referee may not issue a turnover order against a receiver in possession of real estate to foreclose a mechanics lien recorded more than four months before the filing of a bankruptcy petition by the owner of real estate).

56. Initially, the bankruptcy court did not have summary jurisdiction to avoid a preferential judicial lien on property obtained by a judgment creditor within four months before the filing of the petition or to order return of any property seized pursuant to the lien. See Bankruptcy Act, ch. 541, § 67, 30 Stat. 544, 564-65 (1898). Accordingly, the trustee had to sue in a plenary proceeding in the appropriate state or federal court. See *Taubel-Scott-Kitzmillier Co., Inc. v. Fox (In re Cowen Hosiery Co.)*, 264 U.S. 426, 430, 438 (1924) (holding that because the bankruptcy trustee did not have either actual or constructive possession, and because the creditor seasonably objected to the court's jurisdiction, "[t]he bankruptcy court . . . did not acquire jurisdiction over the controversy in summary proceedings").

In 1933, Congress gave the bankruptcy court summary jurisdiction for such proceedings. See Bankruptcy Act, § 67a(1), (4), as amended by Chandler Act, ch. 575, § 1, 52 Stat. 840, 876 (1938) (codified as amended at 11 U.S.C. § 107(a)(4) (1976) (repealed 1978)) (granting summary jurisdiction for judgment liens on property obtained by a creditor "within four months before the filing of a petition in bankruptcy"); see also *Wisconsin Furnace Supply Co. v. Kroog (In re Mercury Heating Co., Inc.)*, 322 F. Supp. 1161, 1162 (E.D. Wis. 1971) (holding that the bankruptcy court had summary jurisdiction under section 67(a) to invalidate garnishment liens obtained less than four months before bankruptcy); *Frank R. Kennedy, The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REFORM 177, 188 (1978) (noting that "Congress has explicitly conferred summary jurisdiction on the bankruptcy court to determine the issues under section 67a [of the Bankruptcy Act]"). The bankruptcy court could also enjoin the enforcement of such a lien pending the determination of the section 67(a) preference proceedings. See *id.* at 188 & n.62.

57. See *In re Siltuk Const. Corp.*, 38 F. Supp. 49, 50 (E.D.N.Y. 1941) (rejecting a bankruptcy trustee's attempt to invalidate a state court order, procured more than a year before the debtor's bankruptcy adjudication, that an obligor owing money to the debtor should pay it to a judgment creditor).

The liberal treatment of creditors in possession in liquidation cases continued until the adoption of the Bankruptcy Code in 1978. When the Supreme Court in 1973 adopted rules imposing an automatic stay of creditor actions in liquidation cases, the automatic stay did not generally extend to actions of creditors in possession of collateral.⁵⁸ Thus, the Bankruptcy Act generally respected the nonbankruptcy rights of creditors in possession in a liquidation case.

B. Debtor Reorganization

Between 1933 and 1938, Congress amended the Bankruptcy Act to provide for the reorganization of insolvent⁵⁹ debtors. Three new reorganization sections appeared in 1933: section 74 for persons

58. See FED. R. OF BANKR. P. 601(a), 411 U.S. 989, 1062 (1973) (repealed 1983, 460 U.S. 975):

The filing of a petition shall operate as a stay of any act or the commencement or continuation of any court proceeding to enforce (1) a lien against property in the custody of the bankruptcy court, or (2) a lien against the property of the bankrupt obtained within 4 months before bankruptcy by attachment, judgement, levy, or other legal or equitable process or proceedings.

See also *LaFortune v. Naval Weapons Ctr. Fed. Credit Union* (*In re LaFortune*), 652 F.2d 842, 849 (9th Cir. 1981) (holding that the postpetition execution sale of a home owned by a debtor in liquidation, as a result of a lien of more than four months age, did not violate the automatic stay); Kennedy, *supra* note 56, at 188, 203-05. The automatic stay under Bankruptcy Rule 601(a)(2), *supra*, against the enforcement of any judicial lien that arose within the four months before the filing of the petition, would include a possessory lien obtained by an unsecured creditor against property items owned by the bankrupt. See FED. R. OF BANKR. P. 601(a)(2), 411 U.S. 989, 1063 (1973) (repealed 1983), *quoted supra*; Kennedy, *supra* note 56, at 205 & n.155.

59. I use "insolvent" to mean either "insolvent" in a balance sheet sense, that is, liabilities exceed assets, or in a cash flow sense, that is, the debtor is unable to pay its debts as they become due. All of these amendments required insolvency in either sense. See Bankruptcy Act, §§ 74(a), 75(c), 77(a), *added by* Act of Mar. 3, 1933, ch. 204, § 1, 47 Stat. 1467, 1467, 1471, 1474 (requiring insolvency for noncorporate persons, farmers, and railroad corporations); *id.* § 77B(a), *added by* Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 912 (requiring insolvency for corporations) (repealed 1938); *id.* §§ 130, 323, 423, 623, *added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 896, 907, 923, 932 (1938) (codified as amended at 11 U.S.C. §§ 530, 723, 823, 1023 (1976) (repealed 1978) (requiring insolvency for reorganization under chapters X through XIII)).

For most debtors under the Code, the term "insolvent" means balance sheet insolvency. See 11 U.S.C. § 101(32)(A), (B) (1994) (defining insolvency for entities other than municipalities). For municipalities filing for bankruptcy relief under chapter 9 of the Code, "insolvent" means a form of cash flow insolvency: "generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or . . . unable to pay its debts as they become due." *Id.* § 101(32)(C)(i)-(ii). Cash flow insolvency also appears in 11 U.S.C. § 303(h)(1) (1994). I find the predominant use of "insolvent" to refer to balance sheet insolvency somewhat strange. The words "solvent" and "insolvent" more easily conjure up images of a cash flow solvency or insolvency: Whether a debtor has sufficient "liquid assets"—such as money and easily alienable property items, like publicly traded securities, that it can convert to cash quickly—to pay its current debts.

other than corporations; section 75 for farmers; and section 77 for railroads.⁶⁰ The following year, Congress added new section 77B to the Act to provide for the reorganization of corporations⁶¹ and in 1935 it amended and restated section 77 for railroads.⁶² Finally, pursuant to the 1938 Chandler Act, Congress replaced the more general reorganization sections, sections 74 and 77B, with four new chapters—chapter X for the reorganization of large corporations; chapter XI for the adjustment of the unsecured debt of smaller businesses; chapter XII for the adjustment of real estate debt of individuals and partnerships; and chapter XIII for the adjustment of debts of wage earners.⁶³ Each of the chapters and sections that authorized the reorganization of debtors extended the bankruptcy court's jurisdiction to the debtor and to his, her, or its "property, wherever located,"⁶⁴ and

60. Bankruptcy Act, §§ 73-77, *added by* Act of Mar. 3, 1933, ch. 204, 47 Stat. 1467. This act drew a distinction between "proceedings to adjudge persons bankrupt" and the new "proceedings for the relief of debtors." *Id.* § 73, 47 Stat. at 1467. The Act added new section 74 for persons other than corporations, section 75 for farmers, and section 77 for railroad corporations. Section 74 was replaced in 1938. Section 75 initially applied only to petitions filed within five years. *Id.* § 75(c), 47 Stat. at 1471. This deadline was eventually extended to March 1, 1949. *See* 5 COLLIER, *supra* note 41, at 101. Section 77, codified as amended at 11 U.S.C. § 205 (1976) (repealed 1978), remained in effect until the adoption of the Bankruptcy Code.

61. *See* Bankruptcy Act, § 77B, *added by* Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911 (codified as amended at 11 U.S.C. § 207 (1934) (repealed 1938)).

62. *See* Bankruptcy Act, § 77, *as amended by* Act of Aug. 27, 1935, ch. 774, § 1, 49 Stat. 911 (codified as amended at 11 U.S.C. § 205 (1976) (repealed 1978)).

63. *See* Bankruptcy Act, §§ 101-276 [ch. X], 301-399 [ch. XI], 401-526 [ch. XII], 601-686 [ch. XIII], *as added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 883-938 (codified as amended at 11 U.S.C. §§ 501-676 [ch. X], 701-799 [ch. XI], 801-926 [ch. XII], 1001-1086 [ch. XIII] (1976) (repealed 1978)).

In 1934, Congress had added a chapter IX dealing with the insolvency of governments and their agencies. *See* Bankruptcy Act, §§ 78-80, *as added by* Act of May 24, 1934, ch. 345, § 1, 48 Stat. 798, *as amended by* Act of April 10, 1936, ch. 186, § 1, 49 Stat. 1198, and Act of April 11, 1936, ch. 210, § 1, 49 Stat. 1203. The Supreme Court declared this Act unconstitutional in *Ashton v. Cameron County Water Improvement Dist. No. 1*, 298 U.S. 513, 531-32 (1936). Congress enacted a new chapter X for insolvent governments in 1937, Bankruptcy Act, §§ 81-84, *as added by* Act of Aug. 16, 1937, ch. 657, § 1, 50 Stat. 653, and renumbered this chapter to chapter IX in the Chandler Act of 1938, Act of June 22, 1938, ch. 575, § 3(a), 52 Stat. 840, 939. Congress amended this chapter on several occasions, and in 1976, it completely revised the chapter. *See* Pub. L. 94-260, 90 Stat. 315 (codified as amended at 11 U.S.C. §§ 401-418 (1976) (repealed 1978)).

64. Bankruptcy Act, §§ 111 [ch. X], 311 [ch. XI], 411 [ch. XII], 611 [ch. XIII], *as added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 884, 906, 917, 931 (codified as amended at 11 U.S.C. §§ 511, 711, 811, 1011 (1976) (repealed 1978)); *id.* § 77B(a), *added by* Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 912 (codified as amended at 11 U.S.C. § 207(a) (1934) (repealed 1938)); *id.* § 74(m), *added by* Act of Mar. 3, 1933, ch. 204, § 1, 47 Stat. 1467, 1470 ("the debtor and his property, wherever located"); *id.* § 75(n), 47 Stat. at 1473 ("the farmer and his property, wherever located"); *id.* § 77(a), 47 Stat. at 1474 ("the debtor and its property wherever located"), *amended by* Act of Aug. 27, 1935, ch. 774, § 1, 49 Stat. 911, 911 (same). Section 75(n) was amended, in part, by the Act of Aug. 28, 1935, ch. 792,

they all⁶⁵ incorporated the general power of a bankruptcy court in law and equity.⁶⁶ In addition, chapter X, section 77 for railroads, and the short-lived section 77B for corporations gave bankruptcy courts the powers that a federal court appointing an equity receivership⁶⁷ would exercise.⁶⁸

Most of the chapters and sections affected the rights of secured creditors. Chapter X⁶⁹ (large corporations), the earlier short-lived section 77B⁷⁰ (corporations), section 75⁷¹ (farmers), and section 77⁷²

§ 4, 49 Stat. 942, 942, to confer jurisdiction over "the farmer and all his property, wherever located . . . including all real or personal property, or any equity or right in any such property."

65. Bankruptcy Act, §§ 112 [ch. X], 312 [ch. XI], 412 [ch. XII], 612 [ch. XIII], as added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 884, 906, 917, 931 (codified as amended at 11 U.S.C. §§ 512, 712, 812, 1012 (1976) (repealed 1978)); *id.* § 77B(o), added by Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 922 (codified as amended at 11 U.S.C. § 207(o) (1934) (repealed 1938)); *id.* § 74(m), added by Act of Mar. 3, 1933, ch. 204, § 1, 47 Stat. 1467, 1470; *id.* § 75(n), 47 Stat. at 1473; *id.* § 77(n), 47 Stat. at 1481, amended by *id.* § 77(l), Act of Aug. 27, 1935, ch. 774, § 1, 49 Stat. 911, 922.

66. See Bankruptcy Act, ch. 541, § 2, 30 Stat. 544, 544 (1898) (codified as amended at 11 U.S.C. § 11(a) (1976) (repealed 1978)).

67. The equity receivership first developed in the nineteenth century when there was no bankruptcy law in effect to resolve the insolvency of interstate railroads. At the petition of a creditor or the railroad, a federal court would, under its general powers as a court of equity, appoint a receiver who would operate the railroad until it could be sold as a going concern instead of being liquidated. The equity receivership became the dominant method for corporate reorganization until the 1930s. See 6 COLLIER, *supra* note 41, ¶ 0.04, at 28-60 (noting that "reorganization through a federal equity receivership was easily the most popular and practicable procedure available prior to the enactment in 1933 and 1934 of §§ 77 and 77B"); Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 21-23 (1995) (stating that the use of equity receivership "blossomed in the late nineteenth century").

68. See Bankruptcy Act, § 111 [ch. X], as added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 884 (codified as amended at 11 U.S.C. § 511(1976) (repealed 1978)); *id.* § 77B(a), added by Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 912 (codified as amended at 11 U.S.C. § 207(a) (1934) (repealed 1938)); *id.* § 77(a), as added by amendment of Act of Aug. 27, 1935, ch. 774, § 1, 49 Stat. 911, 911.

69. See Bankruptcy Act, §§ 116(2), 216(1), (7), 221(2) (modification of secured debt and issuance of certificates with priority over secured obligations), as added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 885, 895 (codified as amended at 11 U.S.C. §§ 516(2), 616(1), (7), 621(2) (1976) (repealed 1978)).

70. See Bankruptcy Act, § 77B(b)(1), (5), (c), added by Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 913, 914, 916 (modification of secured debt through issuance of securities or otherwise) (codified as amended at 11 U.S.C. § 207(b)(1), (5), (c) (1934) (repealed 1938)); see also *In re Philadelphia & Reading Coal & Iron Co.*, 117 F.2d 976, 978 (3d Cir. 1941) (holding, in a reorganization case under section 77B, that a mortgage trustee, who had possession of the debtor's bonds and stocks, but not the right to receive the interest on the bonds or the dividends on the stock until default by the debtor, was not entitled to the payment of the interest and dividends after the debtor filed a petition for reorganization).

71. See Bankruptcy Act, § 75(j), added by Act of Mar. 3, 1933, ch. 204, 47 Stat. 1467, 1472 (extension of time for payment of secured debt) (codified as amended at 11 U.S.C. § 203(j) (Supp. VII 1933) (expired 1949)).

(railroads) each authorized reorganization plans that modified the rights of secured creditors so long as their interests were adequately protected or the plans were otherwise fair and equitable.⁷³ Under chapter XII, individuals or partnerships could modify the rights of creditors secured by real estate to the same extent.⁷⁴ In addition, under amendments added to section 75 (farmers) in 1934 and 1935, farmers could receive a moratorium on the foreclosure of secured creditors' liens.⁷⁵

Other chapters and sections were more limited. Chapter XI (small corporations) allowed only for the arrangement of the claims of unsecured creditors of the corporation.⁷⁶ Chapter XIII plans for wage earners could deal with secured creditors only if they agreed.⁷⁷

72. See Bankruptcy Act, § 77(b), (c)(3), *added by* Act of Mar. 3, 1933, ch. 204, 47 Stat. at 1476 (authorizing modification of secured debt and issuance of certificates with priority over secured obligations) (codified as amended at 11 U.S.C. § 205(b), (c)(3) (1976) (repealed 1978)).

73. See David Gray Carlson, *Postpetition Interest Under the Bankruptcy Code*, 43 U. MIAMI L. REV. 577, 590-96 (1989) [hereinafter *Postpetition Interest*] (evaluating the rights of secured creditors under the 1898 Bankruptcy Act).

74. See Bankruptcy Act, §§ 446, 461(1), (11), *as added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 920-21 (modification of secured debt and issuance of certificates with priority over secured obligations) (codified as amended at 11 U.S.C. §§ 846, 861(1), (11) (1976) (repealed 1978)).

75. Bankruptcy Act, § 75(s), *added by* Act of June 28, 1934, ch. 869, 48 Stat. 1289, 1289-91 (codified as amended at 11 U.S.C. § 203(j) (Supp. VII 1933) (expired 1949)). This amendment added a new subsection, (s), to section 75 to provide for a five-year moratorium on secured creditor foreclosure. Bankruptcy Act, § 75(s)(7). The Supreme Court in *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 601 (1935), declared this subsection unconstitutional. Congress then reenacted a revised subsection (s) to provide for a three-year moratorium. See Act of August 28, 1935, ch. 792, § 4, 49 Stat. 942, 943-45. The Supreme Court upheld this revision in *Wright v. Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 470 (1937), and in *Wright v. Union Central Life Insurance Co.*, 304 U.S. 502, 517-18 (1938). See also Carlson, *Postpetition Interest*, *supra* note 73, at 588 & n.46 (discussing the *Vinton Branch* holding); James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 979-81 (1983) (same).

76. See Bankruptcy Act, §§ 356, 371, *as added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 910, 912 (codified as amended at 11 U.S.C. §§ 756, 771 (1976) (repealed 1978)). Certain secured creditors could nevertheless be affected by a chapter XI case, such as creditors who obtained a lien within four months of the filing of the petition or creditors whose security interest was not perfected. See, e.g., *In re Pine Tree Feed Co.*, 112 F. Supp. 124, 126 (D. Me. 1953) (holding, in a chapter XI case, that "if property of the debtor is in the hands of an equity receiver . . . , where no lien exists . . . which antedates bankruptcy by more than four months, the bankruptcy court's jurisdiction over such assets in the hands of the nonbankruptcy receiver is paramount and exclusive"); James E. Yacos, *Secured Creditors and Chapter XI of the Bankruptcy Act*, 44 AM. BANKR. L.J. 29, 29-30 (1970) (describing cases that invalidated security interests for failure to perfect under state law).

77. See Bankruptcy Act, §§ 646, 652, *as added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 934 (codified as amended at 11 U.S.C. §§ 1046, 1052 (1976) (repealed 1978)).

Noncorporate debtors reorganizing under the short-lived section 74 could obtain an extension of the time of payment of debt secured by property only in the possession of the debtor.⁷⁸

Some of these amendments to the Bankruptcy Act expressly affected the creditor in possession of property items by authorizing an injunction against foreclosing liens; imposing an automatic stay against foreclosing liens; and requiring a return of property items in the creditor's possession to the bankruptcy trustee or the debtor in possession. In other cases, despite the absence of specific statutory authority, a few courts relied on the grant of equitable powers to bankruptcy courts and their jurisdiction over the debtor's "property" to enjoin foreclosure sales by a creditor in possession or to require the creditor in possession to return the property items.

1. *Stay and Injunction of Foreclosure.*—

a. *Explicit Statutory Provisions.*—Some of the reorganization chapters and sections either included an automatic stay of creditor foreclosure actions or authorized an injunction against foreclosure actions. Courts would issue injunctions and deny relief from an automatic stay or a previous injunction so long as the interests of the secured creditor were protected.⁷⁹ In particular, approval by the

78. See Bankruptcy Act, § 74(h), added by Act of Mar. 3, 1933, ch. 204, § 1, 47 Stat. 1467, 1470 (allowing an extension of the time for payment of debts secured by property items in the "actual or constructive possession of the debtor" or in the possession of any custodian or receiver appointed by the bankruptcy court pursuant to this section).

79. See, e.g., *Caplan v. Anderson*, 256 F.2d 416, 419 (5th Cir. 1958) (holding that, unless a secured creditor received protection and satisfaction of its debt or there was a clear showing at a hearing that its rights would not be affected by further delay, the court must vacate the automatic stay against the foreclosure of a ship mortgage in a chapter X case and permit the creditor to foreclose its lien); *infra* notes 88-90; see also 6 COLLIER, *supra* note 41, ¶ 3.32, at 669-70 (surveying chapter X cases); Patrick A. Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 BUS. LAW. 15, 31 (1974) [hereinafter *Restraint*] (analyzing the criteria considered by courts entering a stay of lien enforcement under section 116(4) or vacating the stay under section 148 of the Bankruptcy Act—possibility of successful reorganization, importance of the property item to reorganization, and protection of the rights of the secured creditor).

By the late 1960s and the 1970s, some courts were less solicitous of the secured creditor when the debtor had possession of property items subject to a security interest. Two authors stated, in the 1970s, that in deciding whether to lift a stay to permit the secured party to foreclose its security interest, a court would weigh the following four factors: whether the debtor had equity; whether the continuation of the stay harmed the creditor; whether there was a reasonable prospect of successful reorganization; and whether withdrawal of the encumbered property items from the debtor would materially impair the reorganization. Accordingly, a lack of positive debtor equity alone would not always warrant relief from the stay. See Peitzman & Smith, *supra* note 54, at 1225-33 (analyzing the factors necessary for relief from the automatic stay); Kennedy, *supra* note 56, at 238-53 (providing a detailed analysis of the factors that bankruptcy courts weighed in enjoining

court of a petition⁸⁰ under chapter X for large corporate reorganizations and filing a petition⁸¹ under chapter XII for real estate arrangements automatically stayed prior pending bankruptcy liquidation, mortgage foreclosure, or equity receivership proceedings and acts or other proceedings to enforce any lien on property of the debtor. Filing a petition under section 75 also automatically stayed creditor collection efforts against farmers.⁸² These provisions automatically precluded a creditor in possession from selling the collateral and applying the proceeds to the debt.⁸³ This automatic stay presaged the automatic stay of section 362 of the Bankruptcy Code.⁸⁴

creditor actions to foreclose liens or in granting relief from the stay); Murphy, *supra*, at 32 (noting that the increasing complexity of secured transactions and the desire of bankruptcy judges to avoid liquidation had "led to some results that have stretched these principles [requiring reasonable possibility of successful reorganization and protection of secured creditor rights] to a startling degree"). One prominent case declined to give the creditor relief when its security interests in motor vehicle equipment was subject to substantial risk through continued use by the debtor on the sole grounds that removal of the equipment would frustrate reorganization and the court decided that there was a reasonable possibility of reorganization. See *In re Yale Express Sys., Inc.*, 384 F.2d 990, 991-92 (2d Cir. 1967) (affirming the lower court's denial of reclamation of debtor's property by a secured creditor); see also Robert J. Rosenberg, *Beyond Yale Express: Corporate Reorganization and the Secured Creditor's Rights of Reclamation*, 123 U. PA. L. REV. 509, 525-32 (1975) (evaluating the effect on the secured creditor of the denial of the secured creditor's request to reclaim the collateral upon debtor's default). The more recent and less protective attitude of the courts when the bankruptcy trustee or the debtor had possession may have eventually infected courts confronted by a creditor in possession, or the different circumstances of a creditor in possession, see *infra* Part IV, may have led courts to resist this liberalizing trend.

80. See Bankruptcy Act, § 148, added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 888 (1938) (codified as amended at 11 U.S.C. § 548 (1976) (repealed 1978)). See, e.g., *Hamblen v. Federal Sav. & Loan Ins. Corp. (In re Thomas J. Grosso Inv., Inc.)*, 457 F.2d 168, 172-73 (9th Cir. 1972) (holding, in a chapter X case, that section 148 stayed the running of a six-month redemption period that followed a mortgage foreclosure sale under Arizona law).

81. See Bankruptcy Act, § 428, added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 918 (1938) (codified as amended at 11 U.S.C. § 828 (1976) (repealed 1978)). Section 428 referred to "real property or chattel real of a debtor." *Id.*; see, e.g., *Meyer v. Rowen*, 181 F.2d 715, 716 (10th Cir. 1950) (holding that because the filing of a petition under chapter XII stays foreclosure proceedings, a postpetition foreclosure sale was void).

82. Bankruptcy Act, § 75(o)(6), as added by Act of Mar. 3, 1933, ch. 204, 47 Stat. 1467, 1473 (codified as amended at 11 U.S.C. § 203(j) (Supp. VII 1933) (expired 1949)) (including any "[s]eizure, distress, sale, or other proceedings under an execution or under any lease, lien, chattel mortgage, conditional sale agreement, crop payment agreement, or mortgage"); see also Kennedy, *supra* note 56, at 179-80 (analyzing the automatic stay under the farm-debtor relief provisions of section 75 of the Bankruptcy Act).

83. See Kennedy, *supra* note 56, at 180 (discussing the short-lived five-year stay imposed on the proceedings of a secured creditor against a debtor-farmer's property where the debtor could not otherwise obtain relief under section 75).

84. 11 U.S.C. § 362(a) (1994), quoted *infra* note 295 and accompanying text.

In addition to the automatic stay, chapters X and XII authorized bankruptcy courts to enjoin creditor actions to enforce liens.⁸⁵ Chapters XI and XIII,⁸⁶ which did not include an automatic stay, also authorized bankruptcy courts to enjoin creditor actions to enforce liens.⁸⁷ Courts generally issued or continued such injunctions against nonconsenting secured creditors in both chapter XI⁸⁸ and chapter XIII⁸⁹ so long as their interests were protected.⁹⁰ Accordingly,

85. Bankruptcy Act, §§ 113, 116(4) [ch. X], 414 [ch. XII], as added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 884, 885, 917-18 (codified as amended at 11 U.S.C. §§ 513, 516(4), 814 (1976) (repealed 1978)); see, e.g., *In re Long Island Properties*, 40 F. Supp. 611, 614 (S.D.N.Y. 1941) (holding, in a chapter X case, that a temporary injunction entered before the bankruptcy court's approval of a petition for reorganization and before the entry of a state court foreclosure judgment made that judgment void).

86. Bankruptcy Act, §§ 314 [ch. XI], 614 [ch. XIII], as added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 907, 931 (codified as amended at 11 U.S.C. §§ 714, 1014 (1976) (repealed 1978)).

87. The short-lived relief provisions of sections 74 and 77B (the precursor to chapters X and XI) and the relief provisions of section 77 for railroads did not contain an automatic stay. These sections also authorized injunctions in more limited situations. Sections 77B and 77 authorized a bankruptcy court to enjoin only judicial proceedings to enforce liens generally. Bankruptcy Act, § 77B(c)(10) (authorizing enjoining or staying judicial proceedings to enforce a "lien upon the estate"), added by Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 917 (codified as amended at 11 U.S.C. § 207(c)(10) (1934) (repealed 1938)); *id.* § 77(l), 47 Stat. at 1481, and § 77(j), 49 Stat. at 921 (codified as amended at 11 U.S.C. § 205(j) (1976) (repealed 1978)). Section 74 allowed enjoining the enforcement of liens of creditors secured by property items in the possession of the debtor. Bankruptcy Act, § 74(n), added by Act of Mar. 3, 1933, ch. 204, § 1, 47 Stat. 1467, 1470 (allowing the court to "enjoin secured creditors who may be affected by the extension proposal"; only secured creditors whose security was in possession of debtor could be affected by the extension proposal).

Nevertheless, relying on the general equity powers of a court of equity, the court's jurisdiction over the debtor's "property," in this case stock pledged to a creditor in possession, and the Supreme Court's decision in *Rock Island*, discussed *infra* in text accompanying notes 102-111, one court affirmed an injunction against the pledgee from selling the stock. See *Marshall & Ilsley Bank v. Brown (In re Brown)*, 84 F.2d 433, 433-34, (7th Cir. 1936). The pledged stock in *Brown* was worth \$240,000 and secured a debt of \$80,000. *Id.* at 435.

88. See, e.g., *In re Tracy*, 194 F. Supp. 293, 295 (N.D. Cal. 1961) (holding that the referee's discretion to enjoin a foreclosure sale of real property is subject to equitable considerations and that the injunction must not cause substantial injury to the creditor); see also Vern Countryman, *Real Estate Liens in Business Rehabilitation Cases*, 50 AM. BANKR. L.J. 303, 313 (1976) (noting that in every case in which the issue of chapter XI lien enforcement arose, courts have held or assumed that they may enjoin lien enforcement against real estate when the debtor had equity).

89. In chapter XIII cases, courts frequently enjoined nonconsenting creditors from foreclosing a mortgage or repossessing an automobile or other personal property in possession of the debtor, or denied reclamation petitions by the secured creditor to recover such property items from the debtor, when the equities justified the action. See, e.g., *Thompson v. Ford Motor Credit Co. (In re Thompson)*, 475 F.2d 1217, 1219 (5th Cir. 1973) (denying a creditor's petition to reclaim an encumbered automobile, despite the debtor's failure to make payments required by the chapter XIII plan, in part, because the creditor remained fully protected); *Hallenbeck v. Penn Mutual Life Ins. Co.*, 323 F.2d 566,

even though chapter XI (small corporations) allowed for the arrangement of the claims of only unsecured creditors of the corporation,⁹¹ a few courts enjoined oversecured creditors in possession from foreclosing liens on the debtor's property items when the debtor had equity in the property items and such injunction did not harm the creditor's interests.⁹² Under chapter XIII for wage earners, which dealt with se-

569-70 (4th Cir. 1963) (holding that jurisdiction over a debtor's property authorized an injunction against a mortgage foreclosure action by a nonparticipating mortgagee when the debtor had substantial equity in his mortgaged home); *Illinois Nat'l Bank & Trust Co. v. Clevenger* (*In re Clevenger*), 282 F.2d 756, 757 (7th Cir. 1960) (rejecting petitions by creditors to reclaim the debtor's automobile and television, because of the court's jurisdiction over the debtor's "property" and because of the substantial debtor equity in the automobile and television); *In re Teegarden*, 330 F. Supp. 1113, 1115 (E.D. Ky. 1971) (denying a secured creditor's petition to reclaim a 1970 Rambler automobile financed under an installment sale contract because the secured creditor was not adversely affected by the arrangement plan); *In re Pizzolato*, 281 F. Supp. 109, 110-11 (W.D. Ark. 1967) (upholding a referee's enjoining of a mortgage foreclosure because the market value of the house was more than double the amount owed on the first mortgage); *In re Rutledge*, 277 F. Supp. 933, 936 (E.D. Ark. 1967) (providing that a referee could enjoin an action to replevin an automobile if the plan, which required monthly payments in the contract amount, were modified to provide that the delinquent payments be brought to date within 30 days); *In re Pizzolato*, 268 F. Supp. 353, 356-57 (W.D. Ark. 1967) (enjoining a secured creditor from repossessing an encumbered automobile because of positive debtor equity); see also Richard E. Poulos, *The Secured Creditor in Wage Earner Proceedings: Dream Versus Reality*, 44 AM. BANKR. L.J. 68, 79 (1970) (stating that a court may enjoin a petition by a creditor to reclaim collateral if the debtor is required to make payments on reasonable terms that assure that the interest of the creditor is protected).

90. See, e.g., *Terry v. Colonial Stores Employee's Credit Union*, 411 F.2d 553, 554-55 (5th Cir. 1969) (affirming the district court's reversal of the referee's decision to deny the creditor's petition for reclamation of an injunction against enforcing a lien against an encumbered car when the debtor's plan did not provide for payment to the secured creditor of the full contract amount); *In re Cassidy*, 401 F. Supp. 757, 759-60 (E.D.N.Y. 1975) (holding that a bankruptcy judge could not enjoin a mortgagee from foreclosing a mortgage loan without first deciding the merits of the creditor's claims that the chapter XIII plan had been proposed in bad faith and that the debtor had no equity).

91. See *supra* note 76 and accompanying text.

92. See *Akron Nat'l Bank & Trust Co. v. Freed & Co.* (*In re Freed & Co.*), 534 F.2d 1235, 1239 (6th Cir. 1976) (upholding the jurisdiction of a court to enjoin foreclosure of a lien by a receiver in a state court lien enforcement proceeding who was in constructive possession of land, but stating that if the debtor held no equity in the encumbered property or if the injunction would not assist in protecting the debtor's estate, then continuation of the stay would be an abuse of discretion); *Silver Gate Sav. & Loan Ass'n v. Carlson*, (*In re Victor Builders, Inc.*), 418 F.2d 880, 882 (9th Cir. 1969) (holding that a bankruptcy court had jurisdiction to enjoin foreclosure proceedings against real estate in the possession of a state court receiver; affirming the district court's decision to remand for determination of equity; and stating that if the debtor has equity "over and above the lien of the trust deed," then the injunction should remain until final decree in chapter XI but if the debtor has no such equity, then the injunction should be dissolved (internal quotation marks omitted)); see also *Murphy, Restraint*, *supra* note 79, at 39-40 (stating that the then "emerging rule" favored the jurisdiction of the court in a chapter XI proceeding to restrain the creditor in possession from exercising its remedies).

cured creditors only if they agreed,⁹³ there were no reported cases enjoining creditors in possession from foreclosing their security interests. Nevertheless, following the lead of the courts analyzing chapter XI, courts might have done so eventually.

Finally, between 1973 and 1976, the Supreme Court promulgated new rules of procedure for reorganization under chapters X through XIII and section 77 for railroads that imposed an automatic stay against "any act or the commencement or continuation of any court proceeding to enforce any lien against [the debtor's] property."⁹⁴ Unlike the automatic stay in liquidation cases, which did not extend to creditors in possession,⁹⁵ these rules prevented creditors in possession from liquidating property items in their possession. The rules allowed a secured creditor relief from the stay "for cause shown" and placed the burden of showing that a stay should continue on the person seeking continuation.⁹⁶ Although Rule 10-601⁹⁷ made the automatic stay effective in a chapter X case upon the filing of the petition instead of approval of the petition as provided in section 148 of the Bankruptcy Act,⁹⁸ and chapters XI and XIII had no automatic stay, the rules reflected the practice and power of bankruptcy courts to enjoin enforcement of liens upon the filing of the petition.⁹⁹ Neverthe-

93. See *supra* note 77 and accompanying text.

94. R. OF BANKR. P. 8-501(a), 425 U.S. 1003, 1048 (1976) (repealed 1983) (section 77 railroad cases); *id.* R. 10-601(a), 421 U.S. 1019, 1069 (1975) (repealed 1983) (chapter 10 cases); *id.* R. 11-44(a), 415 U.S. 1003, 1033 (1974) (repealed 1983) (chapter 11 cases); *id.* R. 12-43(a), 421 U.S. 1019, 1116 (1975) (repealed 1983) (chapter 12 cases); *id.* R. 13-401(a), 411 U.S. 989, 1177 (1973) (repealed 1983) (chapter 13 cases).

95. See *supra* note 58 and accompanying text.

96. R. OF BANKR. P. 8-501(c), 425 U.S. 1003, 1049 (1976) (repealed 1983); *id.* R. 10-601(c), 421 U.S. 1019, 1069-70 (1975) (repealed 1983); *id.* R. 11-44(d), 415 U.S. 1003, 1034 (1974) (repealed 1983); *id.* R. 12-43(d), 421 U.S. 1019, 1117 (1975) (repealed 1983); *id.* R. 13-401(d), 411 U.S. 989, 1177-78 (1973) (repealed 1983).

97. R. OF BANKR. P. 10-601(a), 425 U.S. 1003, 1048 (1975) (repealed 1983).

98. See *supra* note 80 and accompanying text (citing section 148 of the Bankruptcy Act and discussing a case under the Act).

99. For example, in *Caribbean Food Products Inc. v. Banco Credito y Ahorro Ponceño*, 575 F.2d 961 (1st Cir. 1978), after the debtor had filed a chapter XI petition, the creditor had notified account debtors to pay to it pledged accounts. *Id.* at 962. The bankruptcy court then ordered the creditor to turn over to the debtor the amounts collected by the creditor on the grounds that the collection of actions by the creditor violated the automatic stay imposed by Bankruptcy Rule 11-44(a). *Id.* at 963. The district court affirmed this order. *Id.* Relying on *Rock Island*, see *infra* notes 102-111 and accompanying text, the appellate court rejected the creditor's argument that Rule 11-44(a) should not apply retroactively to the credit agreement, which had become effective before the Supreme Court adopted the Rule. *Id.* at 964. The court of appeals also noted that the creditor remained protected and was not prejudiced by the stay. *Id.*; see also *Yacos*, *supra* note 76, at 31 (discussing the prevalence of ex parte injunctions against foreclosure of liens in chapter XI cases despite the requirement for notice before an injunction under § 314 of the Bankruptcy Act).

less, Rule 928¹⁰⁰ provided that none of the bankruptcy rules extended or limited the subject matter jurisdiction of bankruptcy courts.¹⁰¹

b. Judicial Extrapolation.—Although the earlier reorganization statutes did not expressly authorize an injunction or a stay of enforcement actions by creditors in possession, a few courts relied on the expanded jurisdiction of a bankruptcy court in reorganizations over the debtor's "property" to enjoin liquidation of property items in the creditor's possession when the debtor had equity in the property items. The leading case was the 1935 Supreme Court decision, *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Railway Co.*,¹⁰² involving a railroad reorganization under section 77.¹⁰³ In *Rock Island*, the railroad filed a petition for reorganization and requested an injunction prohibiting several secured creditors holding mortgage bonds as collateral from selling the collateral to repay their debts.¹⁰⁴ The bankruptcy court granted the requested injunction because it determined that the liquidation of the collateral, the value of which greatly exceeded the amount of the debt, would prevent the orderly preparation and consummation of a reorganization plan.¹⁰⁵ The creditors appealed and the Supreme Court upheld the injunction.¹⁰⁶

The Court stated that a bankruptcy court was essentially a court of equity¹⁰⁷ and that the power to issue an injunction when necessary to prevent the impairment of its jurisdiction was inherent in a court of

100. R. OF BANKR. P. 928, 411 U.S. 989, 1103 (1973) (repealed 1983) ("These rules shall not be construed to extend or limit the jurisdiction of courts of bankruptcy over subject matter.").

101. See *Akron Nat'l Bank & Trust Co. v. Freed & Co. (In re Freed & Co.)*, 534 F.2d 1235, 1237 (6th Cir. 1976) (holding that Rule 11-44 did not obviate examination of a bankruptcy court's power in a chapter XI case to enjoin the foreclosure of a lien by a creditor in possession and requiring the bankruptcy court to determine whether the debtor had equity).

102. 294 U.S. 648 (1935).

103. *Id.* at 657.

104. *Id.*

105. See *id.* at 658-60, 666.

106. *Id.* at 675-84.

107. The Court quoted the statutory language giving bankruptcy courts "such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings." *Id.* at 675 (quoting Bankruptcy Act, ch. 541, § 2, 30 Stat. 544, 544 (1898), 11 U.S.C. § 11 (Supp. VII 1933) (internal quotation marks omitted)). The Court also relied on the All Writs Act, § 262 of the Judicial Code, 28 U.S.C. § 377 (Supp. VII 1933) (codified as revised in 28 U.S.C. § 1651(a) (1994)), which authorized United States courts "to issue all writs not specifically provided for by statute, which may be necessary for the exercise of their respective jurisdictions." *Id.* (internal quotation marks omitted).

bankruptcy as in a court of equity.¹⁰⁸ The Court also recited the grant of jurisdiction to bankruptcy courts in section 2(15) of the Act to issue orders necessary for the enforcement of the Act's provisions.¹⁰⁹

In addition, the Court noted that the bankruptcy court had summary jurisdiction over the debtor's "property." It stated that the debtor had equity in the collateral, that this equity was a property interest, and that it was "property" within the statutory grant of jurisdiction.¹¹⁰ Accordingly, the Court concluded that the bankruptcy court had the power to issue the injunction and had properly exercised its discretion.¹¹¹

The partial reliance by the Court on the bankruptcy court's jurisdiction over the debtor's "property" is problematic. By itself, the word "property" is ambiguous.¹¹² The debtor's "property" could mean property items owned by the debtor, the colloquial meaning of "property."¹¹³ These include things like a parcel of land, a car, an account, or, in this case, mortgage bonds. The phrase could also mean the legal interests of the debtor in the property items—the legal meaning.¹¹⁴ In the case of property items in the possession of a creditor, the debtor's "property" is the debtor's equity interests in those items. The Court apparently thought that interpreting "property" to mean

108. *Id.*

109. *Id.* at 676 (citing Bankruptcy Act, ch. 541, § 2(15), 30 Stat. 544, 544 (1898); 11 U.S.C. § 11(15) (1926) (empowering the bankruptcy court to "make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this act")).

110. *Id.* at 681, 683.

111. *Id.* at 676, 679. The Court also held that the reorganization provisions of section 77 were within the congressional power under the Bankruptcy Clause. *Id.* at 671. See generally Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 387, 541-42 (1996) (discussing the Court's views of Congress's power to legislate under the Bankruptcy Clause). In addition, the Court held that section 77, as applied to permit the injunction, did not deprive the creditors of their state law property rights in violation of the due process guarantees of the Constitution. *Rock Island*, 294 U.S. at 680.

112. See generally Plank, *Bankruptcy Estate*, *supra* note 9, at 1194-95, 1200-03 (discussing "the ambiguity inherent in the word 'property' and the underlying complexity of property interests").

113. See generally THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 1550 (2d ed. unabridged, 1987) (defining property as, among others, "that which a person owns; . . . something at the disposal of a person"); WEBSTER'S THIRD INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 467 (1976) (defining property as, among others, "something that is or may be possessed").

114. See generally ROGER A. CUNNINGHAM ET AL., LAW OF PROPERTY §§ 1.1, 1.2, at 1-7 (2d ed. 1993) (noting that property is comprised of legal relations between persons with respect to "things" and that those relations may be expressed in terms of the "interests" that a person may have in a thing); Plank, *Bankruptcy Estate*, *supra* note 9, at 1200-03 (analyzing the structure of single tier, two tiered and multitiered property interests).

only the debtor's equity interest was sufficient to support an injunction against actions that affected the debtor's "property."

This analysis is flawed. The debtor's equity interest is defined and limited by the creditor's power to sell the property items that are the collateral. Under nonbankruptcy law, the debtor without possession has only the right to redeem the creditor's security interest and the right to surplus from the proceeds of the foreclosure sale.¹¹⁵ It has no right to stop the foreclosure sale without redemption.¹¹⁶ Because the right of the creditor to extinguish the debtor's equity interest defines the limit of the debtor's equity interest, jurisdiction of the bankruptcy court, without more, over this contingent interest does not authorize an injunction that would stop the creditor from exercising its rights and that would in effect expand the debtor's property interests.¹¹⁷

Faced with a similar issue, the Court of Appeals for the Second Circuit in *In re Prudence-Bonds Corp.*¹¹⁸ avoided the analytical flaw in *Rock Island* by interpreting the word "property" to mean the property items owned by the debtor and not the debtor's equity interest in the property items.¹¹⁹ The court held that the grant of jurisdiction over the debtor's "property" in section 77B¹²⁰ authorized the bankruptcy court to restrain the sale by a creditor in possession of mortgages owned by the debtor.¹²¹ In its analysis, the court drew a distinction between the debtor's equity in the "property" and the "property" it-

115. See *infra* note 267 and accompanying text (discussing an owner's rights in property items subject to the security interest of a creditor in possession).

116. See generally Plank, *Bankruptcy Estate*, *supra* note 9, at 1202-03, 1236, 1259-60, 1265 (discussing the extent of an owner's equity interest in property items in the rightful possession of a creditor).

117. For example, if the debtor were a lessee of real property under a lease for a definite term and had filed a petition one month before the lease expired, the bankruptcy court would have jurisdiction over the remaining term of the lease, but the court's jurisdiction over the lease would not extend the term of the lease.

118. 77 F.2d 328 (2d Cir. 1935).

119. *Id.* at 330.

120. Bankruptcy Act, § 77B(a), added by Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 912 (codified as amended at 11 U.S.C. § 207(a) (1934) (repealed 1938)).

121. *Prudence-Bonds*, 77 F.2d at 330. The debtor had pledged the mortgages to indenture trustees to secure bonds issued by the debtor. See *id.* at 329. The bankruptcy court later approved a plan of reorganization that required the indenture trustees for eighteen series of bonds secured by the mortgages to transfer the mortgages to a new corporate trustee for the benefit of the bondholders. See *Brooklyn Trust Co. v. Kelby (In re Prudence-Bonds Corp.)*, 134 F.2d 105, 107-08 (2d Cir. 1943). *Brooklyn Trust* tells the fascinating story of many years of litigation (including three decisions by the court of appeals) over the jurisdiction of the bankruptcy court to require the old trustees to account for their alleged negligence in allowing the debtor to remove mortgages from the lien of the indentures before bankruptcy.

self.¹²² In liquidations, as the court noted, the bankruptcy court had jurisdiction over the debtor's equity but did not have jurisdiction over "property" in the creditor's possession.¹²³ The jurisdictional grant in section 77B, however, gave the bankruptcy court jurisdiction over the debtor's "property." Accordingly, "property" held by a pledgee, in which the debtor had an equity, was within the bankruptcy court's jurisdiction.¹²⁴ Pursuant to its powers as a court of equity and section 2(15) of the Act, the court of appeals held that the bankruptcy court could prevent the disposition of those property items and the destruction of the debtor's equity.¹²⁵

The court's use of the term "property" to mean the property items owned by the debtor and not the debtor's interest in the property items was consistent with the Act's definition of property of the estate. Section 70 of the Act vested the trustee "with the title of the bankrupt" to all of a long list of property items or property interests.¹²⁶ The statute's reference to "title" and the distinction between "property" in some of the clauses and the specific types of property interests, such as "interests in patents,"¹²⁷ "powers,"¹²⁸ and "rights of

122. *Prudence-Bonds*, 77 F.2d at 330 (explaining that the debtor had equity in the property items that it owned, the mortgages).

123. *Id.*

124. *But see* *Reighard v. Higgins Enter. Inc.*, 90 F.2d 569, 570 (3d Cir. 1937) (doubting that the court had jurisdiction to take possession of the real estate in the hands of the mortgagee after default without first curing the default under the mortgage).

125. *Prudence-Bonds*, 77 F.2d at 330-31. The express power to grant an injunction under section 77B was limited to enjoining the commencement or continuation of judicial proceedings to enforce any lien. *See* Bankruptcy Act, § 77B(c)(10) (authorizing enjoining or staying judicial proceedings to enforce a "lien upon the estate"), *added by* Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 917 (codified as amended at 11 U.S.C. § 207(c)(10) (1934) (repealed 1938)).

126. Bankruptcy Act, ch. 541, § 70a, 30 Stat. 544, 565-66 (1898) (codified as amended at 11 U.S.C. § 110(a) (1976) (repealed 1978)). As originally enacted, there were six types of property items or interests specified in six numbered clauses, and the time for determining title of the bankrupt was "the date he was adjudged a bankrupt." *Id.* The most general of these types of property items was set forth in clause (5), "property which prior to the filing of the petition [the bankrupt] could by any means have transferred or which might have been levied upon and sold under judicial process against him." *Id.* In 1938, Congress added four more items in two numbered clauses and two unnumbered paragraphs. Bankruptcy Act, § 70a, *as amended by* ch. 575, 52 Stat. 840, 879-80 (1938) (codified as amended at 11 U.S.C. § 110(a) (1976) (repealed 1978)). In this legislation, Congress also changed the time for determining the title of the bankrupt to "the date of the filing of the petition." *Id.* § 70a, *as amended by* ch. 575, 52 Stat. 840, 879 (1938) (codified as amended at 11 U.S.C. § 110(a) (1976) (repealed 1978)).

127. Bankruptcy Act, ch. 541, § 70a(2), 30 Stat. 544, 566 (1898) (codified as amended at 11 U.S.C. § 110(a)(2) (1976) (repealed 1978)).

128. *Id.* § 70a(3), 30 Stat. 544, 566 (1898) (codified as amended at 11 U.S.C. § 110(a)(3) (1976) (repealed 1978)).

action,"¹²⁹ suggests that the debtor's "property" meant the "property item" owned by the debtor and not the specific property interest of the debtor in the property item. Accordingly, under this understanding of the debtor's "property," the bankruptcy court's jurisdiction extends to property items held by a creditor in possession. Later courts relied on this colloquial meaning of property to require creditors in possession to return property items to the bankruptcy trustee or to the debtor in possession.¹³⁰

2. Return of Property Items.—

a. Explicit Statutory Provisions.—Some of the reorganization chapters and sections authorized bankruptcy courts to order the return of certain types of property items no longer in the debtor's possession as of the filing of the petition. Chapter X¹³¹ and chapter XII,¹³² as well as section 77 for railroad reorganization¹³³ and the short-lived section 77B for corporations,¹³⁴ provided that, if a receiver

129. *Id.* § 70a(6), 30 Stat. 544, 566 (1898) (codified as amended at 11 U.S.C. § 110(a)(6) (1976) (repealed 1978)).

130. See *infra* notes 142-148, 151-155 and accompanying text (describing cases relying on the colloquial meaning of "property").

131. Bankruptcy Act, §§ 256, 257, added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 902 (1938) (codified as amended at 11 U.S.C. § 657 (1976) (repealed 1978)). Section 256 stated:

A petition may be filed under this chapter notwithstanding the pendency of a prior mortgage foreclosure, equity, or other proceeding in a court of the United States or of any State in which a receiver or trustee of all or any part of the property of a debtor has been appointed or for whose appointment an application has been made.

The first sentence of section 257 stated: "The trustee appointed under this chapter, upon his qualification or if a debtor is continued in possession, the debtor, shall become vested with the rights, if any, of such prior receiver or trustee [referenced in section 256] in such property and with the right to the immediate possession thereof."

See also *Clark Brothers Co. v. Portex Oil Co.*, 113 F.2d 45, 48 (9th Cir. 1940) (upholding the jurisdiction of the district court for the district of Oregon as a bankruptcy court over that of the district court for the eastern district of Texas, in which receivers had been appointed in an equity receivership).

132. Bankruptcy Act, §§ 506, 507, added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 927 (1938) (codified as amended at 11 U.S.C. §§ 906, 907 (1976) (repealed 1978)). Section 506 and the second sentence of 507 were identical to section 256 and the first sentence of section 257, quoted *supra* note 131.

133. Bankruptcy Act, § 77(i), added by Act of Aug. 27, 1935, ch. 774, § 1, 49 Stat. 911, 921, restating *id.* § 77(k), added by Act of March 3, 1933, ch. 204, § 1, 47 Stat. 1467, 1480.

134. Bankruptcy Act, § 77B(i), added by Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 920 (codified as amended at 11 U.S.C. § 207(i) (1934) (repealed 1938)); see also *Troutman v. Compton (In re Greyling Realty Corp.)*, 74 F.2d 734, 736 (2d Cir. 1935) (applying section 77B(i) to require the return to the bankruptcy trustee of property items (real estate, mortgages on real estate, and proceeds of the mortgages) in the possession of a state court receiver appointed for the debtor before the filing of an involuntary petition against the debtor).

or trustee had been appointed by a state or federal court to take control of all or a part of the debtor's property in a receivership proceeding,¹³⁵ the debtor could nevertheless file a petition to reorganize under the Bankruptcy Act, and the bankruptcy trustee or the debtor in possession could obtain possession of such property. Moreover, chapter X¹³⁶ and chapter XII¹³⁷ allowed the bankruptcy trustee or the debtor in possession to reacquire possession of mortgaged property in the possession of a trustee under a trust deed or a mortgagee under a mortgage.¹³⁸ Courts would order turnover under chapter X, however,

135. In *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 221-24 (1936), the Supreme Court had interpreted the requirement for the initiation of an involuntary reorganization case under Bankruptcy Act, § 77B(a), added by Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911, 913 (codified as amended at 11 U.S.C. § 207(a) (1934) (repealed 1938)), that the debtor's property be in the possession of a receiver or the debtor have committed an act of bankruptcy. The Court stated that "receiver" meant a receiver appointed in an equity receivership, not a receiver appointed to foreclose a mortgage lien. *Duparquet*, 297 U.S. at 221-22.

136. Bankruptcy Act, § 257, added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 902 (1938) (codified as amended at 11 U.S.C. § 657 (1976) (repealed 1978)). The second sentence of section 257 stated: "The trustee or debtor in possession shall also have the right to immediate possession of all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage." *Id.*

See also *In re Franklin Garden Apartments*, 124 F.2d 451, 454 (2d Cir. 1941) (holding that, under section 257, the bankruptcy court could order a mortgagee in possession of an encumbered apartment building to return possession of the building to the debtor). The court of appeals in *Franklin Garden Apartments* stated that section 257 was apparently enacted in response to the Supreme Court's interpretation of section 77B, the predecessor to chapters X and XI, in *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 221-24 (1936), discussed *supra* note 135, which distinguished between a receiver appointed in an equity receivership and a receiver appointed to foreclose a mortgage lien. *Franklin Garden Apartments*, 124 F.2d at 453-54. This statement is not accurate. It is more likely that Congress was simply continuing the provision added to section 74(m) in response to *Hardenbrook v. Landquist*, 70 F.2d 929, 935-36 (7th Cir. 1934), discussed *infra* note 142.

137. Bankruptcy Act, § 507, added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 927 (1938) (codified as amended at 11 U.S.C. § 907 (1976) (repealed 1978)). The third sentence of section 507 was identical to the second sentence of section 257, quoted *supra* note 136, except that the words "real property and chattels real" appeared in section 507 instead of the word "property" in section 257.

138. It is not clear whether and to what extent section 257 in chapter X, which was not limited solely to real property as was chapter XII, was intended to apply to personal property items. See John Gerdes, *Corporate Reorganizations: Changes Effected by Chapter X of the Bankruptcy Act*, 52 HARV. L. REV. 1, 17 n.94 (1938) (observing that "[w]hether the statute [section 257] is intended to apply to personal property . . . is not certain"); Patrick A. Murphy, *Use of Collateral In Business Rehabilitations: A Suggested Redrafting of Section 7-203 of the Bankruptcy Reform Act*, 63 CAL. L. REV. 1483, 1487 n.20, 1492 (1975) [hereinafter *Use of Collateral*] (asserting that it is "probable that section 257 (11 U.S.C. § 657) includes personal and real property lien foreclosure trustees, as well as mortgagees and trustees in possession of non-judicial foreclosure action" (citations omitted)). Gerdes noted that the section was based on a proposal of the National Bankruptcy Conference that was limited to "real property and chattels real" and that possession of those types of property items usually occurred only as a result of default, in contrast to personal property, which might be in

only if the debtor had equity in the property items in the creditor's possession and there was a reasonable prospect for reorganization.¹³⁹ These standards presumably would apply to the "little used chapter XII,"¹⁴⁰ although one court, late in the life of the Bankruptcy Act, suggested that in a chapter XII case it was sufficient to weigh the possibility of successful reorganization against the risk to the secured creditor.¹⁴¹

a creditor's possession simply for the sake of security. Gerdes, *supra*, at 17 n.94. On the other hand, he noted that, although the term "trust deed" instead of "trust indenture" might indicate an intent to limit the statute to real property, the word "mortgage" would normally include chattel mortgage, a specific form of security device for personal property items. *Id.* Most of the reported cases applying section 257 were limited to real property but a few applied it to personal property in the possession of a mortgagee. See cases discussed *infra* note 139 and accompanying text; see also *In re Portland Elec. Power Co.*, 97 F. Supp. 903, 909-11 (D. Ore. 1947) (stating that section 257 applied to personal property as well as to real property, but declining to order an indenture trustee holding, as collateral for a bond issue, stock owned by the debtor to return the stock to the bankruptcy trustee; also stating that the court would not order the turnover without protecting the interests of the creditor).

139. See, e.g., *First Pennsylvania Banking & Trust Co. (In re Georgetown on the Delaware, Inc.)*, 466 F.2d 80, 82-83 (3d Cir. 1972) (holding that the bankruptcy court abused its discretion in ordering a mortgagee in possession to return an apartment building to the bankruptcy trustee because the debtor had no meaningful equity, and there was no evidence to show a probability for a successful reorganization); *In re Flying W Airways, Inc.*, 442 F.2d 320, 324 (3d Cir. 1971) (*Flying WI*) (vacating a bankruptcy court's ex parte order to creditors in possession of aircraft to return the aircraft to the bankruptcy trustee, and ordering the court to consider on remand the possibility of reorganization, existence of any equity, and the relationship of the trustee's possession to reorganization); *In re Riker Delaware Corp.*, 385 F.2d 124, 126 (3d Cir. 1967) (stating that a turnover order "in which the debtor had no demonstrable equity could be confiscatory . . . [and] without prospect of reorganization would be alien to the purpose of a Chapter X proceeding"); *In re Flying W Airways, Inc.*, 341 F. Supp. 26, 103 (E.D. Pa. 1972) (*Flying W II*) (finding on remand from *Flying WI*, *supra*, that the debtor had no equity in an aircraft seized by a creditor prepetition and that there was no reasonable prospect of a successful reorganization and ruling that the aircraft, turned over to the trustee pursuant to an ex parte turnover order, be returned to the creditors); *infra* notes 148, 157 and accompanying text (discussing cases in which the debtor had equity in the property items in the creditor's possession). Neither *Flying WI* nor *Flying W II* discussed the language of section 257, which applied to "mortgages," but the creditor in possession in those cases held a security interest under an "Aircraft Chattel Mortgage-Security Agreement." *Flying W II*, 341 F. Supp. at 42.

140. Paul F. Festersen, *Equitable Powers in Bankruptcy Rehabilitation: Protection of the Debtor and the Domsday Principle*, 5 CREIGHTON L. REV. 221, 221 (1972) (reprinted in 46 AM. BANKR. L.J. 311 (1972)).

141. See *Charlestown Sav. Bank v. Martin (In re Colonial Realty Inv. Co.)*, 516 F.2d 154, 158 (1st Cir. 1975) (holding that under section 507 the bankruptcy court could order a mortgagee in possession of an encumbered apartment building to return possession of the building to the debtor). The Court of Appeals for the First Circuit further held that, before the income from the property could be used for administrative expenses of the estate, the bankruptcy court had to determine the probable benefit, or at least the absence of harm, to the secured creditor. *Id.* at 160. Finally, the court ruled that the bankruptcy court should determine whether the petition had been filed in good faith and whether

b. Judicial Extrapolation.—Despite the absence of an explicit provision requiring return,¹⁴² a few courts also relied on the jurisdiction of a bankruptcy court in reorganizations over the debtor's "property" to require the return of property items in the creditor's possession. For example, the Court of Appeals for the Eighth Circuit in *Grand Boulevard Investment Co. v. Strauss*¹⁴³ held that the jurisdictional provisions of the short-lived section 77B (corporations) authorized the bankruptcy court to order the return of a real property item—an apartment building—in the possession of mortgage trustees.¹⁴⁴

there was a sufficient possibility of reorganization to justify whatever risk the secured creditor's collateral might suffer. *Id.* at 160-61. In this regard, the court acknowledged that its standard may be less protective to the secured creditor than that applied by the Third Circuit. *See id.* at 161 n.13 (noting that "[a] contrary view has been expressed . . . principally by the Third Circuit" (citing *Flying WI*, 442 F.2d at 323-24; *In re Riker Delaware Corp.*, 385 F.2d at 125-26)). *Cf. In re Maidman*, 466 F. Supp. 278 (S.D.N.Y. 1979). *Maidman* involved a debtor who had obtained a turnover order from a receiver, appointed to foreclose a mortgage, who had possession of the mortgaged real estate, but subject to an existing lease entered into by the receiver. *Id.* at 283. The court held that the filing of a chapter XII petition order did not void the lease, but it did not provide any details of the underlying turnover order.

142. The short-lived section 74 (for noncorporate debtors) presented an interesting statutory hybrid. This section allowed only an extension of the time of payment of debts secured by property items in the possession of the debtor. Bankruptcy Act, § 74(h), added by Act of Mar. 3, 1933, ch. 204, § 1, 47 Stat. 1467, 1470, discussed *supra* note 78 and accompanying text. Congress, however, amended section 74 in 1934 to extend the bankruptcy court's jurisdiction to "property of the debtor" in the possession of receivers or mortgagees. *See* Act of June 7, 1934, ch. 424, § 2, 48 Stat. 911, 923 (amending section 74(m) to include the bankruptcy court's jurisdiction over "property of the debtor in the possession of a trustee under a trust deed or a mortgage, or a receiver, custodian or other officer of any court in a pending cause"). The purpose of the amendment was most likely to overrule the cryptic holding in *Hardenbrook v. Landquist*, 70 F.2d 929 (7th Cir. 1934), decided May 3, 1934, which found that section 74(h)'s jurisdictional limitation to extension of debts secured by property only in the possession of the debtor or bankruptcy receiver precluded a bankruptcy court from enjoining a foreclosure proceeding against real estate in the possession of a state court receiver or to issue a subpoena to the mortgagee. *Id.* at 935-36. Courts later held that the amended section 74(m) gave the bankruptcy court jurisdiction to require creditors in possession of property items to return them to the bankruptcy trustee. *See Mellin v. Monsen (In re Monsen)*, 74 F.2d 411, 412 (7th Cir. 1934) (holding that the express grant of jurisdiction by section 74(m), as amended, authorized the transfer of real estate in the possession of a receiver appointed by a state court to the bankruptcy court); *In re Faour*, 72 F.2d 719, 720 (2d Cir. 1934) (relying specifically on the court's jurisdiction under section 74(m) over "property of the debtor" in ordering transfer of all remaining assets to bankruptcy trustee); *In re Jacobs*, 7 F. Supp. 749, 751-52 (N.D. Ill. 1934), *appeal dismissed*, 73 F.2d 1002 (7th Cir. 1934) (reading section 74(m) as giving bankruptcy courts power over real estate in the hands of a state court receiver appointed to foreclose a deed of trust).

143. 78 F.2d 180 (8th Cir. 1935).

144. *Id.* at 185-86. The debtor owned an apartment building subject to a mortgage securing outstanding bonds. *See id.* at 181. Two years before the petition, the debtor de-

Quoting extensively from *Rock Island*, the court noted the grant of equity powers to bankruptcy courts, including the power to issue orders necessary to effectuate reorganizations, and the court's jurisdiction over the debtor's "property."¹⁴⁵ Further, relying on the same meaning of "property" used in *Prudence-Bonds*,¹⁴⁶ the court concluded that the bankruptcy court's jurisdiction extended not just to the debtor's equity in the apartment building but to the entire apartment building.¹⁴⁷ Accordingly, it held that the bankruptcy court had the power to order the return of possession of the apartment building to the debtor or to the trustees appointed by the bankruptcy court.¹⁴⁸

faulted on the bonds and gave possession of the apartment building to the trustees under the mortgage. *See id.* The trustees had begun foreclosure proceedings in state court. *See id.*

145. *Id.* at 182-83 (citing *Continental Ill. Nat'l Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry. Co.*, 294 U.S. 648 (1935)).

146. 77 F.2d 328 (2d Cir. 1935); *see supra* notes 118-124 (discussing the definition of property used by the Court of Appeals for the Second Circuit).

147. *Grand Boulevard*, 78 F.2d at 183-84. The court did not mention *Prudence-Bonds*. Instead, the court transformed the meaning of "property" in the jurisdictional grant from the debtor's equity in *Rock Island* to the property item itself. *Id.* It quoted the discussion in *Rock Island* that the debtor's equity in the collateral was "property" and that the bankruptcy court had jurisdiction over this equity. *Grand Boulevard*, 78 F.2d at 182-83; *see also supra* text accompanying note 110 (discussing *Rock Island*). The court then stated, "[i]n the case at bar, as in the *Rock Island Case*, it is claimed that the sale of the *encumbered property*" would interfere with forming and carrying out a reorganization plan. *Id.* at 183 (emphasis added). Thereafter, the court used the word "property" to mean the apartment building, not the debtor's equity in the building.

148. *Id.* at 185 (explaining that the expanded jurisdiction of the bankruptcy court extended to all of the debtor's property). Because the bankruptcy court had rejected the petition for the return of possession, the court of appeals did not address the appropriateness of the relief. *Id.* at 186.

See also *National Builders Bank v. Schwartz (In re Moulding-Brownell Corp.)* 101 F.2d 664, 666 (7th Cir. 1939) (holding that the bankruptcy court's jurisdiction over the debtor's "property"—meaning its equity interest—in a reorganization under section 77B allowed a bankruptcy trustee to wrest control from a creditor over accounts with a face amount of more than \$37,000 securing a debt in the amount of \$15,343). In *Schwartz*, the creditor had been collecting the accounts before the filing of the petition. *Id.* at 665. This case contrasts with *In re Philadelphia & Reading Coal & Iron Co.*, 117 F.2d 976, 978 (3d Cir. 1941), discussed *supra* note 70, in which the debtor was entitled to receive the interest on bonds and dividends on stock pledged to and held by a creditor, and therefore the creditor did not have control over the interest and dividends. *Id.* The court in *Philadelphia & Reading Coal & Iron Co.* also stated that, if there were no equity in the collateral as alleged by the creditor, the court should direct the bankruptcy trustee to disclaim any interest in the collections. *Id.* In addition, it noted that the order was a temporary order which required the bankruptcy trustee to deposit the collections in the separate accounts pending a determination of whether reorganization was feasible. *Id.* at 978-79; *see also In re Nineteenth & Walnut Streets Corp.*, 9 F. Supp. 625, 626-27 (E.D. Pa. 1935) (treating an apartment house owned by the debtor but in the possession of mortgage trustees for mortgage backed bonds as the debtor's "property" and holding that the bankruptcy court could order return of possession to the bankruptcy trustee because of the grant of jurisdiction over

After the Chandler Act of 1938 replaced sections 74 and 77B with chapters X through XIII,¹⁴⁹ several decisions also upheld the bankruptcy court's power in chapter X to order the return of property items in the possession of a creditor in situations not covered by the express return provisions of section 257.¹⁵⁰ The leading case is *Reconstruction Finance Corp. v. Kaplan*.¹⁵¹ In *Kaplan*, the United States Court of Appeals for the First Circuit relied on the jurisdictional provisions for chapter X to affirm the lower court's approval of a reorganization plan requiring a secured creditor to return personal property items in its possession to the debtor.¹⁵² The court of appeals noted that the specific return power in section 257,¹⁵³ though analogous, did not apply because the creditor did not have possession as a mortgagee or under a trust deed.¹⁵⁴ Nevertheless, relying on *Rock Island*, *Prudence Bonds Corp.*, and *Grand Boulevard Investment Co.*, the court of appeals held that the general equity powers of the bankruptcy court and the jurisdiction of the bankruptcy court over all of the debtor's property authorized the bankruptcy court to approve a plan of reorganization requiring return of the collateral.¹⁵⁵ The court of appeals further

the debtor's "property" and the grant to the bankruptcy court of the same powers that a federal court would have if it had appointed a receiver in equity to take possession, incorrectly citing section 77B(i) instead of section 77B(a)).

149. Act of June 22, 1938, ch. 575, 52 Stat. 840, 883-938 (adding Bankruptcy Act, §§ 101-686) (codified as amended at 11 U.S.C. §§ 501-1086 (1976) (repealed 1978)).

150. See *supra* notes 131, 136 and accompanying text (quoting section 257).

151. 185 F.2d 791 (1st Cir. 1950); see also *Murphy, Use of Collateral*, *supra* note 138, at 1492-93 (discussing *Kaplan*). Other pertinent cases include *Mulin v. Allen (In re Muntz TV, Inc.)*, 229 F.2d 228, 231 (7th Cir. 1956) (citing *Kaplan*, interpreting the word "property" to mean the property item owned by the debtor, and holding that the bankruptcy court has jurisdiction over and could order the return of \$16,000 cash deposited with a landlord/creditor to secure the debtor's obligations under a lease) and *In re Manning*, 104 F. Supp. 506, 510-11 (N.D. W. Va. 1952) (stating that under the general grant of jurisdiction to bankruptcy courts and court decisions, such as *Rock Island*, *Kaplan*, and *Prudence-Bonds*, the creditor in possession, a warehouse with an oversecured warehouse lien, had to obey an order to return personal property to the bankruptcy trustee and therefore did not lose the priority of its lien against subordinate creditors when it delivered personal property items).

152. *Kaplan*, 185 F.2d at 797.

153. See *supra* notes 131, 136 and accompanying text (quoting section 257).

154. *Kaplan*, 185 F.2d at 795. *Murphy* stated that the court assumed, without discussion, that its powers under section 257 extended to personal property. *Murphy, Use of Collateral*, *supra* note 138, at 1492. This statement is not quite right. The court merely noted that the bankruptcy court's jurisdiction extended to all property, but it explicitly stated that section 257 "may not specifically authorize a turnover order displacing the ordinary possessory lien of a pledgee of collateral or other personal property." *Kaplan*, 185 F.2d at 795.

155. *Kaplan*, 185 F.2d at 798; cf. *Pettit v. Olean Indus., Inc.*, 266 F.2d 833, 835 (2d Cir. 1959) (holding that the bankruptcy court's power to determine the amount and validity of claims against the debtor and the security for such claims under Bankruptcy Act §§ 596 & 597 (codified as amended at 11 U.S.C. §§ 996 & 997 (1976) (repealed 1978)) authorized the court to assume jurisdiction to determine the right to proceeds of accounts held by

held that the bankruptcy court's approval of the plan was not an abuse of discretion because it was supported by the bankruptcy court's findings.¹⁵⁶ The bankruptcy court had found that (i) the value of the debtor's assets possessed by the creditor substantially exceeded the creditor's claim¹⁵⁷ and (ii) the reorganization plan was "fair, equitable, and feasible."¹⁵⁸

The courts, however, were not unanimous in extending the bankruptcy court's jurisdiction in a chapter X case to require turnover of property items held by a creditor. For example, in *Bradshaw v. Loveless (In re American National Trust)*,¹⁵⁹ the Court of Appeals for the Seventh Circuit held that the bankruptcy court did not have summary jurisdiction in a chapter X case to order the turnover of property items in the hands of a creditor.¹⁶⁰ In this case, the debtor had entered into a contract to buy a shopping center from the sellers. To secure its obligation to complete the contract, the debtor delivered to the sellers \$50,000 in cash and one parcel of real estate.¹⁶¹ Before the closing of the sale, the debtor filed a petition to reorganize. The reorganization trustee then sought to reject the purchase contract and to obtain the return of the \$50,000 and the parcel.¹⁶² The district court authorized the trustee to reject the contract and ordered the sellers to return the property items in their possession.

On appeal, the court of appeals found that the trustee for the debtors had the power to reject the purchase contract under section 116(1) of the Bankruptcy Act.¹⁶³ The court of appeals also held,

third parties and pledged to a creditor). In *Lake Shore Financial Corp. v. Weir (In re Cuyahoga Finance Co.)*, 136 F.2d 18 (6th Cir. 1943), the trustee in a chapter X case sought to redeem stock held by a creditor of the debtor. *See id.* at 19. As a prelude, the trustee also sought to establish and to set-off against the debt owed to the creditor the amount that the creditor owed to the debtor. *See id.* Relying on the general grant of jurisdiction to the court over the debtor's property and its powers as a court of equity, the court held that it had summary jurisdiction to determine the amount of the mutual set-offs, even though the creditor had not filed a claim in the chapter X case. *Id.* at 20-21.

156. *See Kaplan*, 185 F.2d at 797.

157. *Id.* at 793.

158. *Id.*

159. 426 F.2d 1059 (7th Cir. 1970).

160. *Bradshaw*, 426 F.2d at 1066; *see also* *United States v. Owens*, 329 F.2d 678, 680 (5th Cir. 1964) (holding that the bankruptcy court in a chapter X case did not have summary jurisdiction over moneys held by the United States owed to the debtors but retained to pay past due taxes owed to the United States Government).

161. *Bradshaw*, 426 F.2d at 1061, 1065-66.

162. *Id.*

163. *See id.* at 1064 (discussing section 116(1) of the Bankruptcy Act and explaining that "[i]f an executory contract is determined to be detrimental or onerous and thereby might hinder an effective reorganization, its rejection should be authorized" (quoting *Workman v. Harrison*, 282 F.2d 693, 699 (10th Cir. 1960))).

however, that neither that section nor any other section of the Bankruptcy Act authorized the bankruptcy court to adjudicate summarily the propriety of the seller's retention of the cash and real property deposit.¹⁶⁴ The court did not discuss *Kaplan* or any other cases in which courts held that the jurisdiction of the bankruptcy court over property of the debtor authorized turnover orders against creditors in possession.

Although the general jurisdictional sections for chapter XI were the same as chapter X, chapter XI provided for the adjustment of only the unsecured debt of a corporation.¹⁶⁵ A plan could not directly affect property items held by a creditor in possession.¹⁶⁶ Nevertheless, one court, after the enactment but before the effectiveness of the Bankruptcy Code, held that the bankruptcy court in a chapter XI case had the power to order a receiver in possession who was foreclosing a mortgage to return possession of the mortgaged property to the debtor in possession.¹⁶⁷ Apparently, this case is the only reported one requiring turnover in a chapter XI case.¹⁶⁸ Moreover, several United States courts of appeals held that the bankruptcy court had no power

164. *See id.* at 1065-66. The trustee had argued that the deposits were simply collateral security for the debtor/buyers' obligation to purchase. *See id.* at 1066. The sellers argued that the deposits were earnest money subject to retention in the event of nonpayment of the purchase price. *See id.* The court considered such distinction irrelevant; in either event, the sellers were "creditors" under the Bankruptcy Act, which defined a "creditor" as including "anyone who owns a debt, demand, or claim provable in bankruptcy," Bankruptcy Act, § 1(11), 30 Stat. 544, 544 (1898) (codified as amended at 11 U.S.C. § 1(11) (1976) (repealed 1978)), because the time of the buyers' performance was not yet due, and the sellers' right to retain the deposit had not become absolute when the chapter X case began. *Bradshaw*, 425 F.2d at 1066.

165. *See supra* note 76 and accompanying text.

166. If property items subject to a security interest were in the possession of the debtor as of the filing of the petition, the bankruptcy court had jurisdiction over such property items. *See In re 221A Holding Corp.*, 1 B.R. 506, 508 (E.D. Pa. 1979) (noting that the "traditional view is that possession by the bankrupt is necessary for the property to pass into the custody of the bankruptcy court").

167. *See id.* at 508. The court, however, reversed the turnover order because the bankruptcy judge abused his discretion when he failed to hold an evidentiary hearing on the turnover and ruled that the bankruptcy court should use the same standards as applied in turnover proceedings under chapter X. *Id.* at 509; *see also supra* notes 139, 151-158 and accompanying text and cases discussed *infra* notes 180-181 (discussing chapter X turnover proceedings).

168. I have found no other cases, and the court in *221A Holding Corp.*, 1 B.R. at 509, stated that counsel in that case and the court had found no cases either applying or refusing to apply the chapter X turnover cases to a turnover order issued under chapter XI. *See also In re Copeland*, 531 F.2d 1195, 1201, 1209 (3d Cir. 1976) (denying, in a chapter XI case, a debtor's attempt under the strong arm power to force the return of stock held by the creditor, and vacating without prejudice a bankruptcy court order enjoining the sale of stock in a creditor's possession because of the bankruptcy court's failure to determine if it had summary jurisdiction); Murphy, *Restraint*, *supra* note 79, at 40-41 (expressing doubt

to require a creditor in possession or its agents, who had taken possession of property items of the debtors to foreclose liens before the filing of a chapter XI petition, to return the property items to the bankruptcy trustee or debtor in possession.¹⁶⁹

Interestingly, although chapter XI did not allow modification of secured debt, debtors used it more often than chapter X because of its flexibility.¹⁷⁰ Most debtors who reorganized under chapter X had to give up control of the reorganization to trustees appointed by the bankruptcy court.¹⁷¹ Moreover, chapter X contained more specific procedural requirements. Chapter XI did not automatically require the appointment of trustees and had more streamlined procedural requirements. The existing management of the debtor maintained their control of the debtor and their control of the reorganization case. Thus, those who controlled insolvent businesses, though they could not modify the rights of secured creditors, had a greater incentive to use chapter XI than chapter X.

that the court in a chapter XI proceeding had jurisdiction to order a creditor in possession to return the property item to the reorganizing debtor).

169. See *Smith v. Hill*, 317 F.2d 539, 542 (9th Cir. 1963) (rejecting the assertion that a bankruptcy court could order a state court receiver, appointed to foreclose a defaulted conditional sale contract, to turn over property items in his possession); *Yoshinuma v. Oberdorfer Ins. Agency*, 136 F.2d 460, 461 (5th Cir. 1943) (rejecting the argument that the court's jurisdiction over the debtor's "property" gave it the power to order a state court receiver, who had possession of real property to foreclose a mortgage, to return the real property to the debtor, and holding that the court's turnover power was no greater than that of a bankruptcy court in a liquidation); *Ben Hyman & Co. v. Fulton Nat'l Bank (In re Ben Hyman & Co.)*, 423 F. Supp. 1006, 1010 (N.D. Ga. 1976) (holding that, although a bank could not set-off amounts in a deposit account against debt owed by debtor to bank, the bankruptcy court did not have the power to order the bank to make the funds in the account available to the debtor without protecting the rights of the creditor); *Countryman*, *supra* note 88, at 319-20 (noting that "a Chapter XI court has no power to enter a turnover order against a receiver appointed by a state court more than four months before the filing of the Chapter XI petition on application of a judgment creditor" (footnote omitted)); see also *Winner Corp. v. H.A. Caesar & Co. (In re Winner Corp.)*, 511 F.2d 1010, 1014-15 (6th Cir. 1975) (holding that a bankruptcy court abused its discretion in ordering a creditor to turn over to the debtor collections of accounts assigned to it before the petition that the creditor had collected and withheld pursuant to an express authorization in a factoring agreement); *Bayview Estates, Inc. v. Bayview Estates Mobile Homeowners Ass'n (In re Bayview Estates, Inc.)*, 508 F.2d 405, 407 (6th Cir. 1974) (holding that the bankruptcy court had no jurisdiction over moneys in the possession of an escrow agent that allegedly were payable by tenants to the debtor).

170. See COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, pt. 1, at 246-47 (1973) [hereinafter *BANKRUPTCY COMMISSION REPORT*] (discussing the differences between chapter X and chapter XI, and noting that "chapter XI has evolved into the dominant reorganization vehicle").

171. The bankruptcy judge had discretion not to appoint independent trustees only if the total indebtedness of the debtor were less than \$250,000. See *Bankruptcy Act*, § 156, added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 888 (1938) (codified as amended at 11 U.S.C. § 556 (1976) (repealed 1978)).

Similarly, chapter XIII plans for wage earners could deal with secured creditors only if the creditors agreed.¹⁷² I found no cases requiring creditors in possession of property items owned by the wage owner, like a car or a house, to return them to the debtor.¹⁷³

C. Summary

On the eve of the enactment of the Bankruptcy Code, the creditor in possession of property items owned by a debtor in bankruptcy under the Bankruptcy Act had the following rights and suffered the following debilities: In a liquidation case, she could foreclose her security interest in property items in her possession and apply the proceeds to her claim unless she had obtained possession as the result of a judicial lien within four months before the adjudication of bankruptcy.¹⁷⁴ In reorganizations under all four chapters, however, an automatic stay prevented a creditor in possession from liquidating property items in its possession.¹⁷⁵ Before the adoption of the automatic stay, a debtor could get an injunction to prevent the liquidation pending development and confirmation of the plan.¹⁷⁶ Courts continued the stay or granted an injunction only when the debtor had equity in the property items and there was a reasonable prospect of reorganization.¹⁷⁷

172. See *supra* note 77 and accompanying text (discussing the extent of chapter XIII); see also *supra* note 89 and accompanying text (surveying chapter XIII cases affirming or entering orders preventing creditor actions to repossess property items subject to the creditors' security interest when the debtors had possession of the property items). Of course, if a creditor were to seize a property item owned by the debtor after the filing of the petition, the bankruptcy court could order the creditor to return the property item to the debtor. See *First Nat'l Bank of Portsmouth, New Hampshire v. Cope*, 385 F.2d 404, 406 (1st Cir. 1967).

173. Cf. *In re Williams*, 422 F. Supp. 342, 345 (N.D. Ga. 1976) (holding that in a chapter XIII case a bank did not have the right to set-off a deposit account against a debt owed to the bank, but that the bankruptcy court did not have the authority to order that the bank make the checking account funds available to the debtor).

174. See *supra* Part I.A (discussing the rights of the creditor in possession when a debtor liquidated under the Bankruptcy Act).

175. See *supra* Part I.B (discussing the rights of the creditor in possession when a debtor reorganized under the Bankruptcy Act).

176. Injunctions were not necessarily automatic. See, e.g., *Reighard v. Higgins Enter. Inc.*, 90 F.2d 569 (3d Cir. 1937) (holding that under section 77B(c)(10), discussed *supra* note 87, the bankruptcy court improperly enjoined the foreclosure sale of mortgaged property two days before the sale date when the debtor had no equity in the property and the costs of liquidation in the bankruptcy case exceeded the costs of the foreclosure proceeding).

177. See *In re General Stores Corp.*, 147 F. Supp. 350 (S.D.N.Y. 1957); *supra* notes 88-90, 92 and accompanying text. In *General Stores*, the court denied a motion to lift an injunction against liquidation of stock in possession of creditor, despite allegations of no equity or no feasible reorganization, because of evidence that the value of the stock exceeded the

In a reorganization under chapters X and XII, the debtor in possession or the bankruptcy trustee could regain possession of property items from a creditor in possession under certain circumstances.¹⁷⁸ The creditor in possession was required to return its collateral only if the debtor had equity in the property items.¹⁷⁹ Moreover, there had to be a reasonable likelihood for a successful reorganization of the debtor.¹⁸⁰ Even when the basis for a turnover order was statutory, the bankruptcy court was required to protect the secured creditor from harm¹⁸¹ before ordering the return of the property items.

amount of the debt and imminence of the trustee's report on the feasibility of a reorganization. *General Stores*, 147 F. Supp. at 355-56. The court's ruling was without prejudice allowing the creditor to file a new motion if a plan were not proposed within 75 days. *Id.* at 355.

178. In addition, if a creditor obtained possession of property items owned by the debtor after the filing of the petition for reorganization, the bankruptcy court would order the return of possession of those property items to the bankruptcy trustee or debtor in possession. *See, e.g., John Hancock Mut. Life Ins. Co. v. Casey*, 134 F.2d 162, 163 (1st Cir. 1943) (holding that real property of the debtor was in "custodia legis" as of the filing of a chapter X petition and affirming a turnover order against a mortgagee that had taken possession after the filing of the chapter X petition).

179. *See supra* notes 139, 148, 157 and accompanying text (discussing cases in which the debtor had equity in the property items in the creditor's possession); *see also* Carlson, *Postpetition Interest*, *supra* note 73, at 590-96 (discussing secured and unsecured creditors' entitlements to postpetition interest under the Bankruptcy Act). Creditors in possession could no doubt agree to relinquish possession even if the debtor had no equity in the property items. *See, e.g., Brooklyn Trust Co. v. Kelby (In re Prudence-Bonds Corp.)*, 134 F.2d 105, 107-08 (2d Cir. 1943) (reciting the earlier approval of a plan of reorganization providing that the indenture trustees for eighteen series of bonds secured by the mortgages, in which the debtor had no equity, transfer the mortgages to a new corporate trustee for the benefit of the bondholders).

180. *See supra* notes 139, 158 and accompanying text; *see also* Melniker v. Lehman (*In re Third Ave. Transit Corp.*), 198 F.2d 703, 706-07 (2d Cir. 1952) (holding that, although the bankruptcy court had the statutory authority to order a first mortgagee to return proceeds of mortgaged properties sold in foreclosure before and after the commencement of a chapter X case, it could do so only if "there is a high degree of likelihood (a) that the debtor can be reorganized in accordance with the Act, within a reasonable time, and (b) that the secured creditors whose security is being compulsorily loaned will not be injured" and further holding that the court had abused its discretion in ordering such return (footnotes omitted)).

181. *See supra* note 180; *see also In re O.V. Corp.*, 386 F.2d 833, 834 (3d Cir. 1967) (per curiam) (holding that a mortgagee in possession was entitled to a full hearing before being ordered to return possession of real property to the trustee in a chapter X case); *In re Franklin Garden Apartments*, 124 F.2d 451, 454 (2d Cir. 1941) (affirming, under chapter X, a bankruptcy court's order requiring a mortgagee in possession of an encumbered apartment building to return possession of the building to the debtor, but, noting that the debtor's equity was small, modifying the order to prohibit the use of the rents for the administrative expenses of the bankruptcy case).

II. THE CREDITOR IN POSSESSION IN DRAFTING THE CODE

Because the Bankruptcy Act of 1898, as amended in 1938, had begun to show its age,¹⁸² Congress formed the Commission on the Bankruptcy Laws of the United States in 1970 to make recommendations for changes in the Bankruptcy Act.¹⁸³ In 1973, the Commission issued its report¹⁸⁴ and proposed a draft of a new bankruptcy act.¹⁸⁵ Congressional sponsors introduced the Commission's act into the House of Representatives and the Senate in the 93d and 94th Congresses,¹⁸⁶ along with a similar but competing proposal recommended by the National Conference of Bankruptcy Judges.¹⁸⁷

The Commission paid scant direct attention to the creditor in possession. The Commission did make, however, many recommendations that affected creditors generally, some of which also affected the creditor in possession. First, it recommended creating bankruptcy courts with the power to adjudicate all bankruptcy-related issues. Its act proposed that the jurisdiction of the bankruptcy courts should extend to "controversies involving property of the estate of the debtor without regard to who has possession."¹⁸⁸ The Commission intended that this jurisdiction extend to creditors in possession and to the property items that they held.¹⁸⁹

182. See generally BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 1, at 2-5 (identifying, as "[p]roblems which caused the [Bankruptcy Laws] Commission to be created," increased bankruptcy filings, administrative costs and delays, inadequacy of relief, and the "need for substantial revision of the system of bankruptcy administration").

183. See Bankruptcy Study Commission, Pub. L. No. 91-354, 84 Stat. 468 (1970), *reprinted in* 1970 U.S.C.C.A.N. 545; see also Klee, *supra* note 29, at 942-43 (discussing the formation of the Commission on the Bankruptcy Laws of the United States).

184. See BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 1.

185. See *id.* at pt. 2 (containing the proposed act).

186. See S. 236, 94th Cong. (1975); H.R. 31, 94th Cong. (1975); S. 4026, 93d Cong. (1973); H.R. 10792, 93d Cong. (1973). See generally Klee, *supra* note 29, at 943-44 (discussing the introduction of the act into the House of Representatives by Congressmen Don Edwards and Charles Wiggins, and into the Senate by Senator Quentin Burdick). Because these bills set forth the Commission's act, I will not provide cites to them when citing the Commission's act.

187. See S. 235, 94th Cong. (1975); H.R. 32, 94th Cong. (1975); H.R. 16643, 93d Cong. (1973). A companion bill was not introduced in the Senate in the 93d Congress. See generally Klee, *supra* note 29, at 943-44.

188. BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, § 2-201(a)(5), at 30; see also *Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong. app. 56 (1975-1976) [hereinafter *Comparison of H.R. 31 & 32*] (comparing the Commission's act, H.R. 31, and the bankruptcy judges bill, H.R. 32).

189. The Commission recommended that the jurisdiction of the new bankruptcy courts include determining "all disputes affecting property in the custody of the court, including that in the possession of the bankrupt on the date of the bankruptcy and the property to

In another major change from the Bankruptcy Act of 1898, the Commission proposed a new definition for the "property of the estate."¹⁹⁰ This definition replaced the long list of ten types of property of the estate in the Bankruptcy Act¹⁹¹ with one general formulation, "all property of the debtor as of the date of the petition," plus a few other items.¹⁹²

The Commission's phrase "property of the debtor" raised the property ambiguity, that is, whether "property of the debtor" meant property items owned by the debtor, the colloquial meaning of "property," or the property interests of the debtor in the property items, the legal meaning.¹⁹³ In the case of property items owned by a debtor but held by a creditor in possession, the legal meaning—the debtor's interests in property—would have excluded the creditor's possessory interests because the property interests of the debtor consist only of the right to redeem the creditor's security interest, the right to surplus in the case of a foreclosure sale, and the other incidents of an equity interest, such as the right to notice of a foreclosure sale.¹⁹⁴ On the other hand, under the colloquial meaning of "property of the debtor," that is, property items owned by the debtor, the court would have jurisdiction over property items owned by the debtor but held by a creditor in possession.

which the debtor had title at the date of the filing of a reorganization petition." BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 1, at 88.

190. *Id.* at 17.

191. *See supra* note 126 and accompanying text.

192. The Commission recommended that the "property of the estate be defined in the act comprehensively and that the tests of transferability and leviability under state law be abandoned" and "that all property owned by the debtor as of the date of the filing of the petition be considered property of the estate subject to administration." BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 1, at 17,192.

Section 4-601(a) of the act proposed by the Commission and the bills introduced into the 93d and 94th Congress provided: "The following is property of the estate: (1) all property of the debtor as of the date of the petition, except as provided in clause (5) of this subdivision." *Id.* pt. 2, at 147; *see* S. 236, 94th Cong. § 4-601 (1975); H.R. 31, 94th Cong. § 4-601 (1975); S. 4026, 93d Cong. § 4-601 (1973); H.R. 10792, 93d Cong. § 4-601 (1973); *see also Comparison of H.R. 31 & H.R. 32, supra* note 188, at 163. Subsection (a)(5) covered the extent to which community property, powers of appointment, and contingent interests were included. The other elements, set forth in subsections (a)(2)-(4), were payments made by or recovered from a general partner of a bankrupt partnership, property transferred prepetition and recovered by the trustee from a custodian or under the avoidance powers (lien avoidance, preference, fraudulent conveyance); and property acquired by the debtor within six months by bequest, devise, or inheritance, or from a divorce property settlement.

193. *See generally* Plank, *Bankruptcy Estate, supra* note 9, at 1194-95, 1200-03 (discussing the legal definition of property).

194. *See infra* note 267 and accompanying text.

It is most likely that the Commission intended or thought of the "property of the debtor" in the colloquial sense. This interpretation of the phrase was the basis for the holding in many of the cases under the Bankruptcy Act extending the bankruptcy court's jurisdiction to creditors in possession.¹⁹⁵ This colloquial definition of "property of the debtor," however, was no longer necessary under the proposed act to give the bankruptcy court jurisdiction over the creditor in possession pursuant to its jurisdiction over property of the debtor.¹⁹⁶ The Commission's act had also proposed that the jurisdiction of the bankruptcy court "extend to all controversies that arise out of a case commenced under this Act."¹⁹⁷ Because the determination of creditor claims has long been a major function of bankruptcy adjudicators,¹⁹⁸ this language includes creditors in possession.¹⁹⁹

The Commission also recommended adding in the case of liquidations and continuing in the case of reorganizations an automatic stay of creditor foreclosure proceedings.²⁰⁰ The proposed act simply provided that a petition filed by or against the debtor "shall operate as a stay of . . . (C) any act to create or enforce any lien against the property of the estate."²⁰¹ The Commission stated that this stay extended to the interest of a debtor as a pledgor in collateral held by a pledgee.²⁰²

Finally, the Commission's act proposed a limited turnover power. Section 4-603 provided that a "custodian" holding property of the debtor was required to return that property to the receiver or trustee for the debtor. These custodians were

- (1) a receiver, trustee, or other officer of a nonbankruptcy court, or

195. See, e.g., *supra* notes 119, 147, 151, 155 and accompanying text (analyzing these cases).

196. See *supra* note 188 and accompanying text (discussing the Commission's proposal on jurisdiction).

197. BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, § 2-201(a), at 30; see also *Comparison of H.R. 31 & H.R. 32*, *supra* note 188, at app. 55-56.

198. See Thomas E. Plank, *Why Bankruptcy Judges Need Not and Should Not be Article III Judges*, 72 AM. BANKR. L.J. 567, 587-88, 605, 609 (1998).

199. In addition, the jurisdiction of the court included "objections to claims, whether secured or not, against the estate." BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, § 2-201(a)(6), at 30; see also *Comparison of H.R. 31 & H.R. 32*, *supra* note 188, at app. 56.

200. See BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 1, at 16-17, 24.

201. *Id.* pt. 2, § 4-501, at 117-18.

202. See *id.* pt. 2, at 122 n.11 (referencing, among others, *Rock Island*, discussed *supra* notes 102-111 and accompanying text, and *Kaplan*, discussed *supra* notes 151-158 and accompanying text).

- (2) an assignee under a general assignment for the benefit of creditors, or
- (3) a trustee or agent under a statute or contract, who is appointed or authorized to take charge of the property for the purpose of enforcing a lien against property of the debtor or of a general administration of the debtor's property for the benefit of creditors.²⁰³

The custodian had to return the property unless either (a) she took possession more than three months before a liquidation preceding had commenced or (b) the bankruptcy court determined that the interests of the creditors were best served by permitting the prior proceeding or administration by the custodian to continue.²⁰⁴

This proposed section did not expressly include the most common types of creditors in possession, pledgees of personal property items, or creditors who had repossessed personal property items to sell them. Although the Commission stated that this section was derived from several sections of the Bankruptcy Act,²⁰⁵ section 4-603(a) applied to a smaller universe of holders of property items owned by the debtor than some of the turnover sections of the Bankruptcy Act. Specifically, sections 257 and 507 of the Bankruptcy Act had authorized the return of property items in the possession of a mortgagee under a mortgage.²⁰⁶ Section 4-603(a) did not.²⁰⁷ Moreover, under section 4-603, turnover could not be required if the custodian had possession for more than three months before the filing of the peti-

203. BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, § 4-603(a), at 158-59; *see also* S. 236, 94th Cong. § 4-603 (1975); H.R. 31, 94th Cong. § 4-603 (1975); S. 4026, 93d Cong. § 4-603 (1973); H.R. 10792, 93d Cong. § 4-603(b) (1973); *Comparison of H.R. 31 & H.R. 32*, *supra* note 188, at app. 169-70.

204. *See* BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, § 4-603(b), at 159; *see also Comparison of H.R. 31 & H.R. 32*, *supra* note 188, at 170-71.

205. BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, at 160. The sections were 11 U.S.C. §§ 2a(21), 69d, 70a(8), 256, 257, 258, 259, 506, 507, 508, and 509 (1976) (repealed 1978). The Commission also referred to them as proposed rules 604, 10-604, and 13-602.

206. *See supra* notes 136, 137 and accompanying text.

207. In a situation analogous to the creditor in possession, section 7-204 of the Commission's act stayed any action by a creditor of a debtor in a reorganization case to set-off a mutual debt owed by the creditor to the debtor. BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, § 7-204, at 237-38; *see Comparison of H.R. 31 & H.R. 32*, *supra* note 188, at 244-45. It also provided generally that the stay did not affect the right of the creditor to withhold payment, but did authorize the bankruptcy court to order the creditor to pay the amount owed to the debtor if the creditor's interests were adequately protected. BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, § 7-204(c), at 237-38; *see Comparison of H.R. 31 & H.R. 32*, *supra* note 188, at 244-45.

tion.²⁰⁸ The full turnover provisions of sections 257 and 507 for chapters X and XII were not so limited. Finally, although one could argue that the reference in section 4-603 to an "agent" authorized under contract to enforce a lien might include a creditor in possession, this argument is not persuasive, as I discuss below.²⁰⁹

Although the 93d Congress took little action on the bankruptcy revision bills, the 94th Congress devoted significant attention to them. Subcommittees in both the House and the Senate conducted lengthy hearings.²¹⁰ After these hearings, the staff of the Subcommittee on Civil and Constitutional Rights of the House Judiciary Committee produced a revised bill near the end of 1976. At the beginning of the 95th Congress in early 1977, the sponsors introduced this bill in the House of Representatives as H.R. 6.²¹¹ H.R. 6 substantially rewrote the Commission's act into the shape of the current Code, revising existing sections of the Commission's act and making significant changes and additions to the Commission's act.

After further discussions in Congress, the sponsors revised H.R. 6 and introduced the revision as a successor bill, H.R. 7330, on May 23, 1977.²¹² The sponsors then revised this bill and introduced the revision, H.R. 8200, on July 23, 1977.²¹³ The House amended H.R. 8200 several times, and after passage by the House, the Senate also amended H.R. 8200.²¹⁴ Just before final passage of the Code, Con-

208. The competing proposal of the National Conference of Bankruptcy Judges also included a section 4-603 with substantially the same language as that of section 4-603 of the Commission's act. See S. 235, 94th Cong. § 4-603 (1975); H.R. 32, 94th Cong. § 4-603 (1975); H.R. 16643, 93d Cong. § 4-603 (1973); see also *Comparison of H.R. 31 & H.R. 32*, *supra* note 188, at 169-71.

209. See *infra* Part III.C.

210. See *Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong. (1975-1976) [hereinafter *House Hearings*] (spanning four volumes and 2700 pages, and covering 35 days of testimony, with over 100 witnesses); *Hearings on S. 235 & S. 236 Before the Subcomm. on Improvement in Judiciary Machinery of the Senate Comm. on the Judiciary*, 94th Cong. (1975) [hereinafter *Senate Hearings*] (comprising one volume of 1316 pages and covering 3 days of testimony, with 75 witnesses); see also Klee, *supra* note 29, at 944 (noting that in contrast to the 93rd Congress, there was "intensive study of the bankruptcy legislation in both the House and Senate . . . during the 94th Congress").

211. See H.R. 6, 95th Cong. (1977); see also Klee, *supra* note 29, at 945-46 (discussing the legislative history of the Bankruptcy Code).

212. H.R. 7330, 95th Cong. (1977); see also Klee, *supra* note 29, at 946.

213. H.R. 8200, 95th Cong. (1977); see also Klee, *supra* note 29, at 947.

214. The Senate began to work on a companion bill, S. 2266, in October 1977. After H.R. 8200 passed the House and was received in the Senate in February 1978, the Senate revised and adopted S. 2266. Although similar to H.R. 8200, S. 2266, as approved, contained substantial differences. Finally, after approving S. 2266, the Senate amended H.R. 8200, as passed by the House, by striking out the text and substituting all of S. 2266. See Klee, *supra* note 29, at 947-53.

gress made last minute amendments to H.R. 8200 as passed by the House, and H.R. 8200, as amended by the Senate, to reconcile differences between them, and Congress enacted these final versions as the Bankruptcy Reform Act of 1978.²¹⁵

H.R. 6, the first draft of the Code, made important changes in the Commission's act that affected the creditor in possession. In one of its most significant changes, H.R. 6 completely revised the formulation for "property of the estate." Instead of defining property of the estate in terms of "property of the debtor" it explicitly incorporated the legal understanding of property by defining property of the estate as the "interests of the debtor in property."²¹⁶ The new definition of "property of the estate" in H.R. 6 is the current definition in the Code, with only slight modifications.²¹⁷ This definition, in turn, pervades the entire Code.²¹⁸ This change completely eliminated the ability of courts to exploit the ambiguity in the word "property" to affect the rights of creditors in possession in the way that courts under the Bankruptcy Act had done.²¹⁹

Another important change was a rewrite of the Commission's automatic stay provisions²²⁰ into a new section 362(a), which contained many of the substantive provisions in the current Code.²²¹ Still other changes rewrote the Commission's proposal allowing the trustee to use, sell, or lease property of the estate in a new section 363, which

215. The bankruptcy reform bills were finalized late in the legislative session. For practical reasons, the sponsors could not use a conference committee to reconcile the differences between the House and Senate bills. Accordingly, the sponsors in the House and in the Senate informally reconciled the differences and both houses accepted the final compromise. See Klee, *supra* note 29, at 953-56.

216. Compare H.R. 6, 95th Cong., § 541(a)(1), at 81-82 (1977) (providing that the first element of property of the estate consists of "all legal or equitable interests of the debtor in property as of the commencement of the case"), with 11 U.S.C. § 541(a) (1994) (containing identical language), *quoted supra* note 13.

217. See generally Plank, *Bankruptcy Estate*, *supra* note 9, at 1219 n.114 and accompanying text (comparing 11 U.S.C. § 541(a) (1994), with H.R. 6, 95th Cong. § 541(a), at 81-83 (1977)); see also *supra* note 216.

218. See Plank, *Bankruptcy Estate*, *supra* note 9, at 1207-13.

219. See, e.g., *supra* notes 119-124, 142, 147, 151, 155 and accompanying text (analyzing the cases).

220. See *supra* notes 200-202 and accompanying text (discussing the Commission's recommendations for the automatic stay).

221. See H.R. 6, 95th Cong. § 362(a) (1977). H.R. 6 provided that:

Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title operates as a stay of:

(1) the commencement or continuation of a judicial, administrative, or other action or proceeding against the debtor, or that affects property of the estate;

(2) the enforcement, against the debtor or against property of the estate, of a judgment;

remained substantially intact throughout the evolution of the Code,²²² and the requirements for the contents of reorganization and arrangement plans.²²³

The creditor in possession received little direct attention. During the hearings on the Commission's act and the competing proposal of the National Conference of Bankruptcy Judges before their revision into H.R. 6, four witnesses did address the creditor in possession. Three witnesses stated that the trustee should, with appropriate guidelines, be able to regain possession of property in the hands of a secured creditor but that the proposed bill did not provide for such return.²²⁴ More particularly, the National Bankruptcy Conference, an

(3) any act to create or enforce any lien against property of the estate; and

(4) the setoff of any debt owing to the debtor against any claim against the estate.

Id. at 41.

222. Compare 11 U.S.C. § 363 (1994), with H.R. 6, 95th Cong. § 363, at 44-45 (1977) (underline indicates additions to H.R. 6, strike-through shows deletions from H.R. 6):

(b)(1) ~~Subject to the limitations of subsections (d) and (e) of this section,~~ (The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.

...
(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, ~~1203, 1204, or 1304 1305~~ of this title; ~~and unless the court orders otherwise, and subject to the limitations of subsections (d) and (e) of this section,~~ 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 . . . [provisions relating to soft collateral or cash collateral omitted].

...
(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

~~(4)(5) a creditor, such entity could be compelled,~~ in a legal or equitable proceeding, ~~could compel such entity~~ to accept a money satisfaction of such interest.

223. Compare 11 U.S.C. § 1123(a)(3), (5), (b)(1), (6) (1994), with H.R. 6, 95th Cong. § 1123(a)(3), (4), (b)(1), (6), at 163-66 (1977); 11 U.S.C. § 1322(b)(2), (11) (1994), with H.R. 6, 95th Cong. § 1322(b)(2), (10), at 163-66 (1977). However, section 1123 in H.R. 6 did not contain the express authorization to "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence" set forth in § 1123(b)(5), *quoted infra* note 344, and section 1322(b)(2) in H.R. 6 did not contain the prohibition against modifying a residential first mortgage contained in § 1322(b)(2).

224. See *House Hearings*, *supra* note 210, at 439 (pt. 1) (prepared statement of Patrick A. Murphy that in a reorganization case "the legislation should expressly deal with the question of when and under what standards displacement of the secured creditor [in posses-

organization of judges, lawyers, and academics interested in bankruptcy, noted that section 4-603 of the Commission's act required turnover by a custodian of property of a debtor.²²⁵ It further noted, however, that neither that section nor any other section contained the requirement set forth in section 257 of the Bankruptcy Act²²⁶ that a mortgagee or other secured creditor in possession return property items to the trustee.²²⁷ The National Bankruptcy Conference further recommended that this turnover power, with appropriate standards or guidelines, be continued for reorganizations and be extended to liquidation cases.²²⁸ Finally, it submitted an amendment to proposed section 4-603 that implemented its suggestion.²²⁹

sion] or its agent should be permitted" and suggesting the concept of "preferential possession" as a further refinement, that is, distinguishing between a pledgee and a creditor repossessing after default); *id.* at 489-92 (testimony of Patrick Murphy to the same effect; also stating that a creditor need not return property in a liquidation); *id.* at 1023 (statement of Walter Vaughn for the American Bankers Association, noting that the contemplated expansion of the jurisdiction of bankruptcy courts would permit turnover orders against creditors in possession and supporting such extension with appropriate safeguards for the creditor); *Senate Hearings, supra* note 210, at 125 (pt. 1) (same); *House Hearings, supra* note 210, at 1757 (pt. 3) (testimony of Robert Grimmig for the American Bankers Association approving the pervasive jurisdiction of the proposed bankruptcy courts but expressing concern "that clear guidelines have not been offered to the court where collateral is in the possession of secured creditors" and stating that "turnovers of collateral should not be ordered except after the most exacting findings by the court mandated by statute after hearing upon notice to the creditors concerned"); *Senate Hearings, supra* note 210, at 125 (pt. 2) (to the same effect).

225. *See House Hearings, supra* note 210, at 1838 (pt. 3) (prepared statement of Leon S. Foreman).

226. *See supra* notes 131 & 136 and accompanying text.

227. *See House Hearings, supra* note 210, at 1838 (pt. 3) (prepared statement of Leon S. Foreman).

228. *See id.*

229. *See id.* at 1838-39 (pt. 3); *id.* at 1847-48 (pt. 3). The Conference's suggestions would have amended section 4-603 as follows (underline indicates additions to 4-603, ~~strike-through~~ shows deletions from 4-603):

Sec. 4-603. Effect of Filing of Petition on Prior Custodian of Debtor's Property and a Creditor in Possession.

(a) Application of Section. If when a petition is filed under this title the property of the debtor is in the possession of—

- (1) a receiver, trustee, or other officer of a nonbankruptcy court, or
- (2) an assignee under a general assignment for the benefit of creditors,

or

- (3) a trustee or agent under a statute or contract, who is appointed or authorized to take charge of the property for the purpose of enforcing a lien against the property of the debtor or of a general administration of the debtor's property for the benefit of creditors, or

- (4) a creditor,

the custodian's rights and duties respecting the property of the custodian and of the creditor in possession shall be governed by this section.

When H.R. 6 emerged, however, it did not contain any language to implement the witnesses' suggestion. It contained a new section 543(b), which was a revision of section 4-603 of the Commission's act. This new section 543(b), which has remained substantially unchanged, was limited to "custodians" in possession of property of the debtor.²³⁰ A "custodian," the definition of which has also remained practically unchanged, did not include a creditor directly in possession of property items owned by a debtor but, like the Commission's proposed section 4-603, was limited to trustees, receivers, and agents.²³¹

H.R. 6 did add a new section on turnover, section 542, requiring any person, other than a custodian, in custody, control or possession of property that the trustee may use under section 363 to return that property to the trustee.²³² This section affects a creditor in possession only to the extent that the creditor has property that the trustee may use, sell, or lease under section 363. Under section 363 as written in

. . . [subsection (b) regarding turnover by custodian omitted]

(c) A creditor to whom this section applies shall deliver the property in his possession (1) to the trustee of the debtor's estate under Chapter V [liquidation] of this Act if the trustee is entitled to sell such property under section 5-203(b), [precursor to 11 U.S.C. § 363(f) (1994), discussed *infra* note 331 and accompanying text] and (2) to the debtor, receiver or a trustee of the debtor's estate under Chapter VII [reorganization] of this Act if the debtor, receiver or trustee is entitled to use such property under section 7-203, or to sell the same under other applicable sections of Chapter VII.

230. Compare 11 U.S.C. § 543(b) (1994), with H.R. 6, 95th Cong. § 543(b), at 85 (1977) (underline indicates additions to H.R. 6, ~~strike through~~ shows deletions from H.R. 6):

(b) A custodian shall—

(1) deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents, or profits of such property, that is ~~and~~ in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case; and

(2) file an accounting of ~~account for~~ any property of the debtor, or proceeds, product, offspring, rents, or profits ~~the value~~ of such property, that, at any time, came into the possession, custody, or control of such custodian.

231. Compare 11 U.S.C. § 101(11) (1994), with H.R. 6, 95th Cong. § 101(10), at 5 (1977) (underline indicates additions to H.R. 6, ~~strike through~~ shows deletions from H.R. 6):

"custodian" means—

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;

(B) assignee under a general assignment for the benefit of the debtor's creditors; or

(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

232. H.R. 6, 8200, 95th Cong. § 542(a), at 84 (1977), *quoted infra* note 252.

H.R. 6,²³³ the trustee may use property of the estate, which excludes the right to possess or use property items in the possession of a creditor.²³⁴ In addition, if certain conditions were met, the trustee could sell property in which the estate and a third party have an interest, which would include property items in the possession of a creditor.²³⁵

In holding that section 542(a) authorized an order to the IRS to return the seized good to Whiting Pools, both the Supreme Court²³⁶ and the Court of Appeals for the Second Circuit²³⁷ relied upon the appearance of section 542 immediately after the testimony of the four witnesses urging Congress to provide for a turnover order against a creditor in possession. Specifically, Judge Friendly for the Second Circuit quoted the testimony directly and stated that the appearance of section 542(a) after this testimony “*compels* the inference that § 542 was added to the Code to make *clear*—as a number of witnesses had explicitly urged—that the turnover power approved in *RFC v. Kaplan*[²³⁸] was to be incorporated in the new statute.”²³⁹ With all due respect, this statement is nonsense. On its face, the language of section 542 does not make Judge Friendly’s result “clear.” Section 542(a) did not explicitly implement the turnover provision that the witnesses before Congress urged. Indeed, the sequence of events envisioned by Judge Friendly compels the opposite inference: Because

233. See *supra* note 222 (quoting the relevant parts of section 363).

234. See *infra* notes 267, 279 and accompanying text.

235. See *supra* note 222 and *infra* Part III.B.2.

236. See *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 207-08 & n.16 (1983) (also stating, “[i]n general, we find Judge Friendly’s careful analysis of this history for the Court of Appeals, 674 F.2d 144, 152-56 (1982), to be unassailable”).

237. See *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 155 (2d Cir. 1982).

238. *Reconstruction Fin. Corp. v. Kaplan*, 185 F.2d 791 (1st Cir. 1950), *discussed supra* notes 151-158 and accompanying text.

239. *Whiting Pools*, 674 F.2d at 155 (emphasis added). Judge Friendly further revealed a lack of knowledge of pre-Code law when, immediately after this statement, he continued:

This inference becomes all the more compelling when one considers that if § 542 did not authorize compelling turnovers by secured creditors in possession, apparently its only use would be to authorize obtaining property from persons in wrongful possession following theft or conversion. Given the circumstances surrounding the inclusion of the section in the Code, the more natural reading of § 542 is that it was intended to codify *RFC v. Kaplan*, and possibly, although we need not decide the question, also extend the turnover power to straight bankruptcy cases.

Id. As discussed below, see *infra* notes 244-251 and accompanying text, giving the bankruptcy trustee the express power to seek turnover from a person in wrongful possession would be a significant improvement from the Bankruptcy Act.

Judge Friendly also apparently was not aware of the last minute change to section 542(a) and the statement of the legislative intent that section 542(a) apply to property acquired by the estate after the filing of the petition. See *infra* notes 252-254 and accompanying text (discussing this last minute change).

section 542(a) appeared instead of a section addressing a creditor in possession, as suggested in the congressional testimony, one could logically conclude that Congress did *not* intend to incorporate a turnover power against the creditor in possession.

The court's error is compounded by its failure to appreciate just what *Kaplan* held. In *Kaplan*, the bankruptcy court had approved a requirement for turnover against the creditor in possession pursuant to a reorganization plan.²⁴⁰ The bankruptcy court had found that (i) the value of the debtor's assets possessed by the creditor exceeded the creditor's claim and (ii) the reorganization plan was "fair, equitable, and feasible."²⁴¹ Section 542(a) references none of those elements and it cannot in any way be construed, in the words of Judge Friendly,²⁴² to "codify" *Kaplan*. Further, in *Whiting Pools*, the creditor was undersecured, not oversecured, and no plan had even been proposed.²⁴³

The appearance of section 542 in H.R. 6 does raise a question: What was Congress trying to do? The answer is simple. Under the Bankruptcy Act, bankruptcy courts regularly issued turnover orders against a variety of persons who had no right to possess the debtor's property items.²⁴⁴ There was, however, no statutory basis for such turnover orders. Indeed, the Supreme Court in *Maggio v. Zeitz*,²⁴⁵ in vacating a contempt order against the debtor's president for refusing to return the debtor's goods to the bankruptcy trustee, noted that the turnover procedure was not expressly created by the Bankruptcy Act.²⁴⁶ Justice Black in a separate opinion stated further that the turnover procedure was unauthorized by statute and illegal.²⁴⁷

240. See *Kaplan*, 185 F.2d at 796-97.

241. *Id.* at 793 (quoting the district court's memorandum); see also *supra* notes 151-158 and accompanying text (discussing *Kaplan*).

242. See *supra* note 239 (quoting *Whiting Pools*, 674 F.2d at 155).

243. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 199-200 (1983) (describing the relevant facts before the court); see also *infra* note 427 (discussing the failure of Whiting Pools to file a plan and the eventual dismissal of Whiting Pools's chapter 11 petition for lack of prosecution).

244. These included: (i) bankrupts who refused to turn over all of their property to the bankruptcy trustee; (ii) persons who removed property from the estate after the filing of a petition; (iii) bailee's or agents of a bankrupt who had possession of property of the estate; (iv) officers of a bankrupt corporation who had possession of property of the estate; and (v) other persons who had no legal right to retain possession of property that had been owned by the bankrupt. See *infra* notes 47-51 and accompanying text (surveying the limits on turnover orders in liquidation cases).

245. 333 U.S. 56 (1948).

246. *Id.* at 61, 64.

247. See *id.* at 80 (Opinion of Black, J.).

Section 542(a) cures this omission. It gives an explicit statutory basis²⁴⁸ for the traditional turnover order against persons other than the debtor.²⁴⁹ Judge Friendly denigrated this role for section 542(a),²⁵⁰ but his view on this point is incorrect. There had been extensive litigation on the scope of the judge created turnover power under the Bankruptcy Act.²⁵¹

248. See, e.g., WALTER RAY PHILLIPS, LIQUIDATIONS UNDER CHAPTER 7 OF THE BANKRUPTCY ACT § 14-1, at 163 (1981) (discussing turnovers in general and relying on section 542 as the statutory basis for “turnovers against parties or entities other than custodians”). One may question, as the Supreme Court did in *Whiting Pools*, 462 U.S. at 207 n.15, why section 542(a) would be necessary at all in view of the broad definition of property of the estate. Section 541(a)(1) includes, as property of the estate, the debtor’s rights under nonbankruptcy law to obtain possession from a third party, such as the right of the debtor to obtain possession from a bailee. See, e.g., *Arens v. Boughton (In re Prudhomme)*, 43 F.3d 1000, 1004 (5th Cir. 1995) (holding, without referring to section 542(a), that because under state law an unearned retainer paid to attorneys remain client funds, an attorney receiving a prepetition retainer was obligated to return the retainer to the bankruptcy trustee as property of the estate). Section 541(a)(1) also includes, as property of the estate, the debtor’s nonbankruptcy right to obtain possession from a person who had converted the debtor’s property interests. See, e.g., *Chapes, Ltd. v. Anderson (In re Scaife)*, 825 F.2d 357, 361-62 (11th Cir. 1987) (holding, without referring to section 542(a), that a trustee could sue for damages for conversion of a ring).

Section 542(a) is a specific application of the general principle set forth in section 541(a). Congress has included in the Code several specific applications of the general principal of section 541(a). See, e.g., 11 U.S.C. § 541(b)(1) (1994) (providing special powers of appointment); *id.* § 541(b)(2) (excluding the interest of a lessee in a terminated lease of nonresidential real property); *id.* § 541(b)(3), as added by the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 3007(a)(2), 104 Stat. 1388, 1388 (1990) (excluding a college’s accreditation status); *id.* § 541(d) (1994) (reiterating the point of section 541(a)(1) that, if the debtor held only the legal title to and not an equitable interest in property, the property of the estate includes only the legal title and not the equitable interest); *id.* § 542(b) (requiring any person owing a debt to the debtor to pay it to the trustee).

Given the absence of express statutory authority for turnover orders under the Bankruptcy Act and the extensive litigation over them, see *supra* notes 244-247 and accompanying text, Congress’s enactment of section 542(a) expressly authorizing the exercise of specific rights that are implicit in the definition of property of the estate represents rational law making. This common exercise of legislative choice provides no support for concluding that section 542(a) does more than what it says it does.

249. The Commission’s act contained explicit language requiring a debtor to turn over all of his or her property to a bankruptcy trustee. BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, § 4-502(a), at 123-24; see also *Comparison of H.R. 31 & H.R. 32, supra* note 188, at 144-45 (requiring that “the debtor shall . . . (6) surrender to the receiver, if one is appointed, or to the trustee all property of the estate”). The Commission stated that clause (6) was a new express requirement that the debtor surrender property. BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 2, at 124 n.2. Clause (6) later appeared in H.R. 6 and the current Code. See 11 U.S.C. § 521(4) (1994) (requiring that the debtor, “if a trustee is serving in the case, surrender to the trustee all property of the estate”); H.R. 6, 95th Cong. § 521(4), at 67-68 (1977).

250. See *supra* note 239 (quoting Judge Friendly).

251. See 2 COLLIER, *supra* note 41, ¶¶ 23.05-23.07, at 469-532.

The later legislative treatment of section 542(a) deals a fatal blow to the argument that the legislative history of section 542(a) supports a turnover order against a creditor in possession in favor of a reorganizing debtor. During the final amendments to reconcile H.R. 8200 as passed by the House, and H.R. 8200, as passed by the Senate, to produce the Bankruptcy Reform Act, Congress made a last minute amendment to section 542(a). This amendment changed the timing of an entity's possession or control of property that the trustee may use from "possession, custody, or control, *on the date of the filing of the petition*" to "possession, custody, or control, *during the case*."²⁵² This change accompanied an addition to the definition of property of the estate to include "[a]ny interest in property that the estate acquires after the commencement of the case."²⁵³

The House and Senate sponsors explained the reason for the change:

Section 542(a) of the House amendment modifies similar provisions contained in the House bill and the Senate amendment treating with turnover of property to the estate. The section makes clear that any entity, other than a custodian, is required to deliver property of the estate to the trustee or debtor in possession whenever such property is *acquired by the entity during the case*, if the trustee or debtor in possession may use, sell, or lease the property under section

252. Compare 11 U.S.C. § 542(a) (1994), with H.R. 6, 95th Cong. § 542(a), at 84 (1977) (~~strike through~~ represents deletion from H.R. 6 and underline represents addition to H.R. 6):

Except as provided in subsection (c) *or* (d) of this section, an entity, other than a custodian, in possession, custody, or control, ~~on the date of the filing of the petition~~ *during the case*, of property that the trustee may use, sell, or lease under section 363 of this title, *or that the debtor may exempt under section 522 of this title*, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

The words "or (d)" were added by the House Committee on the Judiciary to the first version of H.R. 8200, see H.R. 8200, 95th Cong. § 542(a), at 412 (as reported by the Committee on the Judiciary September 8, 1977), and the words "or benefit" first appeared in the Senate version of the Code, see S. 2266, 95th Cong. § 542(a) (1978) at 426 (as reported by Mr. DeConcini of the Committee on the Judiciary on July 14, 1978). The reference to exemption under section 522 was added when "during the case" was added in September 1978. *Id.*

Notwithstanding these changes in section 542(a), the Supreme Court in *Whiting Pools* stated that "[section 542(a) as introduced in H.R. 6] remained unchanged through subsequent versions of the legislation." *Whiting Pools*, 462 U.S. at 208. This mistake demonstrates not only the Court's failure to find all of the relevant legislative history for section 542 but also the general deficiency of relying on selective parts of legislative history instead of the words of the statute.

253. 11 U.S.C. § 541(a)(7) (1994).

363, or the debtor may exempt the property under section 522²⁵⁴

If a court is to substitute the legislative history²⁵⁵ for the wording of the statute in interpreting section 542(a), this statement of legislative history would preclude using section 542(a) for turnover orders against any creditor in possession. A creditor in possession—who has possession before the case—does not “acquire” any property interests after the commencement of the case.²⁵⁶

One can speculate why neither the Commission nor the Congress directly addressed the creditor in possession. Perhaps the Commission and the Congress thought the general jurisdictional provisions of the new Code covered the creditor in possession. The change in the definition of property of the estate, however, abrogated this possibility. Perhaps the Commission and Congress thought that the custodian provisions covered the creditor in possession. This seems unlikely, however, in view of the precise definition of a custodian and the pre-Code history.

Perhaps Congress thought that section 542(a) did authorize turnover against the creditor in possession. One can think this way, however, only if one thinks that “property of the debtor” under the Commission’s act and “property of the estate” under section 541(a)(1) includes property items owned by the debtor in the possession of the creditor. Apparently someone on the staff of the subcommittee drafting the Code thought it did. A staff report issued in July 1977 described the content of section 542(a) as “Turnover by Credi-

254. 124 CONG. REC. H11089 (Sept. 28, 1978) (statement of Don Edwards, Upon Introducing the House Amendment to the Senate Amendment to H.R. 8200), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6455 (emphasis added); *see also* 124 CONG. REC. S17406 (Oct. 6, 1978) (statement of Dennis DeConcini, Upon Introducing the Senate Amendment to the House Amendment to H.R. 8200), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6455 (same).

255. In discussing the legislative history, the Supreme Court in *Whiting Pools* noted that the House and Senate Reports were silent on the issue of turnover by a creditor in possession. *Whiting Pools*, 462 U.S. at 207. The House and Senate Reports discussing section 542 do not reflect this last minute change in section 542(a) because they were written when the draft section 542(a) referred to the possession or control at the filing of the petition. “Subsection (a) of [section 542] requires anyone holding property of the estate *on the date of the filing of the petition*, or property that the trustee may use, sell or lease under 363, to deliver it to the trustee.” H.R. REP. NO. 95-595, at 369 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6325, and S. REP. NO. 95-989, at 84 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5870 (emphasis added).

256. Such use of this legislative history would not be appropriate. The section is not limited to what the sponsors state is its purpose. Section 542(a) does not use the wording “acquired during the case.” It refers to a third party in possession “during the case.” This language would include a third party who has possession of property of the estate at the beginning of the case—bailees, agents, converters, but not creditors in possession.

tor."²⁵⁷ This is the only direct evidence that I could find that section 542(a) may have been intended to address the creditor in possession. Even if this were so, the later legislative developments discussed above overrule this intent.²⁵⁸ More important, however, the specific language of section 542 did not implement such possible intent.²⁵⁹

Perhaps Congress wanted to treat creditors in possession differently. Creditors in possession represent two discrete subsets of creditors: (a) creditors who hold property items owned by the debtor but whose possession is not necessary to the debtor's business or activities—the pledgee—and (b) creditors who have repossessed movable tangible or reasonably liquid intangible property items upon default. These creditors in possession were not new creatures. The pledge has been around for hundreds of years,²⁶⁰ and the right to the self-help remedy of repossession has been part of American law for at least a century,²⁶¹ and both include the remedy of foreclosure sale. Article 9 of the U.C.C., which confirmed the right to self-help repossession and streamlined foreclosure sale, has been around since 1952 and has been in effect in all states since the middle 1960s.²⁶² On the other

257. See STAFF OF SUBCOMM. ON CIVIL & CONST. RIGHTS OF HOUSE COMM. ON JUDICIARY, 95TH CONG., 1ST SESS., TABLE OF DERIVATION OF H.R. 8200 12 (Comm. Print 1977).

258. See *supra* notes 252-254 and accompanying text.

259. See *supra* notes 232-234 and accompanying text; *infra* notes 321-323 and accompanying text.

260. See 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 1.1, at 5-9 (1965) (comparing the pledge and mortgage), §§ 1.3-1.4, at 12-20 (analyzing the pledge of intangibles such as notes and stocks), § 1.6, at 22-23 (discussing the simple requirements for a pledge and citing an eighteenth century treatise); 2 GILMORE, *supra*, § 42.1, at 1129 n.4 (citing eighteenth and nineteenth century authorities on pledges); Garrard Glenn, *The Pledge as a Security Device*, 24 VA. L. REV. 355, 371-79 (1938) (noting that the pledge had become a true security device before the mortgage had developed and analyzing cases and authorities beginning in the seventeenth century when the equity of redemption of a mortgage became recognized).

261. See 2 GILMORE, *supra* note 260, § 42.1, at 1127-29 (discussing the right to repossess); see also James R. McCall, *The Past as Prologue: A History of the Right to Repossess*, 47 S. CAL. L. REV. 58, 62 (1973) (noting that the "historical antecedents of the right to repossess . . . are . . . quite extensive" (footnote omitted)); Eugene Mikolajczyk, Comment, *Breach of Peace and Section 9-503 of the Uniform Commercial Code—A Modern Definition for an Ancient Restriction*, 82 DICK. L. REV. 351, 352-54 (1977) (explaining that the "self-help" remedy of repossession, known as "recaption or reprisal" was recognized in seventeenth century England, and that self-help remedies were recognized in the United States "at least as early as 1842" (footnote omitted)).

262. The first official draft of the U.C.C. was approved by the National Conference of Commissioners on Uniform State Laws and the American Law Institute in 1952. See U.C.C. (Official Draft 1952). This draft was enacted in Pennsylvania in 1953. UNIF. COMMERCIAL CODE, 3 U.L.A. 1-2 (1992). After some further revisions, the Official Text was finally adopted in 1962, and by the end of the 1960s, this text had been adopted in all states other than Louisiana. *Id.*

hand, it is not hard to believe, given the massive changes wrought by the Code, that Congress did not think of these problems.

Finally, it is possible that Congress had no actual intent because the members could not agree. Should debtors have a turnover power against creditors in possession, as illustrated by *Kaplan*?²⁶³ It may be that legislators holding different views on the issue agreed to disagree on the policy issue and agreed on the language of the Code, thinking that the courts would sustain each side's view. In any event, whatever one's views on the appropriate use of legislative history, and whatever thoughts individual members of Congress had on the issue, courts must still pay particular attention to the language of the statute. As Justice Thurgood Marshall once remarked, when the legislative history is ambiguous, we must focus on the statute.²⁶⁴

III. THE CREDITOR IN POSSESSION IN THE TEXT OF THE CODE

An analysis of the creditor in possession under the Bankruptcy Code must begin with the definition of property of the estate and an examination of the relevant property interests of a borrower who owes an obligation to a creditor in possession. The main component of "property of the estate" is "all legal or equitable interests of the debtor in property."²⁶⁵ If a borrower who owes an obligation to a creditor in possession of property items owned by the borrower becomes a debtor under the Bankruptcy Code, property of the estate consists of the interests of that borrower in those property items at the time of the filing of the petition.²⁶⁶ These interests, at a minimum, consist of the following: (1) legal title to the property items; (2) the right to redeem the creditor's security interest and regain possession of the property items; (3) the right to any surplus upon a foreclosure sale of those

263. See *Reconstruction Fin. Corp. v. Kaplan*, 185 F.2d 791, 795 (1st Cir. 1950), discussed *supra* notes 151-158.

264. See *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 412 n.29 (1971) ("The legislative history of both § 4(f) of the Department of Transportation Act . . . and § 138 of the Federal-Aid Highway Act . . . is ambiguous Because of this ambiguity it is clear that we must look primarily to the statutes themselves to find the legislative intent.")

265. See 11 U.S.C. § 541(a)(1) (1994), *quoted supra* note 13. The nature of the other subsections of section 541 shows why subsection 541(a)(1) is the principal source for the definition of property of the estate. The other enumerated items, though important, have lesser significance. They refer to community property, *id.* § 541(a)(2), and to property added to the estate after the commencement of the case, *id.* § 541(a)(3)-(7). For the adjustment of debts under chapter 12 (family farmers) and chapter 13 (individuals with regular income), property of the estate also includes property of the kind specified in section 541 acquired by the debtor and earnings from services performed after the commencement of the case until the case is closed, dismissed, or converted. See *id.* §§ 1207, 1306.

266. 11 U.S.C. § 541(a)(1).

property interests; and (4) any ancillary rights, such as the right to notice of the foreclosure sale.²⁶⁷

Conversely, the interests of the creditor in possession of the property items consist of the following: (1) the right to possession of the property items, whether as a result of an original voluntary pledge or the repossession by the creditor upon the borrower's default; (2) the right to sell the property items and apply the sale proceeds to the borrower's obligation; and (3) related ancillary rights.²⁶⁸ Other rights may be allocated to either of the parties by contract, such as in the case of investment securities the right to receive payments of interest or dividends, voting rights, or the right of a creditor in possession to repledge the investment securities.²⁶⁹

For purposes of the Bankruptcy Code and the definition of property of the estate, the interests of the debtor (and hence the bankruptcy estate) and the creditor in possession are mutually exclusive. Although it is not necessary as a conceptual matter to view component property interests as exclusive, it is necessary to view property interests under the Code as exclusive for the Code to have a coherent meaning of property.²⁷⁰ Accordingly, under the Code, whatever one party has, the other does not have. When either party exercises its rights under its property interests, even if that action causes the extinction of the other's interests in the property item, that party is not interfering with the other's property interest. Thus, a redemption by the debtor of the creditor's security interest by paying the amount of the obligation extinguishes the creditor's security interest, but it does not "diminish," "control," "interfere with," or "adversely affect" the creditor's property interest.²⁷¹ The redemption merely defines the limit of the property interest. By definition, the secured creditor only has a right to its property interest to secure the debt. The possibility—nay, the likeli-

267. See generally GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW §§ 4.1-4.23, at 127-78, §§ 4.27-4.29, at 185-195, §§ 6.1-6.7, at 408-43, §§ 7.1-7.3, at 467-72, § 7.31, at 571-72 (3d ed. 1994) (real property); 1995 U.C.C. §§ 9-208, -502(2), -504(2), (3) -506 (personal property); 1998 U.C.C. §§ 9-208, -209, -210, -608, -610(b), -611, -612, -613, -614, -615, -616, -623, -625 (same); Plank, *Bankruptcy Estate*, *supra* note 9, at 1202-03, 1236.

268. See generally NELSON & WHITMAN, *supra* note 267, §§ 4.24-25 at 178-83, § 4.29 at 189-95, § 7.9-7.22 at 490-544 (real property); 1995 U.C.C. §§ 9-207, -501, -502, -503, -504, -505 (personal property); 1999 U.C.C. §§ 9-207, -601, -607, -609, -610 (same); Plank, *Bankruptcy Estate*, *supra* note 9, at 1202-03, 1236.

269. See, e.g., Kenneth C. Kettering, *Repledge Deconstructed*, 61 U. PITT. L. REV. 45 (1999).

270. See generally Plank, *Bankruptcy Estate*, *supra* note 9, at 1259-62 (concluding that interpreting property interests as exclusive is necessary for a coherent interpretation of property of the estate in the Bankruptcy Code).

271. See Plank, *Bankruptcy Estate*, *supra* note 9, at 1263-67.

hood—and eventuality of the extinction of the security interest upon payment is an inherent, inseparable part of that property interest.

Similarly, the creditor in possession may divest the debtor of its legal title to the property items by foreclosing the debtor's equity if the debtor fails to pay the secured obligation. The possibility of such divestiture is an inherent limitation on the debtor's property interest, just as the expiration of a lease for a term of years. Although in a colloquial sense most laypersons (and unfortunately many bankruptcy courts)²⁷² might think that a foreclosing secured creditor is "affecting" the debtor's property interests, under the definition of property of the estate the foreclosing creditor is merely defining the limits of that property interest.

The Supreme Court has recognized the exclusive nature of property of the estate in dicta in *Owen v. Owen*,²⁷³ and in its holding in *Citizens Bank of Maryland v. Strumpf*.²⁷⁴ In *Strumpf*, the Court rejected the argument that an administrative hold by a bank on a checking account of a debtor violated the automatic stay against an act to possess or to control property of the estate under section 362(a)(3).²⁷⁵ The Court stated:

Respondent's reliance on these provisions [§ 362(a)(3) & (a)(6)] rests on the false premise that petitioner's administrative hold took something from respondent, or exercised dominion over property that belonged to respondent. That view of things might be arguable if a bank account consisted of money belonging to the depositor and held by the bank. In fact, however, it consists of nothing more or less than a promise to pay, from the bank to the depositor, . . . and petitioner's temporary refusal to pay was neither a taking of pos-

272. See *infra* note 299.

273. 500 U.S. 305 (1991). The Court stated:

Section 522(b) provides that the debtor may exempt certain property "from property of the estate"; obviously, then, an interest that is not possessed by the estate cannot be exempted. Thus, if a debtor holds only bare legal title to his house—if, for example, the house is subject to a purchase-money mortgage for its full value—then only that legal interest passes to the estate; the equitable interest remains with the mortgage holder, [11 U.S.C.] § 541(d). And since the equitable interest does not pass to the estate, neither can it pass to the debtor as an exempt interest in property. Legal title will pass, and can be the subject of an exemption; but the property will remain subject to the lien interest of the mortgage holder.

Id. at 308-09.

274. 516 U.S. 16 (1995); see also Plank, *Bankruptcy Estate*, *supra* note 9, at 1255-59 (discussing *Citizens Bank of Maryland v. Strumpf*).

275. See *Strumpf*, 516 U.S. at 21 (citing 11 U.S.C. § 362(a)(3) (1994), *quoted infra* in text accompanying note 295).

session of respondent's property nor an exercising of control over it, but merely a refusal to perform its promise.²⁷⁶

Even in *United States v. Whiting Pools, Inc.*,²⁷⁷ the Court recognized the exclusive nature of the interests of the debtor, Whiting Pools, and the creditor in possession, the IRS. Addressing the statutory provisions, the Court noted that section 542(a) required the return of property that the trustee may use, sell, or lease under section 363(b) and (c)²⁷⁸ and that under section 363(b) and (c),²⁷⁹ the trustee may use, sell, or lease "property of the estate," that is, Whiting Pools's interests in the seized goods.²⁸⁰ The IRS was not in "possession, custody, or control" of Whiting Pools's interests in the goods, since those interests consisted only of (1) its right to any surplus²⁸¹ if the IRS sold the goods for more than the amount of the lien;²⁸² (2) its right to redeem the IRS's lien on the goods by paying the amount of taxes due;²⁸³ and (3) its right to notice of the foreclosure sale.²⁸⁴

The Court did not reject this analysis of section 541(a)(1). Instead, to avoid the import of this statutory language, the Court expanded the definition of property of the estate: "Although these statutes could be read to limit the estate to those 'interests of the debtor in property' at the time of the filing of the petition, we view them as a definition of what is included in the estate, rather than as a limitation."²⁸⁵ The Court then concluded that Congress's general policy of favoring reorganization²⁸⁶ and the testimony of four witnesses to Congress that the Code should include a turnover power against cred-

276. *Id.* (citations omitted).

277. 462 U.S. 198 (1983).

278. *See id.* at 202-03.

279. The Court referred specifically to "property of the estate" under subsections (b) and (c). *Id.* at 203. Section 542(a) refers to section 363. Section 363(f) also authorizes the trustee to sell "property," which has a broader meaning than property of the estate, if the conditions of that subsection are met. *See infra* Part III.B.2. That subsection was not applicable in *Whiting Pools* because the debtor in possession wanted return of the goods for use and not sale, and the conditions of that subsection, such as having sufficient proceeds to satisfy the lien, could not be satisfied.

280. *See Whiting Pools*, 462 U.S. at 203 (stating that "[s]ubsections (b) and (c) of § 363 authorize the trustee to use . . . property of the estate" if creditors' interests are protected).

281. *See* 26 U.S.C. § 6342(b) (1994).

282. A surplus was not likely because the amount of the lien was \$92,000 and the liquidation value of the goods was \$35,000. *See Whiting Pools*, 462 U.S. at 200.

283. *See* 26 U.S.C. § 6337(a) (1994).

284. *See id.* § 6335(b).

285. *Whiting Pools*, 462 U.S. at 203.

286. *Id.* at 203-04. *See generally infra* note 430 (discussing the Court's understanding of why Congress favors reorganization).

itors in possession justified the turnover order against the IRS.²⁸⁷ In effect, by court fiat, property of the estate also includes a new judicially created subset—a possessory interest in property items owned by the estate but actually possessed by a creditor.²⁸⁸

As I have explained in greater detail elsewhere,²⁸⁹ the Court's statement that section 541(a) is not limiting and that there may be other unarticulated interests that may be part of property of the estate is wrong. It ignores the dominant meaning of the words "comprised of" in section 541(a) as limiting and not merely inclusive,²⁹⁰ and it also ignores direct legislative history of Congress's intent that the definition of property of the estate not expand the debtor's rights.²⁹¹ As discussed above, the Court later repudiated the notion that the definition of property of the estate is not limiting in *Owen*²⁹² and *Strumpf*.²⁹³ Because, under *Owen* and *Strumpf*, property of the estate consists of only those items set forth in the statute, *Whiting Pools* cannot stand. Applying the Bankruptcy Code becomes straightforward. The debtor in possession only gets the return of those property interests to which it has a right of possession. With no ambiguity in the statute, no court need inquire into the legislative history or policy.²⁹⁴

287. *Whiting Pools*, 462 U.S. at 207-08; see *supra* notes 224-229, 236-243 and accompanying text (discussing in detail the legislative history on which the Court relied and criticizing the Court's use of this legislative history).

288. *Id.* at 207 ("In effect, § 542(a) grants to the estate a possessory interest in certain property of the debtor that was not held by the debtor at the commencement of reorganization proceedings.").

289. See generally Plank, *Bankruptcy Estate*, *supra* note 9, at 1238-42 (explaining that Congress's use of the words "is comprised of" in section 541(a) suggests Congress's intent to limit the bankruptcy estate to the items specifically enumerated).

290. *Id.* at 1238-40.

291. The House Report stated that the new bankruptcy law "determines what is property of the estate by a simple reference to what interests in property the debtor has at the commencement of the case." H.R. REP. NO. 95-595, at 175 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6136. The House Report referred to the Bankruptcy Commission Report for the detail. *Id.* The Bankruptcy Commission Report made the same point. BANKRUPTCY COMMISSION REPORT, *supra* note 170, pt. 1, at 192. The Senate Report similarly stated that section 541 "defines property of the estate, and specifies what property becomes property of the estate." S. REP. NO. 95-989, at 175 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5868. The Senate Report also noted that, although the section included actions and claims by the debtor against others, it was not intended to expand the debtor's rights against other parties more than they exist at the commencement of the case. *Id.* at 82, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5868.

292. See *supra* note 273 (quoting *Owen v. Owen*, 500 U.S. 305 (1991)).

293. See *supra* notes 274-276 and accompanying text (discussing *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16 (1996)).

294. See *Negonsott v. Samuels*, 507 U.S. 99, 104 (1993) (holding that the State of Kansas had jurisdiction over major offenses committed by or against Indians on Indian reservations, and stating, "[o]ur task is to give effect to the will of Congress, and where its will has been expressed in reasonably plain terms, that language must ordinarily be regarded as

Recognizing the demise of *Whiting Pools*, however, and the plain language of sections 542(a) and 363(b) and (c) do not give the creditor in possession a free hand to deal with the property items. A detailed examination of several provisions of the Bankruptcy Code will delineate the rights and powers of a creditor in possession of property items formerly owned by a debtor and now owned by the bankruptcy estate. Those rights and powers center on two basic issues: (1) to what extent does the automatic stay apply to prevent the creditor in possession from selling the property items; and (2) to what extent may the bankruptcy trustee or the debtor in possession interfere with the creditor's prepetition, nonbankruptcy right to possession.

A. *The Automatic Stay*

The automatic stay will prevent a creditor in possession from foreclosing its security interest, but not for the reasons that most people think. Such creditor action is stayed not as an act against property of the estate or property of the debtor under section 362(a)(3)-(5) but as an act to collect a claim under section 362(a)(6). Specifically, section 362(a) provides, in relevant part, that the filing of a petition stays:

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

conclusive"); *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 254 (1992) (holding that an interlocutory order issued by the district court sitting as an appellate court in bankruptcy was appealable and stating that, notwithstanding the argument that legislative history pointed to a different result, when the words of a statute are unambiguous, then "judicial inquiry is complete"); *Rubin v. United States*, 449 U.S. 424, 430 (1981) (holding that a fraudulent pledge of stock to a bank as collateral for a loan is an offer or sale of a security subject to the anti-fraud provision of the Securities Act of 1933 and stating, "[w]hen we find the terms of a statute unambiguous, judicial inquiry is complete, except in rare and exceptional circumstances."); *see also West Va. Univ. Hosps., Inc., v. Casey*, 499 U.S. 83, 97-101 (1991) (holding that the plain meaning of the statute allowing recovery of "attorneys fees" against the losing party in civil rights litigation excluded recovery of expert witnesses fees and rejecting arguments that the legislative history, including the remarks of some members of Congress, and statements of policy in congressional committee reports required a different result). In particular, in rejecting the argument that the congressional purpose in enacting the specific statute must prevail over the ordinary meaning of the statutory terms, the Court stated:

The best evidence of that purpose is the statutory text adopted by both Houses of Congress and submitted to the President. Where that contains a phrase that is unambiguous—that has a clearly accepted meaning in both legislative and judicial practice—we do not permit it to be expanded or contracted by the statements of individual legislators or committees during the course of the enactment process.

Id. at 98-99.

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title.²⁹⁵

Some courts seem to take for granted that a creditor foreclosure action in a bankruptcy case is an act "against property of the estate" and therefore a violation of section 362(a)(3)'s stay of acts to "exercise control over property of the estate."²⁹⁶ This conclusion is not correct. As discussed above, under the definition of property of the estate, any action by the creditor to foreclose the equity interest in property items owned by the bankruptcy estate does not control the estate's interests in the property items; it merely defines the limits of that interest.²⁹⁷

To be sure, if the estate has possession of a property item, any action by a creditor to seize the property item would violate section 362(a)(3). Section 362(a)(3) stays acts to "obtain possession . . . of

295. 11 U.S.C. § 362(a)(3)-(6) (1994). Subsections (1), (2), (7), and (8) provide that filing a petition acts as a stay of:

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

...

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

Id. § 262(1)-(2), (7)-(8).

296. See, e.g., *In re Nowell*, 232 B.R. 370 (Bankr. S.D. Ohio 1999) (holding that the postpetition sale of a car repossessed prepetition by a secured creditor was exercising control over the property of the estate in violation of section 362(a)(3); also erroneously holding that such sale did not violate the stay against collecting a claim under section 362(a)(6), discussed *infra* in text accompanying note 310); see also *infra* note 299 (discussing other cases misinterpreting section 362(a)(3)).

297. See *supra* notes 272-284 and accompanying text (discussing the exclusive nature of a debtor's equity interest); see also David Gray Carlson, *Junior Secured Creditors and the Automatic Stay*, 6 AM. BANKR. INST. L. REV. 249, 250-51 (1968) (acknowledging this analysis but also pointing out that *Whiting Pools's* expansion of the property of the estate extends the automatic stay to the creditor's interest).

property from the estate.”²⁹⁸ This subsection prevents a creditor not in possession from obtaining possession. This prohibition, however, does not apply to the creditor in possession. A foreclosure sale by a creditor in possession does not violate section 362(a)(3).²⁹⁹

Similarly, a creditor foreclosure sale of property items does not violate the automatic stay as an act to “enforce any lien against property of the estate” under section 362(a)(4).³⁰⁰ Though the creditor’s interest in a property item is a lien on the property item, it is not a lien on the estate’s equity interest in the property item. It therefore is not a lien against property of the estate.³⁰¹ Again, some courts have erroneously concluded otherwise because they either assume, as *Whiting Pools* suggests, that the repossessed property items in the possession of a creditor are still property of the estate, or they erroneously confuse the property item with the estate’s interest in the property item.³⁰² Nevertheless, because a creditor’s lien against property items is not a lien against property of the estate—the debtor’s equity interest—a creditor exercising its foreclosure rights would not violate the

298. 11 U.S.C. § 362(a)(3) (1994).

299. There is a line of cases that represent the most egregious examples of judicial misunderstanding of the stay and property of the estate. See *Knaus v. Concordia Lumber Co.* (*In re Knaus*), 889 F.2d 773, 775 (8th Cir. 1989) (holding that the mere failure of a creditor in possession to return a property item upon demand of the trustee or the debtor in possession violates the automatic stay against controlling property of the estate under section 362(a)(3)); *TransSouth Fin. Corp. v. Sharon* (*In re Sharon*), 234 B.R. 676, 682 (B.A.P. 6th Cir. 1999) (same); *In re Berscheid*, 223 B.R. 579, 581-82 (Bankr. D. Wyo. 1998) (stating that under section 362(a)(3) the prepetition creditor in possession must return the property item to the debtor and to obtain adequate protection it must seek relief in court); *In re Zaber*, 223 B.R. 102, 104-06 (Bankr. N.D. Tex. 1998) (finding that a creditor in possession of property items owned by the debtor is exercising control over property of the estate under section 362(a)(3) and refusal to return such property items violates the automatic stay); *General Motors Acceptance Corp. v. Ryan*, 183 B.R. 288, 289 (Bankr. M.D. Fla. 1995) (same); *Coats v. Vawter* (*In re Coats*), 168 B.R. 159, 165 (Bankr. S.D. Tex. 1993) (same); *Carr v. Security Sav. & Loan Ass’n*, 130 B.R. 434, 437 (D.N.J. 1991) (same). This situation should be distinguished from those cases in which a creditor seized property items after the filing of the petition. See *Abrams v. Southwest Leasing & Rental, Inc.* (*In re Abrams*), 127 B.R. 239, 244 (B.A.P. 9th Cir. 1991) (holding that a creditor’s repossession of a debtor’s automobile after they learned of debtor’s bankruptcy violated the automatic stay); *In re Holman*, 92 B.R. 764, 766 (Bankr. S.D. Ohio 1988) (finding that debtor’s automobile was repossessed by creditor after debtor had filed a voluntary petition under chapter 7 of the Bankruptcy Code). In these cases, the estate had possession at the commencement of the case. Postpetition deprivation of the estate’s possessory interest in property is exactly the type of activity prohibited by the automatic stay.

300. 11 U.S.C. § 362(a)(4) (1994).

301. A lien against property of the estate may arise when the trustee grants a lender a security interest in property of the estate under 11 U.S.C. § 364(c) (1994).

302. See, e.g., 3 WILLIAM COLLIER, BANKRUPTCY ¶ 362.03[6][b], at 362-28 through -29 (Lawrence P. King ed., 15th ed. 1999).

section 362(a)(4) stay against enforcing the lien against property of the estate.³⁰³

Finally, a creditor foreclosure sale of encumbered property is not an act to enforce a prepetition lien against "property of the debtor" under section 362(a)(5). Under section 541(a)(1), whatever interest a debtor had in property became part of the bankruptcy estate. The bankruptcy trustee or the debtor in possession has custody and control over property of the estate.³⁰⁴ After the filing of the petition, a debtor has no interest in property of the estate. The debtor may have some property interests after the commencement of the case that are not property of the estate. These include property interests that the debtor has exempted from property of the estate and therefore from the claims of its general creditors under section 522,³⁰⁵ property items that do not become property of the estate such as the earnings of an individual debtor from services after the case has commenced,³⁰⁶ and property abandoned to the debtor.³⁰⁷ The stay only applies to these interests,³⁰⁸ and none of them conflicts with the rights of a creditor in possession.³⁰⁹

303. This interpretation of section 362(a)(4) does not make it any more superfluous than it already is. Any act to "control" property of the estate under subsection (3) would include an act to create, perfect, or enforce a lien against property of the estate under subsection (4). Subsection (4) also becomes completely redundant under this interpretation. The redundancy was created in 1984, when Congress added "control" to section 362(a)(3). See Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 441(a)(2) (1984), *reprinted in* 1984 U.S.C.A.N. (98 Stat.) 333, 371. Before this amendment, subsection (4) had independent meaning, which is to prevent the enforcement of liens created postpetition on property of the estate under 11 U.S.C. § 364 (1994).

304. See 11 U.S.C. § 323(a) (1994) (providing that the trustee is the "representative of the estate").

305. See *id.* § 522(b) (specifying what interests in property that an individual debtor may exempt from property of the estate).

306. *Id.* § 541(a)(6); see also Plank, *Bankruptcy Estate*, *supra* note 9, at 1215 (describing other exclusions from property of the estate).

307. See 11 U.S.C. § 554 (1994) (prescribing when property of the estate may be abandoned).

308. See Frank Kennedy, *Automatic Stays under the New Bankruptcy Law*, 12 U. MICH. J. LAW REFORM 1, 19-20 (1978) (stating that "the automatic stay of the statute operates against the creation, perfection, or enforcement of a lien against the debtor's property" that is exempt property and property that never comes into the estate).

309. An individual debtor can exempt only his or her interest in a property item. See 11 U.S.C. § 522(d) (1994) (referring to the "debtor's interest" in specified property items); see also *Owen v. Owen*, 500 U.S. 305, 308-09 (1991) (stating that the debtor may exempt from the estate only those interests included in the estate), *quoted supra* note 273. If the debtor has no equity in a property item, the debtor cannot exempt anything. If there is debtor equity, the debtor can take its exemption from the surplus after the liquidation of the property item.

This interpretation of the automatic stay does not reduce the effectiveness of the automatic stay against a creditor. If a debtor does not voluntarily pay a debt, a creditor in possession can collect or recover its debt only by selling the property items and applying the proceeds of the sale to the payment of the debt. Such a foreclosure sale would be an "act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case" under section 362(a)(6).³¹⁰ Accordingly, continued possession of the property items by a secured creditor would not violate the automatic stay, but selling them would. To proceed with a foreclosure sale, a creditor in possession must obtain relief from the automatic stay under section 362(d).

Section 362(d) provides that a bankruptcy court "shall" grant relief from the stay on several grounds.³¹¹ The first ground, under subsection 362(d)(1), is "for cause."³¹² "Cause" includes "the lack of adequate protection of an interest in property."³¹³ Cause would include a decline in the value of an undersecured secured creditor's collateral unless it is otherwise provided "adequate protection," such as periodic payments to compensate for the decrease in value or a security interest in other property of the estate.³¹⁴ Subsection 362(d)(2) allows relief from a stay against property items owned by the estate if the debtor has no equity in the property items and such property items are not necessary for reorganization.³¹⁵ This subsection also provides relief from the stay under subsection (a)(6)

310. 11 U.S.C. § 362(a)(6) (1994), *quoted supra* in text accompanying note 295.

311. *Id.* § 362(d). Section 362(d) provides:

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property under subsection (a) of this section, if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

(3) [provisions relating to relief from a stay of an act against single asset real estate under subsection (a) omitted.]

Id.

312. *Id.* § 362(d)(1), *quoted supra* note 311.

313. *Id.*

314. *Id.* § 361; *see also* *United Sav. Ass'n v. Timbers of Inwood Forest Assoc.*, 484 U.S. 365, 370 (1988) (noting that section 362(d)(1) gives a secured creditor protection against a decline in value of collateral subject to a security interest).

315. 11 U.S.C. § 362(d)(2) (1994), *quoted supra* note 311.

preventing a creditor in possession from foreclosing the estate's interest in a property item to pay its claim.³¹⁶

In conclusion, if the debtor has equity, the creditor in possession may not obtain relief from the stay. If the debtor has no equity,³¹⁷ the creditor in possession may obtain relief from the stay if the property items are not necessary for reorganization.³¹⁸ If the property items are necessary for reorganization, the creditor may not get relief even if the debtor has no equity as long as the value of the property items was not declining.³¹⁹ A creditor in possession who gets relief from the

316. Subsection (d)(2) applies only to the "stay of an act against property" under section 362(a). Although paragraphs (3), (4), and (5) of subsection (a) specifically refer to "property of the estate" or "property of the debtor," paragraph (6) also stays acts against property because it stays acts by creditors to foreclose their liens. The word "property" in subsection (d)(2) must mean the property item. Although the word "property" in the opening clause of subsection (d)(2) and in clause (d)(2)(B) could mean either the property items in the possession of the creditor, or the possessory interest in the property items that the debtor formerly had and conveyed to the creditor in possession, the phrase "property" in subsection (d)(2)(A) must mean the property item. Subsection (d)(2)(A) speaks of "equity in such property." The debtor has an equity interest in the property item. The debtor does not, however, have an equity interest in the possessory interest that the creditor has obtained. Thus the word "property" should be given the same meaning—"property item"—in all three places, especially in view of the reference to "such property" in the second and third instances.

If one disagreed that subsection (d)(2) applies to a stay under paragraph (a)(6), one would reach the same result under subsection (d)(1), requiring cause for relief. If the debtor has no equity in the property item and possession of the property item is not necessary for reorganization, then the creditor has cause for relief. The stay does not benefit the estate but does harm the creditor. If the debtor has equity, the creditor is oversecured and therefore it gets interest on its claim. *Id.* § 506(b). Absent other factors, the creditor does not have cause. If the property item is necessary for reorganization, the creditor will not have sufficient cause for relief.

317. Both section 362(d)(2) and section 363(f)(3) fail to take into account an oversecured creditor with a priority security interest in a property item in which the debtor has no positive equity because of subordinate liens that exhaust the remaining value. Technically, such a creditor is entitled to relief from the automatic stay, and such an oversecured creditor in possession need not return the property item. A possible solution is discussed *infra* notes 338-342 and accompanying text.

318. See *Vieland v. First Fed. Sav. Bank (In re Vieland)*, 41 B.R. 134, 139 (Bankr. N.D. Ohio 1984) (holding in a chapter 13 case that, because the debtor had no equity and the property item was not necessary for reorganization, the stay should be lifted).

319. This limitation of the creditor's rights significantly changed pre-Code law. Although undersecured creditors under the Bankruptcy Act were not entitled to interest on their claim in the bankruptcy case, *Sexton v. Dreyfus*, 219 U.S. 339, 346 (1911), undersecured creditors would obtain relief from a stay or injunction to liquidate the property item because the debtor lacked equity. See *infra* Part I.A. The ability to obtain relief ameliorated the inability to receive interest. The Supreme Court in *United Savings Ass'n v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365 (1988), however, ruled that the requirement for "adequate protection" in section 362(d)(1), did not include interest payments to compensate the creditor for the inability to liquidate the collateral. *Timbers*, 484 U.S. at 370. See generally *Carlson, Postpetition Interest*, *supra* note 73, at 581-89 (discussing the background of the concept of adequate protection).

stay may sell the property item to collect its claim. If the creditor may not get relief from the stay, the next question is what may or must the creditor do during the case with the property items in its possession.

B. Turnover

A creditor in possession of property items owned by the estate may not sell them to collect the debt without relief from the stay. Aside from a preferential levy by a previously unsecured judgment creditor,³²⁰ may the trustee force the creditor to return the property items?

Analysis of the text of the Bankruptcy Code refutes *Whiting Pools's* answer to this question. Section 542(a) requires an entity in possession, custody, or control of property that the trustee may use, sell, or lease under section 363 to deliver that property to the trustee.³²¹ Pursuant to section 363(b) and (c), the trustee may use, sell, or lease "property of the estate."³²² When a creditor has possession of property items owned by the estate, under section 541(a) the property of the estate consists not of the property items possessed by the creditor but only the estate's equity interest in those items. This equity interest consists only of the estate's right to any surplus from the sale of the property items, the right to redeem the creditor's lien on the property items by paying the amount of the claim, and its ancillary rights, such as the right to notice of the foreclosure sale.³²³ The creditor does not have custody or control over these interests, and section 542(a) does not apply to the creditor in this context.

Although the *Whiting Pools's* result is textually wrong, analysis of the text of the Bankruptcy Code does produce three possible ways in which a trustee can regain possession of a property item held by a

The trustee or debtor in possession has the burden of proving that the property is not necessary for reorganization. 11 U.S.C. § 362(g)(2) (1994). In *Timbers*, the Court held:

What this [section 362(g)(2)] requires is not merely a showing that if there is conceivably to be an effective reorganization, this property will be needed for it; but that the property is essential for an effective reorganization *that is in prospect*. This means, as many lower courts, including the en banc court in this case, have properly said, that there must be "a reasonable possibility of a successful reorganization within a reasonable time."

Timbers, 484 U.S. at 375-76.

320. See 11 U.S.C. § 547(b) (1994), discussed *supra* note 6.

321. *Id.* § 542(a), quoted *supra* note 252.

322. *Id.* § 363, quoted *supra* note 222.

323. See *infra* notes 282-284 and accompanying text (discussing the types of interests that were in the IRS's "possession, custody, or control" in *Whiting Pools*, 462 U.S. at 203).

creditor.³²⁴ (1) the trustee can obtain possession by redeeming the security interest of the creditor in possession; (2) if there is equity in the property item, the trustee can require the creditor in possession to return the item to the trustee so that the trustee can sell it; and (3) if the property item is necessary for reorganization, the debtor in possession or debtor can require the turnover if the confirmed plan so provides.

1. *Redemption.*—The bankruptcy trustee (including a debtor in possession) can always redeem the creditor's security interest by paying the amount of the creditor's claim. The debtor's right of redemption, part of its equity interest, is part of the property of the estate.³²⁵ Upon such redemption, the entire property interest in the property item becomes property of the estate. To finance the redemption, the trustee may borrow money and grant to the new lender a security interest in the property item.³²⁶

This solution is attractive primarily when the estate has equity in the property item. This option also provides a good check on whether the estate in fact has any equity in the property item. A trustee will not generally redeem the property unless there is a positive equity. In addition, another lender will not refinance the redemption on a secured basis if it does not give the property item a value comparable to what the trustee or the bankruptcy court believes is the value. An inability to find another lender willing to lend on a secured basis will call into question the trustee's or court's valuation. Finally, redemption does not give the secured creditor in possession any benefit at the expense of the other creditors. Until the creditor's security interest is redeemed, the secured creditor's claim will earn interest so long as the value of the property item exceeds the amount of the claim.³²⁷

324. I exclude from this discussion the ability of a trustee to avoid a preferential transfer under 11 U.S.C. § 547(b) (1994), *discussed supra* note 6. Only certain "statutory liens" (meaning a lien "arising solely by force of a statute on specified circumstances or conditions, or lien of distress for rent, whether or not statutory," *id.* § 101(53)) may be avoided as preferences under 11 U.S.C. § 545 (1994). The IRS's lien in *Whiting Pools* was an unavoidable statutory lien. Accordingly, the only route for the debtor in possession to regain the goods was through the turnover provisions.

325. The right of redemption arises if the creditor declares an event of default and initiates a foreclosure sale. Most debt transactions also provide that the filing of a petition is an event of default. Even for those that do not, the filing of a petition accelerates all outstanding debts. Moreover, most consumer debt transactions allow prepayment at any time before default and most commercial transactions allow prepayment after some period of time.

326. 11 U.S.C. § 364(c) (1994).

327. *See id.* § 506(b). Section 506(b) states in part:

If there is no equity in the property item, and the item is not necessary for reorganization, it makes little sense for the trustee to pay more (the amount of the undersecured claim) to acquire the item. As discussed below in subpart 3, however, if there is no equity in the property item, but it is necessary for reorganization, the trustee may not obtain possession until a plan so providing is confirmed. To obviate any difficulties this delay may cause, if the property is truly necessary for reorganization and there is a strong possibility for a reorganization, the trustee could negotiate for the return of the property item for a redemption price less than the amount of the debt. The creditor will often have an incentive to return the item to avoid storage costs.³²⁸

2. *Liquidation of the Property Item.*—Section 542(a) provides another possibility if there is equity in the property item. Section 542(a) states that a bankruptcy trustee may get turnover of property “that the trustee may use, sell, or lease under section 363” in the possession of a third party.³²⁹ As we have seen, section 363(b) and (c) do not apply to the creditor in possession.³³⁰ Section 363(f), however, does. Section 363(f) states that the trustee may, if certain conditions are met, sell property items “free and clear of any interest” in those property items of an “entity other than the estate.”³³¹

To sell property items in which a creditor has a security interest, the trustee must satisfy the conditions of section 363(f). One condi-

[t]o the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

Id.

328. See, e.g., *United States v. Whiting Pools, Inc.*, 10 B.R. 755, 757 (Bankr. W.D.N.Y. 1981) (noting that it cost the IRS \$2500 per month to store the items it seized from Whiting Pools).

329. 11 U.S.C. § 542(a) (1994), *quoted supra* note 252.

330. See *supra* notes 267, 278-284 and accompanying text.

331. 11 U.S.C. § 363(f) (1994), *quoted supra* note 222. Section 363(f) states, in part, that “[t]he trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if” certain conditions are satisfied. *Id.* The word “property” in this subsection refers to property items in which the estate has an interest because “property of the estate” excludes the interests of others in a property item. See *id.*; *supra* notes 265-284 (discussing the exclusiveness of this definition of property of the estate). One might argue that the phrase “under §§ (b) or (c)” suggests that “property” means property of the estate, but this reading contradicts the definition of property of the estate. Instead, the reference of subsections (b) or (c) simply incorporates the limitations of those subsections that distinguish between sale in and out of the ordinary course of business. See also Plank, *Bankruptcy Estate*, *supra* note 9, at 1223-24 (analyzing section 363(f)’s reference to subsections (b) and (c)).

tion for the sale of such a property item is that the sale price exceed the value of all of the liens on the property item.³³² Accordingly, if there is equity in the property item the trustee can sell it.³³³ Because the trustee can sell the property item under section 363(f), she can compel the creditor in possession under section 542(a) to return the property item to effect the sale.³³⁴ This result is consistent with the provisions imposing the automatic stay. As discussed above, if the debtor has equity, the creditor in possession is not entitled to relief from the automatic stay.³³⁵ In this case, it does not matter whether the debtor is liquidating under chapter 7 or reorganizing under chapters 11, 12,³³⁶ or 13, as long as the trustee (or debtor in possession or debtor) is obtaining possession to sell the property item.³³⁷

Section 363(f)(5) offers another possibility of a turnover order against oversecured creditors in possession even when the estate has no equity. Section 363(f)(5) allows the sale if the secured creditor "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."³³⁸ Assume that a creditor in possession has a claim, say \$100, that is less than the value of the property item, say \$150, but there are one or more junior creditors with a se-

332. See 11 U.S.C. § 363(f)(3), *quoted supra* note 222.

333. See also David Gray Carlson, *Undersecured Claims Under Bankruptcy Code Sections 506(a) and 1111(b): Second Looks at Judicial Valuations of Collateral*, 6 BANKR. DEV. J. 253, 260-63 (1989) (discussing the provision in 11 U.S.C. § 363(f) for the sale of property free and clear of liens); see also David Gray Carlson, *Turnover of Collateral in Bankruptcy: Must a Secured Party-in-Possession Volunteer?*, 6 J. BANKR. L. & PRAC. 483, 490 n.35 (1997) [hereinafter *Turnover of Collateral*] (noting that "a trustee cannot sell collateral when no debtor equity exists" (quoting 11 U.S.C. § 363(f)(3))).

334. See 11 U.S.C. § 363(f) (authorizing the trustee to sell property in which entities other than the estate has an interest under the conditions specified in that section), *quoted supra* note 222; *id.* § 542(a) (requiring that property in the possession of another entity that the trustee may sell must be delivered to the trustee), *quoted supra* note 252.

335. See *supra* note 311 (quoting 11 U.S.C. § 362(d)); *supra* notes 311-315 (discussing section 362(d)'s requirements for relief from the automatic stay).

336. 11 U.S.C. § 1206 (1994) also provides for the sale of certain types of property items without meeting the requirements of § 363(f):

After notice and a hearing, in addition to the authorization contained in section 363(f), the trustee in a case under this chapter may sell property under section 363(b) and (c) free and clear of any interest in such property of an entity other than the estate if the property is farmland or farm equipment, except that the proceeds of such sale shall be subject to such interest.

Id. § 1206.

337. For many types of property items, such as investment securities, instruments, chattel paper, or accounts, the trustee need not have possession or control to sell if the prospective buyer has sufficient information about the property items. Many businesses sell these types of property items even though a warehouse lender has possession of or control over them.

338. 11 U.S.C. § 363(f)(5), *quoted supra* note 222.

curity interest in the property item whose claims, say \$100, when added to the claim of the creditor in possession exceed the value of the property item.³³⁹ The sale price of the property item—\$150—would not exceed the value of the liens³⁴⁰ and section 363(f)(3) would not apply. Nevertheless, because the estate has a right to redeem and bankruptcy accelerates all claims, the creditor in possession could be compelled to accept payment of its claim. Therefore, if the junior creditors consented to the sale of the property item under section 363(f)(2),³⁴¹ sections 363(f)(2) and (5) together would permit the trustee to regain possession of the property item in the creditor's possession for the purpose of sale.³⁴²

339. Even when a creditor has possession, junior creditors may have perfected security interests. Examples include a mortgagee in possession of real property subject to a properly recorded second mortgage, see, e.g., NELSON & WHITMAN, *supra* note 267, § 7.15, at 503-07, § 7.31, at 571-73, and secured creditors in possession or control of personal property against which a junior creditor has filed a valid financing statement, see 1995 U.C.C. §§ 9-115(4), -302, -304, -305 (perfection by filing, possession, or control); 1999 U.C.C. §§ 9-310 -312, -313, -314 (same).

340. There may be a drafting glitch in this subsection. The drafters may have intended to refer to the value of their claims secured in whole or in part by the property item, or in my example, \$200. The value of any lien, however, never exceeds the value of the property, which in my example is \$150, but is always equal to or, in the case of the oversecured creditor, less than the value of the property item. Nevertheless, even with this more correct interpretation, the statute still works technically. The value of the property, \$150, does not exceed the value of the lien, \$150.

341. 11 U.S.C. § 363(f)(2), *quoted supra* note 222.

342. Some courts have held that, under 11 U.S.C. § 363(f)(5) (1994), a trustee may sell property items in which a creditor has a security interest even if the price will not be sufficient to pay the claim in full. One court has held that, because section 1123(a)(5)(E) allows a plan to provide for the satisfaction of a secured creditor's lien (which is valued only to the extent of the value of the property item), the trustee can sell the property item free of the secured creditor's lien and pay the proceeds to the secured creditor. See *In re Healthco Int'l, Inc.*, 174 B.R. 174, 176-77 (Bankr. D. Mass. 1994). Accord *In re James*, 203 B.R. 449, 453-54 (Bankr. W.D. Mo. 1997) (noting that the potential cause of action to avoid preferential transfer is a proceeding that can compel money satisfaction of security interest). I doubt that Congress intended this result, especially in view of the restriction to "a legal or equitable proceeding" which does not necessarily include a plan confirmed in a bankruptcy case. There is no consensus in the case law on this issue. See, e.g., *Healthco Int'l, Inc.*, 174 B.R. at 177 n.6 (interpreting section 363(f)(5) as not requiring trustee to pay creditor in full when selling collateral); *In re General Bearing Corp.*, 136 B.R. 361, 365 (Bankr. S.D. N.Y. 1992) (stating that under section 363(f)(5), creditor could not be forced to accept less than full satisfaction of its interest); *Richardson v. Pitt County (In re Stroud Wholesale, Inc.)*, 47 B.R. 999, 1003 (Bankr. E.D. N.C. 1985), *aff'd per curiam* 983 F.2d 1057 (4th Cir. 1986) (stating that "the only reasonable interpretation of [§ 363]f(5) is that 'money satisfaction' means full satisfaction of creditors' interests in sales in liquidation of the estate"). It also contradicts the policy that requires lifting of the automatic stay if the debtor has no equity in the property. It further contradicts the incentives. If the debtor has no equity in the property, the secured creditor has the strongest incentive to maximize the sale proceeds to recapture as much of its claim as possible. If the secured creditor

In any event, if the creditor in possession is undersecured, that is, the creditor's claim is greater than the value of the property item, section 542(a) does not authorize a turnover order. This result is also consistent with the provisions of the Bankruptcy Code imposing the automatic stay. As discussed above, if the property item is not necessary for reorganization, then the undersecured creditor in possession is entitled to relief from the automatic stay to sell the property item and to apply the sale proceeds to its claim.

3. *Turnover Pursuant to a Confirmed Plan.*—If the property item in the creditor's possession is necessary for reorganization, the creditor in possession is not entitled to relief from the automatic stay even if there is no equity.³⁴³ Nevertheless, there is no express provision in the Code that directly authorizes a turnover order against the creditor in possession. The provisions of the Code relating to reorganization plans, however, allow a plan to require the turnover of property items in the possession of a creditor.

For reorganizations under chapter 11, section 1123 specifies that a plan may "modify the rights of holders of secured claims" and may contain other provisions consistent with title 11.³⁴⁴ Accordingly, the

believes that the trustee could get a better result, it could (and does) authorize the trustee to conduct the sale.

343. See *supra* note 315 and accompanying text (discussing the requirements of 11 U.S.C. § 362(d)(2) for granting relief from the automatic stay). The statement in the text assumes that the creditor does not have "cause" for relief from the automatic stay, such as lack of adequate protection against a decline in the value of the property item, under 11 U.S.C. § 362(d)(1) (1994), *discussed supra* notes 310-314 and accompanying text.

344. 11 U.S.C. § 1123(b)(5), (6) (1994). Section 1123 provides that:

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—

...

(3) specify the treatment of any class of claims or interests that is impaired under the plan;

...

(5) provide adequate means for the plan's implementation, such as— . . .

(E) satisfaction or modification of any lien;

...

(b) Subject to subsection (a) of this section, a plan may—

(1) impair or leave unimpaired any class of claims, secured or unsecured, or of interests;

...

(5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; and

(6) include any other appropriate provision not inconsistent with the applicable provisions of this title.

Id.

plan may provide that a creditor in possession of property items necessary for reorganization must return those property items to the debtor in possession. Of course, a turnover requirement would impair the claim of the creditor in possession.³⁴⁵ Even if the creditor did not accept the plan,³⁴⁶ the court may still confirm the plan. To do so, the plan must provide that the creditor will receive the value that it would have received in a liquidation³⁴⁷ and the plan does not discriminate unfairly, and is fair and equitable with respect to the creditor's claim.³⁴⁸

Chapter 12 for family farmers³⁴⁹ and chapter 13 for individuals with regular income³⁵⁰ also would allow a plan to require the return of property items held by a creditor in possession. The court may confirm any plan under these chapters that required return of the property items in the creditor's possession over the objection of the creditor if (1) the creditor retains its lien and receives the value of its allowed secured claim, that is, the value of the property item³⁵¹ and (2) "the debtor will be able to make all payments under the plan."³⁵²

There is one limitation on the power of a plan to require turnover against a creditor in possession. A plan under chapter 11 may not modify the rights of the holder of a claim secured only by a mortgage on the debtor's principal residence.³⁵³ Accordingly, if a mortga-

345. *Id.* § 1124(1), (2)(D).

346. *Id.* § 1126.

347. *Id.* § 1129(7)(a)(ii).

348. *Id.* § 1129(b).

349. *Id.* § 1222(b). Section 1222(b) provides that:

Subject to subsections (a) and (c) of this section, the plan may—

...

(2) modify the rights of holders of secured claims, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; . . . and

(11) include any other appropriate provision not inconsistent with this title.

Id.

350. *Id.* § 1322(b). Section 1322(b) provides that:

Subject to subsections (a) and (c) of this section, the plan may—

...

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; and . . .

(10) include any other appropriate provision not inconsistent with this title.

Id.

351. *Id.* §§ 1225(a)(5)(B), 1325(a)(5)(B).

352. *Id.* §§ 1225(a)(6), 1325(a)(6).

353. *Id.* § 1123(b)(5). Chapter 13 also includes this limitation. *Id.* § 1322(b)(2). However, notwithstanding section 1322(b)(2), the debtor may cure any default until the real property is sold. *Id.* § 1322(c)(1). Accordingly, in chapter 13, the plan may require the creditor to return possession if the plan cures the mortgage default.

gee actually obtains possession of the debtor's residence before the filing of a petition—an extremely rare event, which can typically happen only if the debtor consents—the mortgagee cannot be forced to return possession to an individual debtor.³⁵⁴ The lesson for an individual debtor in financial trouble who hopes to reorganize under chapter 11 is to file a petition before the mortgagee obtains possession (which the mortgagee typically does not do) or finally forecloses the debtor's equity interest (including any postforeclosure statutory rights of redemption).³⁵⁵

Until a plan is confirmed, the creditor in possession may not sell the items but may retain them. This interpretation creates a temporary stalemate between the creditor in possession and the debtor in possession.³⁵⁶ This stalemate need not last long. The debtor in pos-

354. If a receiver is appointed to foreclose the mortgage, section 543 would authorize a turnover order against the receiver as a "custodian." See *infra* notes 359, 362, 380 and accompanying text.

355. See *Boyd v. United States (In re Boyd)*, 11 F.3d 59 (5th Cir. 1994). In *Boyd*, the debtor filed a chapter 13 petition 33 months after a mortgage foreclosure sale of his home and shortly after the state appellate court affirmed a judgment for eviction. *Id.* at 61. The court found that the debtor had no interest in the house under Mississippi law after the foreclosure sale and the recordation of the trustee's deed before filing the petition and held that the confirmation of a chapter 13 plan by the bankruptcy court without objection from the creditor did not revert the house in the debtor. *Id.*

See also *Brown v. Financial Enter. Corp. (In re Hall)*, 188 B.R. 476, 483 (Bankr. D. Mass. 1995) (holding, where the foreclosure was completed before filing, that the home was no longer property of the estate, even though the debtor was still in possession); *In re Smith*, 169 B.R. 659, 661 (Bankr. E.D. Miss. 1994) (holding that property purchased by a bank at a prepetition foreclosure sale, even though the deed remained unrecorded at time of petition by chapter 13 debtor, was not property of estate); *Abdelhaq v. Pflug*, 82 B.R. 807, 810 (Bankr. E.D. Va. 1988) (holding that a foreclosure sale under deeds of trust of condominium units, before the filing of a chapter 11 petition, extinguished the debtors' interest in such property); *Welborn v. Ruegsegger (In re Welborn)*, 75 B.R. 243, 245 (Bankr. D. Mont. 1987) (holding that chapter 12 debtors' interest as buyers under a real estate installment sale contract was terminated, pursuant to the state court foreclosure action and before the filing of a bankruptcy petition, and thus the debtors could not reinstate the contract for deed pursuant to a chapter 12 payment plan); *In re Cretella*, 42 B.R. 526, 530 (Bankr. E.D.N.Y. 1984) (holding that (1) under New York law, a purchaser of property at a prepetition real estate foreclosure sale divested the debtor of any interest in property even though the actual deed was neither delivered nor offered to be delivered until after the petition was filed, and therefore (2) under the Code the debtor lacked power to de-accelerate or reinstate the mortgage and cure any defaults); *In re Rice*, 42 B.R. 838, 846-47 (Bankr. D.S.D. 1984) (holding that (1) despite a mortgage foreclosure sale, debtors retained their one-year statutory right of redemption when they filed their bankruptcy petition, which became part of property of the estate; (2) the debtors exercised their right of redemption through their chapter 13 plan to which the lender failed to object; and (3) the creditor was not entitled to relief on the basis that the bankruptcy court did not have subject matter jurisdiction over the real property).

356. This temporary stalemate is not unique. The Supreme Court held in *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 19 (1996), that a bank with a right of set-off against the

session can always redeem the property item, although it would normally do so only if there were equity. In any event, the debtor and the creditor can negotiate a settlement. An undersecured creditor who has repossessed property items will often have a strong incentive to return the seized property items. Continued possession by the undersecured creditor imposes obligations and costs which the creditor will not recoup from the debtor. For example, in *Whiting Pools*, retaining possession of the goods that the IRS seized from Whiting Pools was costing the IRS \$2500 per month.³⁵⁷

C. *The Creditor in Possession is Not a Custodian*

Section 543(b) authorizes a turnover order against a "custodian" in custody, control, or possession of "property of the debtor."³⁵⁸ If a creditor in possession were a custodian, section 543(b) would authorize the turnover. A "custodian" includes a "trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property."³⁵⁹ A creditor in possession is not a trustee or a receiver under this definition. In addition, a creditor who has possession before default to create or perfect a security interest has not been "appointed or authorized"³⁶⁰ to take charge of the debtor's property items for the purpose of enforcing the lien. Although the ability to foreclose quickly is a benefit from such possession, it is not the main or sole purpose.

It is also too great a stretch to think of a repossessing creditor as an "agent." Certainly a repossessing creditor owes some duties to the debtor. It must pay any surplus of a foreclosure sale to the debtor, and it must account for any proceeds that it receives before foreclosure.³⁶¹ These duties, however, do not make it an agent for the

debtor's checking account could freeze the account. The administrative hold created a temporary stalemate. Under 11 U.S.C. § 553(a), and § 542(b), the debtor cannot access the money in the account, but the bank cannot set-off its claim against the amount in the deposit account under section 362(a)(7). *Id.* § 362(a)(7), *quoted supra* note 295. The status quo is preserved until the account is liquidated and the bank is paid or until a plan governing the account and the bank's claim is confirmed.

357. *United States v. Whiting Pools, Inc.*, 10 B.R. 755, 757 (Bankr. W.D.N.Y. 1981).

358. 11 U.S.C. § 543(b), *quoted supra* note 230.

359. *Id.* § 101(11), *quoted supra* note 231.

360. *Id.*

361. *See generally* NELSON & WHITMAN, *supra* note 267, §§ 4.27-29, at 185-95, § 7.31, at 571-73, 189-95 (real property); 1995 U.C.C. §§ 9-207, -502(2), -504(2) (personal property); 1999 U.C.C. §§ 9-207(c), -608, -615 (same).

debtor.³⁶² In an agency relationship, the agent agrees to act on behalf of the principal.³⁶³ One essential element of an agency relationship is the ability of the principal to control the agent.³⁶⁴ A debtor, however, does not have the power to control the creditor. The creditor controls the foreclosure sale, within the limits of the applicable law.³⁶⁵ The debtor cannot control the sale or require the creditor to sell to a particular buyer.³⁶⁶ Indeed, as long as the creditor is commercially reasonable, I doubt that the debtor could even control how the creditor pays any surplus to the debtor.³⁶⁷

If Congress had intended to include a creditor in possession as a custodian under the Code, the history of the Bankruptcy Act suggests that it would have done so more explicitly. The definition of "custodian," including the reference to "agent," copies the summary jurisdiction powers of the bankruptcy court under section 2(21) of the Bankruptcy Act.³⁶⁸ Under the judicial interpretation of the Act, how-

362. See NELSON & WHITMAN, *supra* note 267, § 4.33, at 195 (distinguishing a receiver appointed by a court to take charge of mortgaged property, who owes duties to the mortgagor, the mortgagee, and third parties with interests in the land, from the mortgagee in possession).

363. See RESTATEMENT (SECOND) OF AGENCY § 1(1), at 7 (1958) ("Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control and consent by the other so to act."). The Restatement comments that

mortgagees, pledgees, and other similar power holders, although having power to sell the property involved under certain conditions or to subject another to contractual liability, are not agents of the power giver; they have not undertaken to exercise such power primarily for the benefit of the person in whose name they formally act, and they are entitled to prefer their own interests in dealing with the subject matter.

Id. § 13 cmt. b, at 59.

364. See *id.* § 14, at 60.

365. These limits consist of such procedural requirements as notice before a foreclosure sale, and the requirement that the sale be commercially reasonable. See 1995 U.C.C. § 9-504(1), (3); 1999 U.C.C. §§ 9-610 to -614.

366. Several authors have stated that a foreclosing creditor is an agent for the debtor, but without a complete analysis of the issue. See T. Edward Malpass, *A Bankruptcy Debtor's Right to Turnover of Property Held by Creditors: A Perspective on Sections 542 and 543 of the Bankruptcy Code*, 88 COM. L.J. 242, 247-48 (1983) (arguing that the obligations of a creditor in possession make it an agent and hence a "custodian"); Luize E. Zubrow, *Rethinking Article 9 Remedies: Economic and Fiduciary Perspectives*, 42 UCLA L. REV. 445, 448 (1994) (asserting that a foreclosing creditor acts as a selling agent for the debtor, but providing no analysis of the elements of the agency relationship and how the debtor-creditor relationship meets these elements); see also Carlson, *Turnover of Collateral*, *supra* note 333, at 491 (simply citing Malpass and Zubrow, *supra*).

367. For example, the creditor need not comply with a debtor demand that the surplus be paid in unmarked, nonconsecutively numbered small bills or a wire transfer of same day funds.

368. See Bankruptcy Act, § 2(21), as added by Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 844 (codified as amended at 11 U.S.C. § 11(21) (1976) (repealed 1978)) (giving the

ever, such "agents" were agents controlled by the debtor, and not adverse claimants.³⁶⁹ Under the Act, a creditor in possession was considered an adverse claimant, and this language in section 2(21) did not give courts under the Act summary jurisdiction in a liquidation case to order turnover by a creditor in possession to a trustee.³⁷⁰ Moreover, the chapter X and chapter XII turnover sections had explicitly applied to a mortgagee in possession,³⁷¹ yet Congress chose not to repeat this language. Further, witnesses before Congress recommended an express turnover provision for repossessing creditors in possession, and stated that the Commission's Act did not contain such a provision.³⁷² H.R. 6 and the later bills that became the Code did not include the recommended provision.³⁷³

Further indication that Congress did not consider a creditor in possession to be an agent within the meaning of the definition of "custodian" is the fact that the Code does not require adequate protection of the interests of the custodian. A custodian is merely entitled to her fees and expenses.³⁷⁴ On the other hand, a creditor in possession has an interest in property that is entitled to adequate protection.³⁷⁵

bankruptcy court jurisdiction to require "receivers or trustees appointed in proceedings not under this Act, assignees for the benefit of creditors, and agents authorized to take possession of or to liquidate a person's property to deliver the property in their possession or under their control" to the bankruptcy trustee or debtor).

369. See *Flournoy v. City Fin. of Columbus, Inc.*, 679 F.2d 821, 823-24 (8th Cir. 1982) (determining that under the Bankruptcy Act of 1898, for summary jurisdiction to attach, the "agent" must acknowledge that he is subject to the bankrupt's demands); see also 1 COLLIER, *supra* note 41, ¶ 2.78[3], at 390.21-390.30 (discussing the debtor's control over agents).

370. See *supra* notes 51-53, 58 and accompanying text (discussing the requirement for plenary suits under the Bankruptcy Act against adverse claimants, including creditors in possession, and citing cases interpreting the Act).

371. See *supra* notes 136-138 and accompanying text (discussing section 257 under chapter X and section 507 under chapter XII).

372. See *supra* notes 224-229 and accompanying text.

373. See *supra* notes 230-234 and accompanying text (discussing the appearance of sections 543(b) and 542 in H.R. 6, 95th Cong. (1977)).

374. See 11 U.S.C. § 543(c)(2) (1994) (stating that the court shall "provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian"); cf. *In re Rimsat, Ltd.*, 193 B.R. 499, 502 (Bankr. N.D. Ind. 1996) (holding that a receiver is not a party in interest for purposes of filing a motion to dismiss a bankruptcy case).

375. See 11 U.S.C. § 361 (1994) (referring to sections 362 (stay), 363 (use), and 364 (granting additional security interests)). A creditor in possession is entitled to relief from the automatic stay for cause, including lack of adequate protection. See *id.* § 362(d)(1), quoted *supra* note 311 and discussed *supra* in text accompanying notes 311-314. Under section 363(e), the trustee may prohibit or condition the sale under section 363 of a property item held by the creditor in possession, as necessary to provide adequate protection of the creditor. See *id.* § 363(e), discussed *supra* in text accompanying note 331. Finally, under section 364, the trustee can grant a superior lien on a property item in the possession of a

The Bankruptcy Code's grant to the custodian of reasonable compensation and reimbursement for its fees gives another significant reason why a creditor in possession is not a custodian. Under non-bankruptcy law, a creditor in possession is entitled to reimbursement for expenses but not compensation for services.³⁷⁶ These expenses are included in the creditor's claim, and to the extent that the creditor were undersecured, such reimbursement would be treated as an ordinary unsecured claim³⁷⁷ subordinate to all administrative expenses. If a creditor in possession, however, were a "custodian" it would be entitled to reimbursement for its expenses and for its services as an administrative expense priority.³⁷⁸ It is extremely unlikely that Congress intended to give a creditor in possession such a priority for its expenses, as well as for its services.³⁷⁹

Both the Senate and the House reports suggest that a custodian does not include a creditor in possession. Discussing the definitions in the Code, both stated that a "custodian" was a prepetition liquidator of the debtor's property or a court appointed officer.³⁸⁰ The de-

creditor if the trustee is unable to obtain credit otherwise and if the interest of the existing creditor is adequately protected. *See id.* § 364(d)(1)(B).

376. *See, e.g.*, 1995 U.C.C. § 9-207(a)(2) (providing that "reasonable expenses, including the cost of any insurance and payment of taxes and other charges incurred in the custody, preservation, use or operation of the collateral [in the creditor's possession] are chargeable to the debtor and are secured by the collateral"); 1999 U.C.C. § 9-207 (same). Typical secured loan agreements and mortgages also provide for reimbursement for the creditor's expenses. *See, e.g.*, WILLIAM C. HILLMAN, COMMERCIAL LOAN DOCUMENTATION, *Form 11.2 Pledge Agreement*, § 4, ¶ 2, at 229, 230 (3d. ed. 1990) (providing that the "undersigned [debtor] agrees to reimburse Bank [the secured creditor], on demand, for any amounts paid or advanced by Bank for the purpose of preserving the Collateral [in its possession] or any part thereof and/or [sic] any liabilities or expenses incurred by Bank as the transferee or holder of the Collateral").

377. *See* 11 U.S.C. §§ 506(a), 726(a)(1)-(3) (1994). Section 506(a) states that a claim of a creditor "is an unsecured claim to the extent that the value of such creditor's interest [in property items subject to a security interest or set-off] . . . is less than the amount of such allowed claim." *Id.* § 506(a). Section 726(a)(2)-(3) provides for the payment of allowed claims after the payment of administrative expenses and claims entitled to priority under 11 U.S.C. § 507(a) (1994). *Id.* § 727(a)(1)-(3).

378. *See id.* § 543(c)(2), *quoted supra* note 374; *In re* 245 Associates, LLC, 188 B.R. 743, 747-48 (Bankr. S.D.N.Y. 1995) (holding that a state court receiver is a "custodian" and noting that several sections of the Code authorize the bankruptcy court to compensate and reimburse the superseded custodian for certain prepetition and postpetition services); *In re* Sevitski, 161 B.R. 847, 854 (Bankr. N.D. Okla. 1993) (same).

379. *See In re Meyer's Inc.*, 15 B.R. 390, 392 (Bankr. S.D. Cal. 1981) (holding that an attaching creditor is not a custodian and therefore is not entitled to reimbursement for expenses).

380. The reports state: "['Custodian'] means a pre-petition liquidator of the debtor's property The definition of custodian to include a receiver or trustee is descriptive, and not meant to be limited to court officers with those titles. The definition is intended to include other officers of the court if their functions are substantially similar to those of a

scription in these reports of the purpose of section 543(b) reinforces the conclusion that it does not apply to a creditor in possession. The reports noted that property of the debtor included property the title to which passed to the custodian, that the section protected obligations incurred by the custodian, and that it allowed the bankruptcy court "to authorize the custodianship to proceed notwithstanding this section."³⁸¹ Finally, the statement of the floor managers for the Code explaining the last minute change to section 542(a), which applies to entities other than a "custodian,"³⁸² confirms this understanding. The floor managers explained that section 542(a) did not apply to an entity—meaning a custodian—that had obtained an order of court authorizing it to retain possession.³⁸³

Before *Whiting Pools* obviated the issue, a majority of courts rejected the argument that a repossessing creditor was a "custodian," and therefore held that section 543(b) did not apply to the creditor in possession.³⁸⁴ Of course, to the extent that courts realize that *Whiting Pools* should no longer be considered good law, this issue may arise

receiver or trustee." H.R. REP. NO. 95-595, at 310 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6267, and S. REP. NO. 95-989, at 23 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5809; *see also* Skinner v. First Union Nat'l Bank (*In re Skinner*), 213 B.R. 335, 340 (Bankr. W.D. Tenn. 1997) (holding that a sheriff who levied on a truck owned by the debtor to satisfy a judgment in favor of a creditor was a "custodian" required to return the truck).

381. H.R. REP. NO. 95-595, at 370 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6326, and S. REP. NO. 95-989, at 84-85 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5870-71.

382. 11 U.S.C. § 542(a), *quoted supra* note 252.

383. *See* 124 CONG. REC. H11089 (Sept. 28, 1978) (statement of Don Edwards, Upon Introducing the House Amendment to the Senate Amendment to H.R. 8200), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6455 (stating that "[t]his section is not intended to require an entity to deliver property to the trustee if such entity has obtained an order of the court authorizing the entity to retain possession, custody, or control of the property"); *see also* 124 CONG. REC. S17406 (Oct. 6, 1978) (statement of Dennis DeConcini, Upon Introducing the Senate Amendment to the House Amendment to H.R. 8200), *reprinted in* 1978 U.S.C.C.A.N. 6505, 6525 (same).

384. *See* Flournoy v. City Fin. of Columbus, Inc., 679 F.2d 821, 823-24 (8th Cir. 1982) (concluding that a repossessing creditor is not a custodian); United States v. Whiting Pools, Inc., 674 F.2d 144, 148-49 (2d Cir. 1982) (finding that the IRS is not a custodian); *In re* Budget Uniform Center, Inc., 71 B.R. 652, 654 (Bankr. E.D. Pa. 1987) (holding that a creditor who caused a sheriff to levy on a debtor's vehicles was not a custodian); *In re* Pride Foods, Inc., 22 B.R. 356, 358 (Bankr. D. Neb. 1982) (finding an attaching creditor not to be an agent and therefore not a custodian); *In re* Debmar Corp., 21 B.R. 858, 859 (Bankr. S.D. Fla. 1982) (finding that the IRS is not a custodian); *In re* Meyer's Inc., 15 B.R. 390, 392 (Bankr. S.D. Cal. 1981) (holding that an attaching creditor "acting for his own benefit, is not within the ambit of the intent of Congress in defining a custodian" and therefore is not entitled to reimbursement for expenses).

But see Brickel v. Merchants Nat'l Bank of Manchester (*In re* Brickel), 11 B.R. 353, 355 (Bankr. D. Me. 1981) (finding a repossessing creditor to be a custodian); *In re* Gunder, 8 B.R. 390, 394 (Bankr. S.D. Ohio 1980) (same); ABD Fed. Credit Union v. Williams (*In re* Williams), 6 B.R. 789, 790 (Bankr. E.D. Mich. 1980) (same).

again. A court intent on finding a turnover power may conclude that a creditor in possession was a custodian and section 543(b) authorized a turnover.

D. The Special Case of Collections from Intangible Property Items

The analysis of the stay of foreclosure sales and the turnover by creditors in possession applies to both tangible and intangible property items. Intangible property items that generate cash payments or other cash proceeds pose additional complexities. A common example is an account subject to Article 9 of the Uniform Commercial Code. An "account" is a right to payment owed to the owner of the account by a third party, the account debtor, for goods sold or services rendered.³⁸⁵ The owner of an account may grant a security interest in it to a creditor. The secured creditor may take control of the account by notifying the account debtor of its security interest and directing that payments be made to the creditor.³⁸⁶ If the owner of the account becomes a debtor under the Bankruptcy Code, the automatic stay against an act to collect a claim will prevent the secured creditor from selling the account to repay the debt.³⁸⁷ The creditor need not, however, return the account (by reassigning it to the trustee) unless the specific turnover provisions discussed above in Part II.B apply: redemption, liquidation, or a confirmed plan. Unless there is some basis for requiring turnover, the creditor may continue to exercise "control" over it.

These results should also apply to the collections on the account that become due or that are paid after the commencement of the case. The automatic stay of acts to collect a claim under section 362(a)(6)³⁸⁸ precludes the secured creditor from applying these postpetition collections to the debt. The stay, however, does not require the account debtor to cease postpetition payment of the amount

385. See 1995 U.C.C. § 9-106 (defining an account as "any right to payment for goods sold . . . or for services rendered"); 1999 U.C.C. § 9-102(a)(2) (defining an account as "a right to payment of a monetary obligation").

386. See 1995 U.C.C. § 9-502(1); 1999 U.C.C. § 9-607(a). Once the secured party notifies the account debtor, the account debtor is obligated to pay the secured party and payment to the debtor does not discharge the obligation to pay the secured creditor. 1995 U.C.C. § 9-318; 1999 U.C.C. § 9-406(a).

387. 11 U.S.C. § 362(a)(6) (1994), *quoted supra* in text accompanying note 295.

Under the definition of property of the estate, the creditor could sell its security interest in the account. However, because courts sometimes confuse the property interest—here the security interest—and the property item—the account—a court might prevent the secured creditor from doing so. See, e.g., *supra* note 299; Plank, *Bankruptcy Estate*, *supra* note 9, at 1257, 1267-73.

388. 11 U.S.C. § 362(a)(6) (1994), *quoted supra* in text accompanying note 295.

due to the creditor or require the creditor to return to the trustee the postpetition collections that the creditor receives.³⁸⁹ Accepting the postpetition collections from the account debtor and holding them would not, by themselves, constitute acts to collect a claim.³⁹⁰ Accordingly, the secured creditor who is receiving postpetition collections on an account must hold them apart, just as the bank in *Strumpf* must continue to preserve the balance in the debtor's checking account, and just as the secured creditor that has repossessed tangible property items of the debtor must continue to hold and preserve those property items.³⁹¹ The bankruptcy trustee may obtain those postpetition collections only to the same extent that it could obtain tangible property items in the possession of a creditor: redemption of the creditor's security interest by paying the amount of the claim, liquidation of the collections to pay the creditor's claim, or confirmation of a plan requiring their return.³⁹²

Unless a plan required the return of the account and the postpetition collections in exchange for other kinds of property interests,

389. This discussion applies only to rights to payment that arose before the filing of the petition and collections to be received by the secured creditor after the petition because of notification to the account debtor. If the creditor has a security interest in an account but has not notified the account debtor before the filing of the petition, the automatic stay would preclude such notification as an act to collect a claim. See *id.* § 362(a)(6), discussed *supra* in text accompanying note 310. This creditor is analogous to a creditor with a security interest in tangible property items in the possession of the estate. On the other hand, any accounts (or any other property interests) that the debtor or the estate acquires after the petition are not subject to the creditor's security interest and hence none of the collections would be encumbered. See *id.* § 552(a); see also *Thacker v. Etter (In re Thacker)*, 24 B.R. 835, 837 (Bankr. S.D. Ohio 1982) (analyzing neither property interests involved nor section 552, but concluding that collection of postpetition wages pursuant to prepetition garnishment violated automatic stay).

390. See *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 21 (1996), discussed *supra* in text accompanying notes 275-276.

391. See 1995 U.C.C. § 9-207(1); 1999 U.C.C. § 9-207(a).

392. Professor Carlson argued that collecting such payments would violate the automatic stay because the payments represent postpetition proceeds of the account in which a new security interest is created, an act stayed by 11 U.S.C. § 362(a)(4) (1994) which stays acts to create security interests in property of the estate. Carlson, *Turnover of Collateral*, *supra* note 333, at 506. I disagree. Professor Carlson may be correct that the attachment of the creditor's prepetition security interest in the account to the proceeds of the account may be the creation of a new, postpetition security interest in such proceeds. Such attachment, however, is not the creation of a security interest in property of the estate stayed by section 362(a)(4). When the secured party has control over the account, unlike the case of pledged accounts in which the account debtor is making payments to the debtor, neither the account nor the payments on the account are property of the estate. The property of the estate is simply the debtor's residual rights. The debtor no longer has any right to the payments themselves, other than the right to redeem those payments or receive the excess of the payments over the debt. Thus, the receipt of those payments does not create a security interest in the interests of the debtor in those payments.

turnover orders for postpetition cash collections on intangible property items make little sense, and the creditor in possession should be allowed to apply those collections to its claim. Allowing the creditor to apply the collections to its claim imposes no additional burden on the debtor. Absent the consent of the secured creditor, any action to use the payments collected by the creditor and the remaining balance of the account requires court approval under section 363(c)(2)(B).³⁹³ Until the collections are so applied, the claim of an oversecured creditor continues to bear interest.

Some cases produce this result by holding that postpetition collections from an account under the control of a creditor belong to the creditor and therefore collections due to or received by the secured creditor after the petition need not be paid or returned to the trustee.³⁹⁴ Although these cases more closely respect the secured

393. 11 U.S.C. § 363(c)(2)(B) (1994). Section 363(c)(2) states:

- (2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection [in the ordinary course of business] 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.

...

(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.

Id. § 363(c)(2). Section 363(a) states:

'[C]ash collateral' means 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, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

Id. § 363(a).

394. See *United States v. Borock (In re Ruggeri Elec. Contracting, Inc.)*, 185 B.R. 750, 752-53 (Bankr. E.D. Mich. 1995) (holding that a prepetition levy by the IRS to collect taxes in the amount of \$196,000 on a bank account containing \$47,000 extinguished the debtor's interest in a bank account). The trustee later recovered the amount seized as a preference. *In re Ruggeri Elec. Contracting, Inc.*, 214 B.R. 481, 488 (E.D. Mich. 1997).

In *Sanwa Bank of California v. Caldwell (In re Caldwell)*, 111 B.R. 836, 838 (Bankr. C.D. Cal. 1990), the court found that a prepetition notice of levy by the California Board of Equalization on a bank account credited with approximately \$7500 to obtain payment of past due sales taxes in the amount of \$826,000 resulted in transfer of ownership of moneys credited to account to Board. See also *Rose v. Commercial Nat'l Bank (In re Rose)*, 112 B.R. 12, 15 (Bankr. E.D. Tex. 1989) (finding that a prepetition notice by the IRS on bank account resulted in transfer of ownership of funds to IRS); *Altman v. Commissioner*, 83 B.R. 35, 38-39 (D. Haw. 1988) (determining that a prepetition levy by IRS on self-settled trust fund account resulted in transfer of ownership of funds to the government). See generally Daniel S. Greenspan, Note, *A Loose End of Whiting Pools: The Chronic Problem of Prepetition*

creditor's property interests, they are not correct. The creditor's interest is still limited to a security interest. True, once the account debtor has received notification to pay the creditor, the creditor has control of the account and the debtor no longer has the right to receive the collections.³⁹⁵ Nevertheless, just as repossession of tangible property items does not effect a change of ownership of those items, notification to the account debtor to pay the creditor does not effect a transfer of ownership. The debtor remains the owner of the account and the postpetition collections. Therefore, the debtor retains the right to surplus from the account (and the collections) over the debt owed to the creditor and the right to redeem the account and the collections.

Other cases hold that, because the debtor still owns those collections, the account debtor or secured creditor must pay the postpetition collections to the trustee.³⁹⁶ These cases are also wrong. Typical of these cases is *SPS Technologies v. Baker Material Handling Corp.*³⁹⁷ In this case, E.C. Campbell, Inc. had pledged to SPS an account due from Baker, the account debtor.³⁹⁸ After Campbell defaulted, SPS notified Baker, the account debtor, to pay to SPS the amount due.³⁹⁹ Campbell then filed a chapter 11 petition to reorganize and demanded that Baker pay it instead of the secured creditor, SPS.⁴⁰⁰

Levies on Cash and Cash Equivalents, 82 VA. L. REV. 163, 170-71 & n.45, 176-78 (1996) (arguing that a prepetition levy on a right to payment practically extinguishes the debtor's interests in the right to payment to the extent of the levy and therefore should be treated as the equivalent of a foreclosure sale).

395. See 1995 U.C.C. § 9-318(3) ("The account debtor is authorized to pay the assignor until the account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee."); 1999 U.C.C. § 9-406(a) (same; also stating explicitly that after notification, payment to assignor does not discharge the obligation to pay the account to the assignee); RESTATEMENT (SECOND) OF CONTRACTS § 338(1) (stating that an assignor has the power to discharge a duty of an obligor, which includes an obligation to pay money, until but not after the obligor receives notice of assignment); see also 1995 U.C.C. § 9-502(1) (providing that upon default or pursuant to agreement before default the secured creditor—the assignee—may notify the account debtor on an account to make payment to it and to take control of proceeds of an account); 1999 U.C.C. § 9-207(a) (same).

396. See *United States v. Challenge Air Int'l (In re Challenge Air Int'l)*, 952 F.2d 384, 385 (11th Cir. 1992) (requiring the IRS to turn over amounts due from an account receivable upon which it had levied before the filing of a bankruptcy petition); *In re AIC Indus.*, 83 B.R. 774, 775-76 (Bankr. D. Colo. 1988) (same); see also Greenspan, *supra* note 394, at 171 n.45; Bonny H. Richardson, Comment, *Prepetition Tax Levies on Intangible Property: The Aftermath of Whiting Pools*, 9 BANKR. DEV. J. 587, 595, 608-12 (1993) (discussing court interpretations of when postpetition collections must be turned over).

397. 153 B.R. 148 (E.D. Pa. 1993).

398. See *id.* at 150.

399. See *id.*

400. See *id.*

Notwithstanding the notification from SPS, Baker paid Campbell, the debtor in possession, and SPS sued Baker to recover the payment.⁴⁰¹

State law⁴⁰² required that Baker as the account debtor pay the secured creditor, SPS. Nevertheless, the district court upheld the postpetition payment to the debtor in possession. Relying on *Whiting Pools*, the district court concluded that the debtor's right to redeem the account and its right to any surplus in the receivable, which had no value because the secured debt exceeded the value of the account, were sufficient to make the account property of the estate, subject to turnover under section 542. Therefore, the court held that the account was properly payable to the debtor in possession instead of the creditor.⁴⁰³

This reasoning disregards the language of the Code. The interests of the estate in the account consist of legal title, the right to surplus, the right to redeem, and other ancillary rights. Neither the account nor the collections themselves are "property of the estate." The misreading of the statute by the court in *SPS Technologies* not only lessens, as a general matter, the security of the rule of law. It also allows the debtor to violate the prohibition of section 363(c)(2) against using cash collateral without court approval.⁴⁰⁴ This situation resembles that in *Strumpf*.⁴⁰⁵ The debtor in *Strumpf* drained his checking account after the bankruptcy court ruled that an administrative hold by the bank to preserve its right of set-off violated the automatic stay, but before the bank got relief from the stay to set-off the account.⁴⁰⁶ Certainly, if a debtor has possession of cash collateral, there is always the risk of debtor misbehavior. Courts should not, however, expand the power of debtors to misbehave by misreading the Code to allow them to regain cash collateral in the creditor's possession or control.

IV. POLICY JUSTIFICATIONS FOR THE TEXTUALIST ANALYSIS

The textualist resolution of the rights of the creditor in possession imposes an automatic stay against creditor liquidation of property

401. *See id.*

402. *See supra* note 395.

403. *SPS Techs.*, 153 B.R. at 153. The court noted that SPS could seek adequate protection, but this may have been fruitless. SPS alleged that Campbell, the debtor in possession, distributed a large portion of the proceeds received, \$114,930, to entities other than SPS or any other secured creditors. *See id.* at 149. The counsel for the debtor in possession did send \$20,000 to SPS. *See id.*

404. *See* 11 U.S.C. § 363(c)(2) (1994).

405. *Citizens of Md. v. Strumpf*, 516 U.S. 16 (1996).

406. *Id.* at 18.

items in its possession and requires turnover from the creditor in three circumstances: through redemption, for the purpose of liquidation by the trustee, or pursuant to a confirmed plan. An analysis of the policy justifications for this solution starts with the policies behind the nonbankruptcy rules. The nonbankruptcy rights of creditor possession, repossession, and even the highly regulated foreclosure sale are particular examples of the fundamental policies of freedom of contract and freedom of alienation of property that are the foundation of our free market economy. These policies, it is generally believed, encourage the efficient allocation of resources to the highest valuing and most productive users, which in turn increases net social welfare.⁴⁰⁷ A creditor agrees to lend money to a borrower at an agreed-upon interest rate. In exchange, the borrower gives the creditor a security interest in property items. The security interest entails either immediate possession of those items or the right to take possession upon default and the right in either event to sell the property items upon default and to apply the proceeds to the debt.

The sooner after default that the creditor can foreclose the borrower's equity interest, the lower the costs to the creditor.⁴⁰⁸ Generally, creditors who can repossess property items, such as cars, instead

407. See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* §§ 1.1, 1.2, at 3-16, § 3.1, at 36-39, § 4.1, at 101-08 (5th ed. 1998); JOSEPH E. STIGLITZ, *PRINCIPLES OF MICROECONOMICS*, 30 (1993); Harris & Mooney, *supra* note 35, at 2049-51.

408. This fact is illustrated in the rating of mortgage backed and asset securities. A rating agency will rate these securities solely on the credit quality of the mortgage loans or other receivables underlying the securities. To assign a rating to securities backed by a pool of receivables, the rating agency will assess the quality of the receivables, estimate the total losses that the pool will experience, and determine the amount of loss coverage required by the pool to achieve a particular rating. For example, the issuer of \$100,000,000 of securities rated AAA by Standard & Poor's backed by a prime pool of mortgage loans would need additional loss coverage of 7% or \$7,000,000. See STANDARD & POOR'S, *STRUCTURED FINANCE CRITERIA* 82-83 (1988). The issuer of the securities can provide loss coverage in several ways, such as an insurance policy or overcollateralization, each of which represents an additional cost. Each rating agency uses many criteria to determine the amount of creditor enhancement to obtain a rating on an issue of mortgage backed securities. Moody's Investors Service, Inc. and Duff & Phelps Credit Rating Co. include in their criteria for mortgage loans the amount of time to foreclose the mortgagor's equity interest in mortgaged property. The more mortgage loans on property in states with longer foreclosure periods, the greater the credit enhancement the rating agency will require. DUFF & PHELPS CREDIT RATING CO., *THE RATING OF RESIDENTIAL MORTGAGE-BACKED SECURITIES* 31 & 32 exh. 29 (1995) (copy on file with the author); *Moody's Approach to Rating Whole Loan Mortgage-Backed Securities*, MOODY'S STRUCTURED TRANSACTIONS GROUP NEWSL. (Moody's Investors Serv., Inc., New York, N.Y.) Jan. 1987 at 5 & app. I at xvii (exh. I); *Moody's State Time from Delinquency to Liquidation Standards* (copy on file with the author); *Moody's Use of Single Family Loan Loss Model Within Rating Analysis*, MOODY'S SPECIAL COMMENT (Municipal Credit Research, Moody's Investors Serv., Inc., New York, N.Y.) June 1998 at 10 (copy on file with the author).

of using judicial procedures, required in many states for mortgage foreclosure,⁴⁰⁹ can foreclose faster. If nothing else, faster foreclosure reduces accrued interest on the loan, and it often reduces losses from the deterioration of the value of the property items after a borrower defaults.⁴¹⁰ Although there is some question about whether lower costs per se increases efficiency,⁴¹¹ lower costs have generally been thought a good thing. The reduction in costs to lenders will allow creditors to provide credit at lower cost to future borrowers and will increase the availability of credit to future borrowers.⁴¹²

Faster foreclosure has another benefit more directly related to efficiency. Foreclosure allows the transfer of assets from a nonpaying borrower to a new owner. In the context of a business borrower, the borrower's inability or unwillingness to repay the secured debt often evidences the fact that the borrower, relative to other borrowers in the same business, is a less productive user of the asset.⁴¹³ To the extent that foreclosure transfers assets from less productive users to more productive users, faster foreclosure promotes efficiency in the sense that it increases net social welfare.⁴¹⁴

409. See NELSON & WHITMAN, *supra* note 267, § 7.11, at 490-92 (noting that judicial foreclosure is the exclusive or generally used method of foreclosure in at least forty percent of the states, and that it has the serious disadvantages of being complicated, costly, and time consuming).

410. The drafters of Article 9 of the U.C.C. determined that a streamlined foreclosure proceeding for personal property would produce greater sale proceeds than the formal procedures that many chattel mortgage statutes had used or that still plague real estate foreclosures. 1995 U.C.C. § 9-504 cmt. 1; 2 GILMORE, *supra* note 260, § 44.4, at 1227-28.

411. See, e.g., David Gray Carlson, *Debt Collection as Rent Seeking*, 79 MINN. L. REV. 817, 820-21 (1995) (noting that lower costs to the participants in a transaction do not automatically increase economic efficiency); David Gray Carlson, *Is Fraudulent Conveyance Law Efficient?*, 9 CARDOZO L. REV. 643, 645 (1987) (same).

412. Lower interest rates have two effects on borrowers. First, they leave borrowers with more money to spend in other ways. Second, lower rates also allow borrowers to qualify to finance the acquisition of property items, such as a house, which they otherwise could not qualify to finance at a higher rate.

413. This conclusion also applies to many cases of consumer borrowing, at least in the case in which a consumer purchases an asset that she really cannot afford. See, e.g. *In re Sharon*, 200 B.R. 181, 196 (Bankr. S.D. Ohio 1996) (involving a chapter 13 case by a debtor who was a single parent with dependent children with monthly income of \$3420 who purchased a luxury sports coupe for more than \$25,000, and who was allowed to retain the car under her plan even though the monthly payments would continue to be more than \$900 a month). The chapter 13 proceeding was later dismissed when the debtor defaulted on her obligations under the plan. See *TransSouth Fin. Corp. v. Sharon (In re Sharon)*, 234 B.R. 676, 690 (B.A.P. 6th Cir. 1999) (Strosberg, J., dissenting) (noting that the \$985 payment on the car was more than double her \$350 rent, that despite having two children and being pregnant with a third the car was a two seater, and that the case was a "bad faith endeavor which ended rapidly after confirmation").

414. See, e.g., POSNER, *supra* note 407, §§ 1.1, 1.2, at 11-15.

In any event, the pledge, the right to the self-help remedy of repossession, and remedy of foreclosure sale have been around for hundreds of years.⁴¹⁵ The longevity of the pledge, repossession, and foreclosure (to a lesser extent) suggests, though it does not prove, their utility.⁴¹⁶ To what extent should bankruptcy policies override the nonbankruptcy policies embedded in the law of pledge, repossession, and foreclosure, and to what extent does the text of the Code harmonize these policies?

The textualist analysis harmonizes the nonbankruptcy and bankruptcy rules well. The automatic stay of course stops the race to the courthouse or to the debtor's property. It preserves the status quo. It gives a trustee time to gather and to liquidate the debtor's assets in an orderly way to pay the creditors. It also allows the debtor an opportunity to propose and to negotiate a reorganization plan. When the reasons for the stay do not apply—for example, the estate cannot benefit by preventing secured creditors from realizing on their security interests because the estate has no equity in the collateral—the stay may be lifted.

The return of property items in which the estate has equity to allow the trustee (including the debtor in possession) to use or to sell them—either through a voluntary redemption or through an involuntary return for liquidation—promotes the nonbankruptcy policy favoring the efficient use of resources. Redemption represents the voluntary choice of the trustee to regain possession of the property items, and as such is presumptively efficient. Liquidation moves the assets from a less productive user, the debtor, to a presumptively more productive user, the buyer at the liquidation sale.

Return through redemption or for liquidation also promotes the bankruptcy policy of substituting the trustee as the representative of the unsecured creditors in place of the insolvent debtor. An insolvent debtor no longer has the incentive to worry about whether redemption or liquidation of particular assets is a good thing, because the debtor will not see the benefit.⁴¹⁷ The debtor's unsecured creditors,

415. See *supra* notes 260-262 and accompanying text.

416. Of course, courts and legislatures have long restrained the freedom of the parties in foreclosing security interests. See generally NELSON & WHITMAN, *supra* note 267, § 7.9-7.22, at 490-544 (discussing real property). The utility of many of these restraints is questionable. For this reason, the Uniform Commercial Code adopted a more flexible method of foreclosure subject to the basic standard of commercial reasonableness. See *supra* note 410.

417. By definition the value of the typically insolvent debtor's unencumbered property interests, including any positive equity in encumbered property items, will be less than the amount of claims of unsecured creditors.

and not the debtor, will reap the reward from maximizing the value of the debtor's assets through redemption or liquidation. In bankruptcy, the trustee or the debtor in possession represents the interests of the unsecured creditors. Accordingly, the trustee has the incentive to maximize the value of the property items by redemption for use or by liquidation, since any increase in value will be available to pay administrative expenses and the claims of unsecured creditors.⁴¹⁸ Furthermore, in the case of liquidation, an oversecured creditor has no incentive to maximize the value beyond the amount of its claim. Its incentive is to be paid its claim. Theoretically, it will not expend any resources or effort to ensure that it obtains more than its claim, because any surplus goes to the debtor.

If there is no equity in the property items, the trustee may only obtain immediate possession by redemption. To do so, however, she must overpay to redeem the property items, because she must pay the full amount of the claim to obtain property valued as less than the claim. She will redeem only if she is convinced that such redemption will produce a greater return to the estate than the amount of the overpayment. Otherwise, the trustee gets no benefit from either redeeming or liquidating the items. The undersecured creditor, however, does have the incentive to maximize the sale proceeds. Thus, relief from the automatic stay furthers the policies of avoiding higher costs and transferring assets to productive users.

The third method by which the trustee may obtain possession of property items held by the creditor in possession—through a confirmed plan—also harmonizes bankruptcy and nonbankruptcy policies to the extent possible. As *Whiting Pools* correctly noted, the Code does reflect a policy favoring reorganization. To the extent that the reorganization provisions of the Code permit a debtor in possession to remain in control of its assets when it does not have a good chance of reorganizing, the Code conflicts with the nonbankruptcy policy favoring the deployment of assets to the most productive users. Without advancing the bankruptcy policy, the stay prevents transfer of the assets to more productive users. The debtor, however, may be a productive user of assets and may be in financial difficulty only because of market conditions beyond its control.⁴¹⁹ If this debtor can reorganize

418. See 11 U.S.C. § 726(a) (1994) (providing for payment of expenses and claims of unsecured creditors); *id.* §§ 503(b), 507(a) (listing the priority of administrative expenses and petition claims).

419. One is tempted to say that any debtor in need of reorganization is by definition not the most productive user of the assets, but that is likely a dubious proposition. I have participated in transactions in which sophisticated institutional lenders agreed to reduce

by restructuring its debt obligations, there may be no need to transfer the assets to another user. To the extent that the reorganization provisions of the Code foster the reorganization of a debtor who has a realistic prospect for success, they are consistent with the nonbankruptcy policy. The problem, which is not unique to the creditor in possession, is how can anyone ever tell if the property item really is necessary for reorganization or if the debtor can be reorganized?

For the creditor in possession, the textualist analysis answers this question better than *Whiting Pools*. Unless the debtor in possession elects to redeem, the requirement that a creditor must return possession only if the plan so provides follows the procedures that the Code establishes for negotiation of all of the claims and interests of creditors and the debtor. Whatever the merits of those procedures,⁴²⁰ the decision on whether the property items should be returned will be made at a later time in the case when there is more information and there has been bargaining among the debtor in possession and the creditors. These procedures are a more reliable way of determining whether the debtor can be reorganized, and whether the debtor should retain the assets, than the early determinations by bankruptcy

the interest rate on or principal amount of their loans to productive owners of assets who were in default for reasons beyond their control. The lenders agreed to renegotiate their loans because they realized that no other owners could operate the assets any better.

420. Many have criticized chapter 11. See, e.g., Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439, 463-89 (1992) (criticizing bankruptcy law's reallocation of nonbankruptcy contractual priorities and recommending the repeal of chapter 11 or at least more judicial restraint in altering those priorities); James W. Bowers, *Rehabilitation, Redistribution or Dissipation: The Evidence for Choosing Among Bankruptcy Hypotheses*, 72 WASH. U. L.Q. 955, 968-26 (1994) (analyzing chapter 11 and concluding that it "cannot be justified as a business rehabilitation measure"); James W. Bowers, *Whither What Hits the Fan?: Murphy's Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution*, 26 GA. L. REV. 27, 34-35, 79-80 (1991) (suggesting that, to the extent that bankruptcy law alters the choices that debtors make before bankruptcy in distributing their property to creditors, there are good economic reasons to object to the Bankruptcy Code); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1054-79, 1088-89 (1992) (on the basis of an empirical analysis, finding that the chapter 11 reorganization provisions make investors worse off and generate net social costs, recommending the repeal of chapter 11, and proposing a model that would avoid court-supervised reorganizations); Edith H. Jones, *Chapter 11: A Death Penalty for Debtor and Creditor Interests*, 77 CORNELL L. REV. 1088, 1089-92 (1992) (analogizing chapter 11 to the death penalty).

Bradley & Rosenzweig's analysis has been criticized. See Donald R. Korobkin, *The Unwarranted Case Against Corporate Reorganization: A Reply to Bradley and Rosenzweig*, 78 IOWA L. REV. 669, 673-74, 712-27 (1993) (critiquing Bradley and Rosenzweig's reform proposal and arguing that they "have failed to establish a plausible empirical or normative case for the radical reform that they urge"); Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig*, 91 MICH. L. REV. 79, 81 (1992) (finding that "Bradley and Rosenzweig's argument for repeal [is] seriously flawed"); Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 YALE L.J. 437, 478-79 (1992) (concluding that the findings of Bradley and Rosenzweig are not supported by their own data).

judges, at a hearing on whether to lift the automatic stay, that the property items in the creditor's possession are necessary for reorganization and that there is a reasonable prospect for reorganization.⁴²¹

Chapter 11 cases often involve considerable delay and most often end in failure instead of a reorganized debtor.⁴²² Moreover, the debtor has the exclusive right to file a plan for the first 120 days after the filing of a petition.⁴²³ Courts routinely extend this deadline.⁴²⁴ Allowing the creditor to retain possession or control of the pledged property items until confirmation or a negotiated settlement eliminates the incentives of the debtor to delay before and after the commencement of a case. Debtors in financial stress facing the prospect of repossession of its property items would have an

421. Cf. Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 126-28 (1984) (discussing the "tendency of bankruptcy judges to undercompensate the secured creditors and overestimate a firms's chances of surviving as a going concern").

422. See NATIONAL BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 610-14 (1997) (noting that "only a small fraction of the Chapter 11 cases filed nationwide end in confirmation of a plan of reorganization" (citation omitted)); Steven H. Ancel & Bruce A. Markell, *Hope in the Heartland: Chapter 11 Dispositions in Indiana and Southern Illinois, 1990-1996*, 50 S.C. L. REV. 343, 348-49 (1999) (noting that out of 2393 chapter 11 petitions filed in Region 10 of the United States Trustee system [about 1% of all petitions, or half the national rate] during 1990-1996, 913, or 38%, ended in confirmed plans; 62% converted to chapter 7 or were dismissed, and a few were left still open); Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and an Analysis of the Law*, 97 COM. L.J. 297, 318-19, 324-25, 329 (1992) (finding that only 17% of 260 chapter 11 petitions filed in the Bankruptcy Court for the Southern District of New York in Poughkeepsie resulted in confirmed plans, a rate comparable to that found in a national study; only 6.5% resulted in consummated plans and rehabilitated debtors; and the average time to confirmation was more than 18 months); see also Grant W. Newton, *A Need to Determine Business Viability*, 4 AM. BANKR. INST. L. REV. 536, 536 (1996) (noting that most of the large number of chapter 11 petitions filed by small, nonviable businesses are simply dilatory tactics, that the assets of the debtors are used by the debtor or its professionals, and that the creditors receive very little, if any, distribution).

Elizabeth Warren and Jay Westbrook suggest that the reported low rate of success for reorganization may be misleading. See Elizabeth Warren & Jay Westbrook, *Financial Characteristics of Business in Bankruptcy*, 73 AM. BANKR. L.J. 499 (1999). They report that a large number of chapter 11 filings may in fact be liquidations, and hence the actual success rate for true reorganizations may be higher than the reported rates. *Id.* at 523-24, 566.

423. See 11 U.S.C. § 1121 (1994).

424. See, e.g., Joseph S.U. Bodoff, *Limiting Exclusivity*, 4 AM. BANKR. INST. L. REV. 496, 496 (1996) (noting that the period for filing a plan under section 1121 is "routinely extended without regard to the consequences of the extension"); Gerald P. Buccino, *Amendments to the Provision of Exclusivity*, 4 AM. BANKR. INST. L. REV. 498, 498 (1996) (arguing that "far too often, debtors have been granted additional periods of exclusivity" beyond the 120 day limit of section 121(b)); Leonard P. Goldberger, *Exclusivity and Successor Liability*, 4 AM. BANKR. INST. L. REV. 520, 520 (1996) (stating "that exclusivity creates structural impediments which artificially limit competition and entrench undeserving owners and management").

incentive to file for reorganization earlier,⁴²⁵ when there may be a better possibility of a successful reorganization, rather than later.⁴²⁶

Debtors who file after repossession admittedly would have a more difficult time reorganizing successfully. So be it. If the loss of possession dooms a reorganization, and the debtor did not file before repossession, then the debtor should be liquidated. If the debtor truly has a realistic chance for reorganization, then it has an incentive to propose and to seek confirmation of a plan quickly to regain possession of the property items held by the creditor in possession. Thus, the requirement for confirming a plan before the return of the property items possessed by the creditor reduces the waste that accompanies the many unsuccessful reorganization attempts that would never succeed and that end in the liquidation of a substantially reduced pool of assets.⁴²⁷

425. Cf. Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 99, 100, 115 (1983) (reporting that 38 of the 48 chapter 11 filings in the Bankruptcy Court for the Western District of Missouri during the first year after the effective date of the Code, October 1, 1979-September 30, 1980, were a direct response to legal action by a creditor that would have seized the debtor's property or closed the debtor's business within two weeks); see also *In re Tracy*, 194 F. Supp. 293, 295 (N.D. Cal. 1961) (describing the precipitation of the borrower's petition for arrangement of unsecured debts under chapter XI of the Bankruptcy Act and a request for an injunction against foreclosure following a creditor's action to foreclose a deed of trust on the borrower's real property).

426. The opinions in *Whiting Pools* do not tell us how much time the debtor had to file for bankruptcy after the initial assessment of the deficiency. See *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 199-200 (1983); *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 145 (2d Cir. 1982); *In re Whiting Pools, Inc.*, 15 B.R. 270, 271 (W.D.N.Y. 1981); *United States v. Whiting Pools, Inc. (In re Whiting Pools, Inc.)*, 10 B.R. 755, 756 (Bankr. W.D.N.Y. 1981). Under the Internal Revenue Code, however, the debtor had a minimum of 40 days between the time of the assessment of a tax deficiency and seizure of the goods. If the taxpayer does not pay the deficiency 10 days after demand, the IRS may collect the deficiency by levying on the taxpayer's property. See 26 U.S.C. § 6331(a) (1994). The IRS, however, must give 30 days notice before it seizes the property items of the taxpayer. See *id.* § 6331(d); see also Richardson, *supra* note 396, at 588-89. Furthermore, unless the taxpayer has admitted its liability, the IRS cannot make an assessment of tax deficiency for at least 90 days after it has sent the taxpayer a notice of a tax deficiency. 26 U.S.C. § 6331(d).

427. *Whiting Pools* is a good example. No reorganization plan was ever filed in this case. Bankruptcy Case Record (docket) at 6, *United States v. Whiting Pools, Inc. (In re Whiting Pools, Inc.)*, No. 81-20063 (CHP 11) Bankr. W.D.N.Y., February 20, 1986 (date of dismissal of case). Of course, its prospects for reorganization were not helped by having to litigate the turnover issue to the Supreme Court. Still, given the previous inactivity of *Whiting Pools* to attempt to reorganize despite the amount of notice (a minimum of 40 days which can easily be extended another 90 days, see *supra* note 426) that it had of the IRS's unhappiness with its misappropriation of federal income and Federal Insurance Contribution Act taxes, it is unlikely that *Whiting Pools* could have been reorganized even if the goods were returned immediately.

The requirement that the plan provide for turnover has a smaller adverse affect on individuals with regular income. In chapter 13 cases, the debtor may file the plan, and often does file the plan, when she files the petition. In any event, she must file her plan within fifteen days.⁴²⁸ Confirmation can occur as soon as a hearing on the plan can be held. This delay should be no greater than the delay necessitated by a hearing on whether the debtor has equity and whether the property item in the possession of the creditor is necessary for reorganization.

The more streamlined procedures for developing and confirming a chapter 13 plan have a cost. They reduce the ability of creditors to bargain for the contents of the plan. For example, in an arrangement under chapter 13, creditors may not propose a plan as they may in a reorganization under chapter 11.⁴²⁹ The chapter 13 procedures therefore deviate more from the policy that promotes the free transfer of property to the highest valuing user. Nevertheless, the chapter 13 procedures do promote the separate long-standing bankruptcy policy of providing a fresh start for individual debtors.

This discussion shows that the Court's general reliance in *Whiting Pools*⁴³⁰ upon a policy favoring reorganization is not a sufficient basis for its conclusion. In that case, the Court failed to recognize the precise policy implications before it. It failed to distinguish between the secured creditor without possession and the creditor in possession.⁴³¹ The policy favoring reorganization kicks in when the debtor files a

428. Chapter 13 plans must be filed within 15 days of the filing of the petition. FED. R. OF BANKR. P. 3015(b) (1994); *see, e.g., In re Sharon*, 200 B.R. 181, 184, 186 (Bankr. S.D. Ohio 1996) (involving a plan filed with petition on March 11, 1996, and confirmed by the court on July 30, 1996).

429. *Compare* 11 U.S.C. § 1321 (1994) (providing only that the debtor may file a plan), *with id.* § 1121(c) (allowing any party in interest to file a plan under chapter 11 if a trustee has been appointed, the debtor has not filed a plan within 120 days, or the debtor has not filed a plan within 180 days that has been accepted by each class of impaired claims or interests).

430. The Court reasoned that Congress intended to provide for the reorganization of troubled enterprises to save jobs, to satisfy creditor claims, and to produce a return for the owner; that Congress presumed that assets would be more valuable if used by a rehabilitated debtor than if sold for scrap; and that reorganization would not be successful if property essential to running the business were excluded from the estate. *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203-04 (1983).

431. In one important section, the Code gives a debtor greater power against a creditor who does not have possession. Section 522 provides that the debtor may exempt certain property of the estate. 11 U.S.C. § 522 (1994). Section 522(f)(2) allows a debtor to exempt the fixing of a lien to the extent that the lien impairs an exemption to which the debtor would have been entitled if such lien is a "nonpossessory" nonpurchase money security interest in household property and other specified items. Accordingly, if an individual debtor had borrowed money and had granted a security interest to the lender in a

petition under chapters 11, 12, or 13. If the debtor has possession of property items subject to a security interest when it files a petition, the stay prevents the secured creditor from seizing the property items or foreclosing its security interest without relief, and the reorganization begins with that state of affairs.⁴³²

If the creditor has possession when the debtor files, the stay still prevents liquidation, and again the reorganization begins with that state of affairs. The absence of any affirmative requirement in the Code for the immediate return of property items to a reorganizing debtor is consistent with a policy of favoring realistic reorganization and reflects a reasonable conclusion that a debtor that was so inept in the conduct of its affairs and was so inattentive to its financial condition as to allow a creditor to seize its property items before it filed for bankruptcy probably could not be reorganized. Accordingly, a general policy supporting reorganization—which allows a debtor with possession of property items to continue to possess and to use them—does not require a creditor in possession of property items immediately to return those items to a reorganizing debtor.

There is another long-standing bankruptcy policy to consider. Bankruptcy law has traditionally allowed a debtor or its unsecured creditors to stop the race of its creditors to the courthouse or to its assets. Under the Code, the debtor or some of its creditors may stop the race by filing a petition, which commences the case.⁴³³ A voluntary petition constitutes an order for relief,⁴³⁴ and an order for relief may be entered shortly after the filing of an involuntary petition.⁴³⁵ Most of the provisions of the Code are tied to the filing of the petition,⁴³⁶ commencement of the case,⁴³⁷ or the order for relief.⁴³⁸ The automatic stay preserves the status quo as of the filing of the petition.

For the most part, the textualist analysis respects this policy. First, the filing of a petition stays the creditor in possession from foreclosing

§400 ruby, she could avoid the fixing of the security interest in the ruby if she retained possession of it but could not if she had delivered possession to the lender.

432. 11 U.S.C. § 362(a)(3), (6), *discussed supra* notes 298, 310 and accompanying text.

433. 11 U.S.C. §§ 301, 303(a) (1994).

434. *Id.* § 301.

435. *Id.* § 303(h) (providing when order of relief may be entered).

436. *See, e.g., id.* § 362(a) (filing a petition effects an automatic stay), *quoted supra* note 295 and accompanying text; *id.* § 541(a) (definition of property of the estate), *quoted supra* note 13.

437. *See, e.g.,* 11 U.S.C. § 362(a)(1), (2), (5), (6), (7) (automatic stay relating to events arising before commencement of case), *quoted supra* note 295 or accompanying text; *id.* § 541(a) (definition of property of the estate), *quoted supra* note 13; *id.* § 545(1)(B), (2) (effectiveness of statutory liens).

438. *See, e.g., id.* § 101(10)(A) (definition of creditor); *id.* § 727(b) (discharge of debts).

the debtor's equity interest. Second, possession by a creditor of property items owned by the debtor to create or perfect a security interest—the simple pledge—does not contravene this bankruptcy policy.⁴³⁹ Third, an oversecured creditor who repossesses a property item upon the debtor's default does not improve its position before the filing of the debtor's bankruptcy petition. The creditor can be forced to give up possession pursuant to redemption or a turnover order to liquidate the property item. The creditor gets paid early, but this benefit does not harm the debtor or the other creditors. Until the oversecured creditor is paid, it is entitled to interest on its claim.⁴⁴⁰

Fourth, repossession by an undersecured creditor does not involve the wasteful dissipation of the debtor's assets that has long been the object of the bankruptcy policy of stopping the race to the courthouse. A primary goal of the bankruptcy policy is to prevent the wasteful liquidation of unencumbered property interests of the debtor by unsecured creditors.

Of course, repossession by a creditor may prevent the reorganization of a debtor. One could view this repossession as violating the bankruptcy policy of stopping the race to the courthouse if one viewed the debtor as the appropriate entity to decide whether the debtor could be reorganized. The Code, however, does not give this decision to the debtor. Although the debtor in chapter 11 has a priority in being able to prepare a plan, the plan will not be confirmed unless most of the creditors agree or the plan provides as much as the creditors would get in a liquidation.⁴⁴¹ In chapters 12 and 13, a court must approve the plan proposed by the debtor after considering any objections by creditors to the plan.⁴⁴² Thus, whether and when the repossessing creditor should be required to return possession, assuming no redemption, is a question that relates more to the bankruptcy policy discussed above of choosing the best way to encourage reorga-

439. One could argue that allowing a debtor to pledge property puts the pledgee in first place and therefore hurts unsecured creditors. This type of priority, however, has not been the object of the bankruptcy policy of stopping the race to the courthouse. I am aware of only one bankruptcy law that abrogated security interests in bankruptcy, and that law lasted for only a few years. See PETER J. COLEMAN, *DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900* at 79 (1974) (discussing a Connecticut debtor relief act in effect from 1765-1767 that provided that the filing of a petition by an insolvent debtor dissolved all existing liens on the debtor's property and allowed all creditors to share in the property items owned by the debtor; the act, however, did not discharge the debtor's liability for the debts).

440. See 11 U.S.C. § 506(b) (1994).

441. See *id.* §§ 1129(7), (8), (b)(1).

442. See *id.* §§ 1224, 1225, 1324, 1325.

nizations that have a reasonable chance of success but to avoid the abuse of the reorganization provisions to delay an inevitable liquidation.

The procedures of other significant insolvency regimes support the policy reasons for the limited turnover power dictated by the textualist analysis of the creditor in possession. The primary insolvency regime for national and state banks and state and federal savings associations is a good example. State and national banks and state and federal savings associations are not subject to the Bankruptcy Code.⁴⁴³ When one of these depository institutions becomes insolvent, the Federal Deposit Insurance Corporation, or FDIC, is generally appointed as receiver or conservator.⁴⁴⁴ The FDIC has broad powers as a receiver or conservator of a depository institution. These include the power to succeed to all rights, titles, powers, and privileges of the institution, to operate the institution, to exercise the functions of the institution's officers, directors and stockholders, to pay obligations of the institution, and, as receiver, to liquidate the institution and to determine claims.⁴⁴⁵

443. See 11 U.S.C. § 109(b)(2), (d) (1994).

444. Pursuant to section 11(c)(2)(A)(ii) of the Federal Deposit Insurance Act, the FDIC must be appointed as the receiver whenever a receiver is appointed for the purpose of liquidation or winding up the affairs of an insured federal depository institution, including a national bank and a federal savings association. 12 U.S.C. § 1821(c)(2)(A)(ii) (1994). The FDIC may also be appointed as a conservator of a federal depository institution when one is appointed to conserve its assets pending either appointment of a receiver for liquidation of the institution or the return of the institution to normal business. See *id.* § 1821(c)(2)(A)(i). The Comptroller of the Currency decides when to appoint a receiver or conservator of a national bank. See *id.* §§ 191, 203. The Office of Thrift Supervision decides when to appoint a receiver or conservator of a federal savings institution. See *id.* § 1464(d)(2).

For state banks and savings associations that are insured by the FDIC, the FDIC may be appointed as a receiver or conservator. See *id.* § 1821(c)(3)(A). If a state bank is a member of the Federal Reserve System, the Federal Reserve Board decides when to appoint the receiver or conservator. See *id.* § 248(o). State statutes also provide for the appointment of the FDIC as receiver. See, e.g., CAL. FIN. CODE §§ 3220, 3221 (West 1999) (appointment as a receiver of insured state bank); *id.* § 8253 (appointment as a receiver of insured state savings association); MD. CODE ANN., FIN. INST. § 5-605 (Michie 1998) (appointment as a receiver of insured state banking institution (bank, trust company, and savings bank)); *id.* § 9-709 (appointment as a receiver of insured state savings and loan association); N.Y. BANKING LAW § 634 (McKinley Supp. 1999-2000) (appointment as a receiver of insured state banking organization (including banks, trust companies, savings banks, and savings and loan associations)).

In some circumstances, the FDIC may appoint itself as a conservator or receiver of an insured state institution even if the state authorities do not seek such appointment. See 12 U.S.C. § 1821(c)(4) (1994). The FDIC may also appoint itself as conservator or receiver of any insured institution to prevent loss to the deposit insurance fund. See *id.* § 1821(c)(10).

445. See 12 U.S.C. § 1821(d)(2), (3).

In addition, the FDIC may repudiate contracts to which the institution is a party if the FDIC determines that performance of the contract would be burdensome, and the disaffirmance or repudiation would promote the orderly administration of the institution's affairs.⁴⁴⁶ These avoidance powers, however, do not permit the avoidance of any legally enforceable or perfected security interest in the assets of any institution except where such an interest was taken in contemplation of the institution's insolvency or with intent to hinder, delay, or defraud the institution or the creditors of the institution.⁴⁴⁷ Finally, the FDIC, as receiver, must establish an expedited claims procedure for claimants who allege the existence of valid security interests in assets of the institution.⁴⁴⁸

Nevertheless, the act granting the FDIC these broad powers does not contain any automatic stay and it does not contain any general turnover power. If the creditor has possession of property items, whether as the result of a pledge or repossession, it may liquidate the collateral so long as it does so in a commercially reasonable manner.⁴⁴⁹

Accordingly, the insolvency laws applicable to depository institutions are willing to allow the creditor in possession to liquidate collateral even when the insolvent institution may have equity in the collateral. This may reflect the fact that most often the property items in the creditor's possession will be securities or loans or other types of liquid collateral for which there is an existing market, and not used goods, for which there is a much less liquid market. Moreover, although the FDIC may operate an insolvent institution, it generally liquidates or disposes of the institution quickly and does not seek to

446. *See id.* § 1821(e).

447. *See id.*

448. *See id.* § 1821(d)(8).

449. *See* Letter from John L. Douglas, General Counsel of the FDIC, dated December 15, 1989, [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,265, at 55,457 (Dec. 15, 1989). In this letter, the General Counsel opined that the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), which substantially revised federal law relating to bank conservatorships and receiverships, does not contain an automatic stay provision similar to that found in the Bankruptcy Code, and that a secured creditor of a federally insured bank for which a receiver had been appointed may undertake to liquidate the creditor's properly pledged collateral by commercially reasonable "self-help" methods, so long as there has been a default in the underlying agreement other than the mere appointment of a receiver. The General Counsel's letter notes, however, that if some action is required by the receiver or if the liquidation of the collateral would require judicial action, then the creditor would have to follow the claims procedure set forth in the FDI Act. Accordingly, when the FDIC has control of property of the institution subject to a security interest, an automatic stay would not be necessary.

reorganize it.⁴⁵⁰ Thus, the policy concerns for the FDIC are not the same as those of a reorganizing debtor under the Bankruptcy Code. Nevertheless, because the FDIC insures the accounts of institutions on behalf of depositors, it stands in the shoes of and has the concerns of a large unsecured creditor. It is instructive that as sophisticated as the FDIC and its laws are, its laws do not contain the far reaching turnover power that *Whiting Pools* gives to the bankruptcy trustee or the reorganizing debtor.

Another insolvency regime that offers some insight to the policy considerations for the textualist solution is the Canadian law on reorganizations. One recent study has examined reorganizations under Canadian law, compared Canadian law with the American Bankruptcy Code, and concluded that reorganizations are much more successful under Canadian law than under the American Bankruptcy Code.⁴⁵¹ The authors found that about 50 percent of 393 debtors successfully reorganized under the Canadian law, in contrast to a success rate of less than 10 percent in the United States.⁴⁵²

The authors suggested several possible reasons for the greater success rate. One possible reason is the absence (during the time period studied) of an automatic stay against secured creditors.⁴⁵³ Although secured creditors could be enjoined for up to six months from foreclosing their security interests, they rarely were.⁴⁵⁴ The authors suggested that, because the secured creditor could repossess its collateral, no company with a heavy load of secured debt could reorganize unless the secured creditors were willing to cooperate in the reorganization.⁴⁵⁵ They also suggested that secured creditors would

450. See 2 MILTON R. SCHROEDER, *THE LAW AND REGULATION OF FINANCIAL INSTITUTIONS* ¶ 12.02, at 12-24 through -49 (1999) (describing the different methods that the FDIC uses to deal with failing or failed institutions, including straight liquidation, purchase and assumption agreements in which another institution purchases the troubled institution or its high quality assets, organizing a new permanent or temporary institution to acquire the assets of the troubled institution and to continue the business of the troubled institution, and assistance to an institution when no receiver or conservator is appointed); OFFICE OF THE COMPTROLLER OF THE CURRENCY, *REPORT OF OPERATIONS—1990* (1991), available in 1991 WL 568627 at 9 (noting that of the approximately 4000 banks supervised by the Office of the Comptroller in 1990, the OCC had closed 95 national banks and placed three in conservatorship to conserve the banks' assets for the benefit of the depositors).

451. See Timothy C.G. Fisher & Jocelyn Martel, *Should We Abolish Chapter 11? Evidence From Canada*, 28 J. LEG. STUD. 233, 234-35 (1999).

452. See *id.* at 246-47.

453. See *id.* at 238 & nn.23, 24.

454. See *id.* at 238 n.24.

455. See *id.* at 254. The firms studied had an average secured debt to asset ratio of about 55% and an average secured debt to total debt ratio of about 30%. See *id.* at 241 & tbl.1, 242. The authors do not describe the ratios for the successful companies, nor do they

be willing to allow the reorganization only if they thought that there was a good chance of success.⁴⁵⁶

This study implies that less interference with the rights of secured creditors would weed out the debtors with a lower probability of successful reorganization. Although the American Bankruptcy Code expressly constrains secured creditors more than the Canadian reorganization law studied by these authors, the absence from the Code of an express turnover provision against a creditor in possession is consistent with a policy favoring a faster resolution of a debtor's bankruptcy case. The textualist analysis allows a creditor in possession to use its possession to force the debtor to make a quicker and more realistic decision either to liquidate or to reorganize. If the debtor chooses the latter, the creditor may use its possession to force a faster proposal and approval of a reorganization plan.

In only a few instances does the Code allow a trustee to undo transactions that occurred before the filing of a petition. These are the avoidance of preferential transfers,⁴⁵⁷ avoidance of fraudulent transfers,⁴⁵⁸ and recovery of property from a custodian.⁴⁵⁹ There are good reasons for each of these explicit reach-back provisions. Unlike these other specific reach-back provisions, however, there is no explicit provision for undoing a creditor's prepetition possession of property items owned by a debtor. There may also be good reasons to require an undersecured repossessing creditor to return property items to a reorganizing debtor before the confirmation of a reorganization plan, notwithstanding the policy discussion above. Patrick Murphy, an experienced commercial and bankruptcy lawyer, testified to Congress in 1975 that it should add to the Code a provision allowing the avoidance of a "preferential possession."⁴⁶⁰ Congress chose not to adopt his suggestion. If debtors should be able to require, before the confirmation of a plan, the return of property items held by a creditor in possession as a "preferential possession" the Congress should explicitly provide for and specify the conditions for such return.

compare the secured debt ratios of the companies reorganizing under Canadian law with the ratios for the companies reorganizing under the Code.

456. *See id.*

457. *Id.* § 547(b).

458. *Id.* § 548.

459. *Id.* § 543(b), *quoted supra* note 230.

460. *House Hearings, supra* note 210, at 439 & 491; *see also supra* note 224.

CONCLUSION

Under the Bankruptcy Act of 1898, a creditor in possession was free to exercise its nonbankruptcy rights over the property items it possessed if the borrower were liquidating. If the borrower were reorganizing, however, the Bankruptcy Act's explicit statutory authorization or the bankruptcy court's assumed equity jurisdiction allowed courts to prevent the creditor from liquidating those property items, and under chapters X and XII, to order creditors in possession to return property items. Courts would do so if the property items were necessary for reorganization and the creditor's interests were protected.

The Bankruptcy Code changed these rules to some extent. It applied an automatic stay to creditors in possession whether the debtor were liquidating or reorganizing. It still allowed for relief from the stay if the debtor had no equity in the property items, but added another qualification: an undersecured creditor could not get relief if the property items were necessary for reorganization. Consistent with the provisions providing relief from the automatic stay, the Code also added an express turnover authorization when the debtor had equity in the property items and the trustee was going to sell them.

For all the attention that the reorganizing debtor received in the Code, however, the Code contains no explicit provision requiring a creditor to return property items in its possession to a reorganizing debtor. This omission is more mystifying in view of the fact that the Bankruptcy Act did have an express turnover provision for mortgagees in possession under chapters X and XII. Nevertheless, the Code does allow a debtor to propose a reorganization plan in which creditors in possession may be required to relinquish possession. These provisions mirror the result in the noted pre-Code case of *Kaplan*. So the question narrows down to this: Should debtors as a matter of policy have almost a blank check—sometimes⁴⁶¹ subject only to an early determination by a bankruptcy judge that the property item is necessary for reorganization—to require a creditor in possession to return the property, which *Whiting Pools* provides? Or should the debtor, who has failed to file for bankruptcy protection before the creditor repossessed the property items, be forced to confirm a plan before it obtains return of such property items, as the Code provides? In my view, the policy embodied in the textualist answer is the better policy. In any event, if the policy should change, who should promulgate such a change—the Supreme Court or the Congress? In my view, if

461. See *infra* note 299.

the policy should change, the Congress and not the Court should do it. Until it does so, we are left, and we should be left, where the statute leaves us.