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Debt Recharacterization in Bankruptcy: Overview and Developments

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Introduction

Recharacterization is a doctrine of bankruptcy law that permits a bankruptcy court to treat as an equity interest in the debtor an investment that, while styled as debt, more closely resembles in substance a contribution to capital. Thus, the "overarching" question recharacterization addresses is whether the debtor-borrower and the putative debtholder intended to grant the latter an enforceable right of payment irrespective of the former's financial performance.[1] If not, then the putative debt is, in substance, an equity interest in the debtor and will be treated as such in bankruptcy.

In the abstract, the recharacterization doctrine represents a relatively straightforward application of a principle that finds expression across many disparate aspects of bankruptcy law and policy—that "substance will not give way to form."[2] By invoking the remedy of recharacterization, the bankruptcy court can ensure that a transaction that substantively amounts to a capital contribution is treated as an interest in, rather than a claim against, the debtor in bankruptcy.

In practice, however, the doctrine has confounded the courts in several respects. First, courts are divided on the legal foundation of the recharacterization doctrine. A majority of courts, including four circuit courts, conceptualize recharacterization as an application of the bankruptcy court's equitable powers and therefore adjudicate recharacterization disputes under a federal common-law test. Two circuit courts, in contrast, have rejected an independent, federal-law basis for recharacterization and instead have grounded recharacterization in the bankruptcy court's authority under Bankruptcy Code section 502 to allow and disallow claims.[3] Courts holding this view conclude that the appropriate inquiry in a recharacterization dispute is simply whether the asserted obligation constitutes a valid debt under applicable state law. Second, even those courts that agree that federal common law supplies the rule of decision in recharacterization disputes have struggled to apply the doctrine in a consistent and predictable manner.

This article provides a roadmap to the evolving doctrine of debt recharacterization. The article begins with an overview of the emergence of debt recharacterization as a standalone cause of action in bankruptcy and describes its practical applications in today's chapter 11 landscape. The article then considers the present state of the law, addressing the ongoing circuit split concerning the substantive law governing debt recharacteriza-

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tion claims and the application of both federal- and state-law frameworks for debt recharacterization.

Discussion

I. Origins and Applications of Debt Recharacterization

A. Emergence of Debt Recharacterization as a Standalone Cause of Action

Recharacterization of putative loans from insiders as equity contributions evolved out of legal doctrines establishing a basis for subordinating all or part of a claim as a remedy for inequitable conduct on the part of the claim holder. In a line of cases spanning from 1939 to 1948, the Supreme Court established the doctrinal foundations of equitable subordination, holding that the bankruptcy court's equitable powers permit it to subordinate the claim of a corporate insider that has "wholly dominated" the debtor and exploited its dominance "unconscionabl[y]" for its own enrichment.[4] In 1978, Congress codified the power of bankruptcy courts to subordinate claims "under the principles of equitable subordination."[5] Bankruptcy Code section 510(c)'s legislative history demonstrates that it was intended to codify the principles of the Supreme Court's seminal equitable subordination cases into the Bankruptcy Code.[6]

Although the Supreme Court did not explicitly endorse, or even refer to, the power of recharacterization in *Pepper v. Litton*, the Court in dicta referred to the subordination of "so-called loans" by insiders resulting in their treatment "in effect as capital contributions."[7] Many of the earliest bankruptcy court decisions on the recharacterization of putative debts as equity cited *Pepper* as expressing the power of bankruptcy courts to determine the treatment of a claim based on substance rather than form.[8]

The modern doctrine of recharacterization diverges from the principles of *Pepper* and related cases in that it does not require a finding of inequitable conduct.[9] The seminal modern recharacterization case, the Sixth Circuit's decision in *AutoStyle*,[10] is important precisely because it cleanly severs recharacterization from its origins in the doctrine of equitable subordination. Whereas inequitable conduct is the basis for subordinating a debt, recharacterization is concerned with whether a debt exists in the first place.[11] As such, a successful recharacterization claim invites a more substantial remedy than a successful equitable subordination claim. Because recharacterization challenges the very existence of a claim, recharacterization invites the disallowance of the putative creditor's entire claim, whereas a successful equitable subordination claim results not in the disallowance of the claim but merely its subordination to other claims. Moreover, the equitable subordination doctrine permits subordination only in proportion to the degree and impact of inequitable conduct. In contrast, recharacterization is a binary question: an investment is either debt or equity and, therefore, a putative debt claim will be recharacterized in its entirety or not at all.[12]

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B. Applications of Debt Recharacterization in Business Chapter 11 Cases

Because debt recharacterization effectively reorders a debtor's capital structure, potentially eliminating entire tranches of funded indebtedness, a successful recharacterization claim can substantially upend the dynamics of a chapter 11 case. Because equity falls last in the priority waterfall in bankruptcy, recharacterization will often significantly reduce the putative debtholder's recovery and, in many cases, eliminate it entirely.[13] Conversely, for junior stakeholders, a successful recharacterization claim may mean the difference between no distribution and a substantial recovery. Indeed, due to the time and resources involved in resolving these challenges, the creditors asserting them often succeed in obtaining some recovery as part of settlements with the debtor and the holders of the claims in question without ever litigating their claims to a final judgment.[14] Debt recharacterization claims are frequently bundled with other claims against the debtholder in question, such as claims for equitable subordination, fraudulent transfer, and, in the case of secured lenders, challenges to the validity or perfection of the lender's security interests.

Debt recharacterization can therefore be an important tool for a debtor, committee, or other party seeking to enhance value for junior creditors. Who may wield this tool is not always straightforward, however. Courts have assumed that recharacterization claims are the property of the bankruptcy estate and that a debtor-in-possession has standing to assert such claims as a function of its power as bankruptcy trustee.[15] Where the debt in question is secured, the DIP or cash collateral order entered in the case may constrain the debtor's ability to assert recharacterization claims.[16] Thus, in practice, recharacterization is often sought by creditors' committees and, less frequently, significant individual creditors. Because the debtor "ordinarily has the sole authority to litigate claims of the estate,"[17] creditors sometimes seek to bring recharacterization claims based on derivative standing.[18] However, some courts, describing recharacterization as "essentially an objection to the allowance of a claim," have permitted creditors to bring recharacterization challenges based on creditors' rights to object to the allowance of claims as provided in Bankruptcy Code section 502(a).[19] Courts have also granted standing to creditors bringing recharacterization claims based on their status as "parties in interest" as described in Section 1109.[20]

II. Standards Governing Debt Recharacterization Claims

A. Does Federal or State Substantive Law Govern Recharacterization Claims?

1. Overview of the Ongoing Circuit Split

While the federal courts now overwhelmingly recognize a cause of action for recharacterization,[21] the underlying source of the recharacterization power is contested and has divided the courts into two factions. The majority view—embraced by the Third, Fourth, Sixth, and Tenth Circuits, as well as

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lower courts in the Second Circuit—locates authority for recharacterization in the bankruptcy courts' equitable powers and holds that federal common law supplies the substantive rule of decision for recharacterization disputes. In contrast, the Fifth and Ninth Circuits have held that debt recharacterization is a state-law question. A recharacterization claim is, on this view, essentially an objection to a claim on the premise that the state law governing the putative debt obligation would not in fact recognize the obligation as a valid debt. Accordingly, the Fifth and Ninth Circuits hold that bankruptcy courts must adjudicate recharacterization claims by applying applicable state contract law.[22]

The nub of the circuit split is whether recharacterization is simply a basis for disallowing a creditor's asserted claim on the ground that the claim is "unenforceable against the debtor . . . under . . . applicable law," or whether recharacterization instead addresses the threshold question of whether the disputed obligation is "a claim to begin with."[23] The minority approach, espoused principally by the Fifth and Ninth Circuits, holds that recharacterization invokes the claims adjudication mechanisms embodied in section 502 of the Bankruptcy Code. Bankruptcy Code section 502 provides, in rough outline, that a claim will be allowed unless it is "unenforceable" under applicable non-bankruptcy law[24]—which, in most contexts means applicable state law.[25] Under this view, a bankruptcy court adjudicating a recharacterization dispute must test whether the putative debt obligation is enforceable as such under applicable state law. If so, the contested obligation constitutes an allowed claim against the debtor; if not, the claim is susceptible to recharacterization.

The federal-law approach, though more widely adopted, rests on murkier analytical foundations. Courts adhering to the majority view appear to treat the classification of an investment as either debt or equity as a threshold inquiry that logically precedes the claim adjudication mechanisms set forth in Bankruptcy Code section 502(b). That is, these decisions reason that courts must decide whether an investment is a *claim* "in the first instance"[26] before they can adjudicate its allowance or disallowance under Bankruptcy Code section 502(b). Although the Bankruptcy Code does not expressly require or even authorize a bankruptcy court to answer this threshold question, courts adopting the majority view conclude that authority to do so is inherent in their equitable powers codified in Bankruptcy Code section 105(a).[27] And because the bankruptcy court's adjudication of this threshold inquiry rests on its equitable power to "carry out of the provisions of [the Bankruptcy Code]," and precedes consideration of the merits of the putative claim under state law, a federal rule of decision should (on this view) govern recharacterization.[28]

The minority approach adopted by the Fifth and Ninth Circuits holds that the distinction between the "first instance" question of characterization, on the one hand, and the enforceability of a putative claim under state law, on the other hand, is illusory and that the two inquiries are indivisible.[29] In short, the Fifth and Ninth Circuits hold that a bankruptcy court faced with a

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recharacterization claim should simply determine whether the putative debt in fact constitutes a valid debt obligation under applicable state law. In answering that question, the bankruptcy court has effectively decided both the characterization and the enforceability of the investment at issue. The Fifth Circuit's opinion in *Lothian Oil* highlights two considerations in support of this approach. First, the Fifth Circuit reasoned that its approach accords with the venerable *Butner*[30] principle that "creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtors' obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code."[31] Second, and relatedly, it avoids recourse to the bankruptcy code's general equitable powers, which the Supreme Court has in recent decisions sharply constrained.[32]

One potential difficulty with the minority approach is that the claims allowance/disallowance provisions of Bankruptcy Code section 502(b) do not expressly contemplate recharacterization; that is, while they provide the bankruptcy court authority to *disallow* a putative debt obligation that is not enforceable as such under applicable state law, they do not, by their terms, authorize the bankruptcy court to reinstate that investment as an equity interest in the debtor. The Fifth Circuit recognized and addressed this concern in *Lothian Oil*. It explained that recharacterization is faithful to the *Butner* principle underlying Bankruptcy Code section 502(b) because it accords the investment at issue the rights it would have under applicable state law. "[R]echaracterizing the claim as an equity interest is the logical outcome of the reason for disallowing it as debt."[33]

2. Prospects for Supreme Court Review

In light of this unresolved circuit split, the Supreme Court in 2017 granted certiorari from the Fourth Circuit's recharacterization decision in *Province Grande* on the question whether bankruptcy courts "should apply a federal rule of decision . . . or a state law rule of decision" when deciding to "recharacterize a debt claim in bankruptcy as a capital contribution."[34] Ultimately, however, the Court dismissed the writ as improvidently granted. Thus, the circuit split remains unabated for the time being, although the Supreme Court's initial grant of certiorari in *Province Grande* suggests that this issue may again attract the attention of the Supreme Court if an appropriate test case presents itself.

Although the federal-law approach commands the support of the majority of the circuits that have addressed the issue thus far, there are plausible reasons to suspect that the Supreme Court might ultimately side with the minority should it elect the resolve the split. In particular, the minority approach dovetails with the "basic federal rule" expressed *Butner* and its progeny that applicable "state law governs the substance of claims."[35] The majority approach is undoubtedly in tension—if not outright inconsistent—with these principles. Given the existing balance of authority, and the circuits' respect for their own precedents, however, it seems likely that the federal-law approach will remain dominant unless the Supreme Court intervenes.

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B. Federal-Law Tests for Recharacterization

However suspect its doctrinal foundations may be, the federal-law approach prevails in most jurisdictions, including in the District of Delaware and the Southern District of New York,[36] the venues of choice for the lion's share of the country's complex chapter 11 cases. Accordingly, the federal-law tests for debt recharacterization merit close consideration. Courts adopting a federal rule of decision for debt recharacterization have applied one of two substantive tests. The Eleventh Circuit applies a simple, disjunctive test that permits recharacterization if either (i) the debtor was undercapitalized at the time of the advance in question or (ii) the putative loan was made in circumstances in which no other disinterested lender would have made the loan. The Eleventh Circuit test has attracted virtually no support outside of the Eleventh Circuit. Instead, the vast majority of courts that adopt a federal-law rule of decision apply variations of an 11-factor test first articulated in the Sixth Circuit's *AutoStyle* decision.

1. The Eleventh Circuit's *N & D Properties* Test

Fifteen years before *AutoStyle*, the Eleventh Circuit adopted a federal rule of decision in *N & D Properties*, applying a much simpler—and more severe—test for recharacterization than approaches developed later in other circuits.[37] Under the test set out in *N & D Properties*, the court will recharacterize as equity any advance of funds made by an insider to its affiliate if (i) the borrower was undercapitalized or (ii) the advance was made "when no other disinterested lender would have extended credit."[38] The *N & D Properties* test is undoubtedly harsh. The test virtually ensures that a rescue loan to a distressed borrower by an existing lender will be recharacterized as equity, even in the face of countervailing considerations that suggest a genuine debt. Perhaps as a result of its severity and reductionism, the per se rule expressed in *N & D Properties* has virtually no support beyond the Eleventh Circuit.

2. The *AutoStyle* Test

(a) Overview and Application of the *AutoStyle* Test

The prevailing framework among courts that have adopted a federal-law rule of decision is a non-exclusive multifactor balancing test initially articulated by the Sixth Circuit in *AutoStyle*. Courts applying the *AutoStyle* test consider the following factors:

(1) the names given to the instruments, if any, evidencing the indebtedness;
(2) the presence or absence of a fixed maturity date and scheduled payments;
(3) the presence or absence of a fixed rate of interest and interest payments;
(4) the source of the repayment;
(5) the adequacy or inadequacy of capitalization;
(6) the identity of interest between the creditor and the stockholder;

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(7) the security, if any, for advances;
(8) the corporation's ability to obtain financing from outside lending institutions;
(9) the extent to which the advances were subordinated to the claims of outside creditors;
(10) the extent to which the advances were used to acquire capital assets; and
(11) the presence or absence of a sinking fund to provide repayments.[39]

These factors will not always point in the same direction.[40] Courts have repeatedly emphasized that the *AutoStyle* factors do not constitute a "mechanistic scorecard," and that the factors ultimately point to an overarching question: "whether the parties called an instrument one thing when in fact they intended it as something else."[41] Thus, no single factor of this test "is controlling or decisive," the factors "must be considered within the particular circumstances" of each case, and the relative significance of the factors "may vary depending upon circumstances."[42]

The first *AutoStyle* factor emphasizes the manner in which the parties to the transaction in question characterized the advance of funds. If the contracting parties referred to the advance as a loan, courts applying the *AutoStyle* test are more likely to find that it was indeed a loan.[43] When analyzing this factor, courts consider primarily the terms of the purported debt instrument, but may also consider how the purported debt is reported in financial statements and accounting records.[44] In some instances, the text of a document is virtually decisive as to the intent of the parties.[45] Even preprinted or incomplete documents can suggest a fixed right to payment constituting a loan.[46] In other situations, however, courts express concern that the text of a document is mere "form" that does not accurately convey the "substance" of the transaction.[47] Courts seem to have firmer confidence in the reliability of descriptions contained in reports to or discussions with regulatory bodies. For example, where certain notes were "recorded as secured debt on [Debtor's] 10Q SEC filing and UCC-1 financing statements," a court found that the parties indeed intended the transaction to be loan.[48] Similarly, the fact that a document filed publicly with the SEC was titled "Revolving Credit Agreement" "weighed, very heavily, against recharacterization."[49]

The second *AutoStyle* factor considers whether the purported loan contains a fixed payment and maturity schedule. The presence of a payment schedule weighs in favor of debt treatment; the absence of thereof weighs in the opposite direction.[50] However, certain debt instruments—such as demand notes, as seen in *AutoStyle*, or revolving credit facilities[51]—lack fixed repayment schedules but are nonetheless treated as debt if other indicia of debt are present.[52] This factor supports recharacterization most strongly when repayment takes the form of royalties or some other unliquidated amount explicitly tied to profits.[53] Importantly, courts sometimes treat the lack of enforcement with respect to contractual repayment terms as an indication that these terms

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do not constitute real obligations, thus weighing this factor in favor of recharacterization.[54]

The third *AutoStyle* factor considers whether the supposed loan accrues interest and requires interest payments.[55] Courts regard this factor similarly to the second factor—the presence of interest obligations supports debt treatment, and the absence of such obligations supports equity treatment. If the putative lender declines to enforce contractual interest payment obligations, courts may weigh the third *AutoStyle* factor against debt treatment. Notably, the holders of the claims being challenged in *AutoStyle* had allowed the borrower to miss interest payments, but the court concluded this fact "at best . . . cut both ways" because "the defendants still expected to be repaid."[56] Finally, like all other factors, interest payments on a purported debt must be analyzed in context: even a zero-interest cash infusion can be a loan if other factors support debt treatment.[57]

The fourth factor considers "the source of repayments," which the *AutoStyle* court glossed to mean whether "the expectation of repayment depends solely on the success of the borrower's business."[58] The application of this standard has engendered significant confusion in its interpretation and application. The principal fissure in the case law is whether this factor evaluates primarily the borrower or issuer's duty to repay or rather its practical likelihood of doing so. Thus, some courts have suggested that a borrower or issuer's unconditional contractual duty to repay the debt upon maturity weighs against recharacterization.[59] Other courts, in contrast, have focused primarily on the practical likelihood of repayment in view of "a borrower's overall capital structure."[60] In particular, many courts place considerable weight on the debtholder's likelihood of repayment in a liquidation. For this reason, courts have held that a security interest—or, at least, a first-lien security interest—is generally sufficient to tally the fourth *AutoStyle* factor in favor of the putative debtholder.[61] Conversely, courts cast a more skeptical eye on putative junior debt that is unlikely to recover in a liquidation scenario and whose holder therefore depends on future cashflows from going-concern operations.[62]

The fifth *AutoStyle* factor weighs in favor of equity treatment if the purported borrower is undercapitalized. In theory, undercapitalization suggests equity treatment because it may indicate that the supposed lender advanced funds with no expectation of repayment, since the borrower would never be able to repay the advance.[63] However, courts have raised doubts as to whether undercapitalization is a probative fact for making recharacterization determinations in the bankruptcy context.[64] Circuit courts on either side of the current circuit split agree that "[i]n many cases, an insider will be the only party willing to make a loan to a struggling business," and "recharacterization should not be used to discourage good faith loans."[65] Courts "exercise caution in this area" because "discourag[ing] owners from trying to salvage a business" is not "desirable as social policy" and would create an "unhealthy deterrent effect" on efforts to rescue distressed companies[66]—"all companies in bankruptcy are in some sense undercapitalized."[67]

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The sixth factor of the *AutoStyle* test looks to an "identity of interest" between creditor and debtor.[68] In discussing this factor, the *AutoStyle* court explained that a "sharply disproportionate ratio" between a stockholder's percentage interest in stock and the purported debt supports debt treatment.[69] Subsequent courts have foregone such "ratio" analyses and instead use this factor to discuss insider status[70] and control rights.[71] Thus, where the putative lender acquires an equity stake or some other control over the borrower's operations pursuant to the supposed debt instrument, courts will recharacterize the instrument as equity.[72] As with the undercapitalization factor, however, courts have raised concerns over whether scrutinizing insider financing may disincentivize efforts to provide liquidity to struggling affiliates.[73]

Under the seventh factor, the existence of a security interest indicates bona fide debt.[74] Although the presence of security is sometimes clear evidence against equity treatment—there is no such thing as secured equity[75]—the absence of security is a more complicated fact to interpret, since distressed borrowers are unlikely to have unencumbered assets to offer as collateral. As the *Lyondell* court explained, "bona fide loans have been made on an unsecured basis for decades, if not centuries."[76]

Pursuant to the eighth *AutoStyle* factor, courts regard with suspicion loans made by insiders where no outside financing was available.[77] As with the fifth and sixth factors, courts have questioned the value of this factor in the distressed lending context, since rescue loans are often made precisely because no outside institution is willing to extend credit.[78] Courts recognize that incumbent stakeholders may provide additional debt financing to a struggling company to protect their existing investments even if a third-party lender with no existing exposure to the company could not underwrite a similar loan.[79]

The ninth factor considers whether repayments under the supposed loan were subordinated to other liabilities. In general, subordination supports recharacterization.[80] Some courts have construed this factor broadly and consider not only whether the indebtedness in question is formally subordinated but whether the debtholder has, in practice, permitted the debtor to defer payment of the debt.[81] On the other hand, even advances containing explicit contractual subordination can be debt where other factors support treatment as debt. In *AutoStyle*, for example, the instruments in question were subordinated with respect to other liabilities, but the court declined to recharacterize the claims, in part because they were secured by collateral.[82] And, as with many *AutoStyle* factors, subordination must be analyzed with special care in the distressed lending context. Although rescue loans may be made on a subordinated basis to keep peace with existing lenders and comply with existing credit documents, the lenders providing such financing may nonetheless intend those advances to create a fixed right to payment.[83]

Pursuant to the tenth *AutoStyle* factor, using funds to purchase capital assets indicates that the advance was actually an equity contribution. In general, the use of funds to meet operating needs, "rather than to purchase capital

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assets, is indicative of bona fide indebtedness."[84] However, advances of funds may be used partially for working capital and partially for capital assets, confounding the analysis under this factor somewhat.[85]

Finally, the eleventh *AutoStyle* factor considers the lack of a sinking fund for repayment as "evidence that . . . advances were capital contributions rather than loans."[86] However, the Sixth Circuit in *AutoStyle* held the presence of liens securing the loan "obviated any need for a sinking fund."[87] And other courts have opined that this factor is obsolete, given that sinking funds are rare in modern corporate finance.[88]

(b) Evolution of the *AutoStyle* Test from Federal Tax-Law Cases

In *AutoStyle*, the Sixth Circuit imported an analytical framework originally developed in tax law jurisprudence, most notably in the Sixth Circuit's prior decision in *Roth Steel*.[89] Although the Sixth Circuit was the first circuit court to adopt a multifactor analysis for making recharacterization determinations in the bankruptcy context, at least the Fifth,[90] Ninth,[91] and Tenth[92] Circuits—in addition to the Sixth Circuit in *Roth Steel*—already employed similar analyses in the tax context. In *AutoStyle*, the Sixth Circuit recognized "some disagreement as to whether tax court recharacterization factors are appropriate for use in bankruptcy cases" but ultimately concluded that the *Roth Steel* factors provide a "general framework for assessing recharacterization claims that is also appropriate in the bankruptcy context."[93]

Although the majority of bankruptcy courts have followed *AutoStyle* in importing the recharacterization analysis used in tax law cases, multifactor approaches have become disfavored in the tax law context. In particular, the United States Treasury issued regulations in 2016 to govern the recharacterization of debt to equity. In the accompanying release materials, the Treasury commented that the new regulations were intended in part to fix the "confusion created by the multifactor tests" in tax cases, describing such tests as "flawed."[94] Although the new Treasury Regulations governing recharacterization are quite complex, they attempt to avoid much of the ambiguity and flexibility inherent to the multifactor approaches applied historically by setting out the various applicable standards and exceptions in a specific, concrete manner. Broadly, the Treasury Regulations only recharacterize related party[95] instruments issued by domestic corporations[96] and focus on how the purported loan was documented,[97] whether the parties' ongoing activities evidence a debtor-creditor relationship,[98] the purpose of the issuance,[99] and the use of the proceeds from the issuance.[100] The new Treasury Regulations thus adopt a more formalistic approach without dispensing of the substantive concerns underlying the historic multifactor analysis.

C. Debt Recharacterization Under State Law

Because the recharacterization approach adopted by the Fifth and Ninth Circuits defers to state-law rules for determining whether an asserted claim is indeed based on an actual debt, the practical impact of adopting a state-law rule of decision depends on the approaches taken by the various states.

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State-law approaches to recharacterization appear to coalesce into one of two paradigms. Several states have employed multifactor tests analogous to the *AutoStyle* test. These states include Idaho,[101] Illinois,[102] Maryland,[103] New Jersey,[104] Texas,[105] and Oregon.[106] In *Emerald*, for example, the district court observed that there is not a "sharp distinction between the federal and [Illinois] state tests" for recharacterization.[107] Although the Illinois Supreme Court case cited in *Emerald* to support this notion did not explicitly apply factors from *AutoStyle* or similar cases, it did use extrinsic facts to determine the intent behind the transaction in question.[108] The *Emerald* court treated that decision as a sufficient basis for applying a multifactor approach similar to the *AutoStyle* test. Similarly, in *Lothian Oil*, the Fifth Circuit did not cite a Texas state law debt recharacterization case. Rather, it cited a state tax law case that imported a federal multifactor test to distinguish debt from equity.[109] This suggests that, as in *Emerald*, federal courts may hold that state law applies a multifactor approach similar to the *AutoStyle* test even where the state courts have not so held.

Other states lack a distinct body of law on debt recharacterization and instead appear to subsume recharacterization disputes under general principles of contract law. The remand decisions in *Fitness Holdings* (following the Ninth Circuit's adoption of a state-law rule of decision) represent the most detailed exposition of the contract-law framework.[110] The district court on remand began with the premise that an executed promissory note creates a contract and thus triggers "the parol evidence rule and other principles of contract interpretation."[111] Thus, the district court applied a familiar two-step approach that required the court first to consider whether the contract (i.e., the promissory note) was reasonably susceptible to conflicting interpretations, and then—and only then—to consider extrinsic evidence bearing on the relative merits of the competing interpretations.[112] The court concluded that the promissory note was unambiguous. The note stated that the debtor "promises to pay" the creditor; specified an annual interest rate; specified interest payment dates and a maturity date; provided for the acceleration of the obligations upon default; and provided that the creditor's delay in exercising its rights would not amount to a waiver.[113] The district court concluded that these terms "unambiguously" gave the creditor "a right to payment" and therefore dismissed the plaintiff's (the debtor's creditors' committee) recharacterization claim.[114] On further appeal, the Ninth Circuit agreed that there was "no basis under California Law to ignore basic contract law" in determining whether a transaction was properly characterized as debt and thus upheld the district court's application of contract-law doctrines to the plaintiff's recharacterization claim.[115]

The law in many other states remains undeveloped, but there are some indications that other notable jurisdictions may hew toward the contract-law framework. For example, the Delaware state courts have had little occasion to address debt recharacterization claims in detail, but the Supreme Court of Delaware has commented that "[t]he question of whether or not the holder of a particular instrument is a stockholder or a creditor depends upon the terms

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of his contract."[116]

New York's answer to this question is particularly consequential given that credit agreements and indentures of large corporate borrowers or issuers are overwhelmingly governed by New York law. New York has no substantial jurisprudence on debt recharacterization, so the likely outcome of a debt recharacterization claim under New York law is speculative. But like California, New York lacks a standalone doctrine of debt recharacterization. This may itself indicate that New York courts would apply general principles of contract law to a recharacterization claim.

More specifically, a New York court faced with a recharacterization claim likely would determine whether, on general principles of contract interpretation, the instrument governing the disputed investment establishes "an obligation to repay an advance."[117] Importantly, however, New York contract law presumptively limits this inquiry to the four corners of the underlying contract: "a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms."[118] Outside or parol evidence is admissible "only if a court finds an ambiguity in the contract"[119] and is not admissible to suggest ambiguity where none exists in the first place.[120]

Insofar as California and New York share roughly similar principles of contract interpretation, the decision on remand in *Fitness Holding* may be indicative of a New York court's approach to a hypothetical recharacterization dispute. That is, a New York court likely would gauge whether the parties intended to create a debt or an equity interest by the plain terms of the parties' agreement—whether the instrument provides for an express right of repayment; specifies an interest rate; delineates payment dates and a maturity date; provides for the acceleration of the obligations upon default; and so forth—and eschew other alleged indicia of intent outside the four corners of the document.

The four-corners approach applied in *Fitness Holdings* places a more demanding burden on the plaintiff seeking recharacterization but does not neuter the doctrine entirely. As the *Fitness Holdings* district court explained (in response to the creditors' committee's complaint that its approach would effectively bar all recharacterization claims), recharacterization is tenable even under the four-corners view where "the substantive terms of the document create equity rather than debt"—for example, where an instrument denominated as a loan lacks fixed interest payments, terms of repayment, and a scheduled maturity.[121] That is, in "appropriate circumstances" a plaintiff can make out a case for recharacterization based on the express terms of the instrument in question without offending the parol evidence rule or other general principles of contract interpretation.[122]

At the same time, the four-corners approach represents a marked departure from the multifactor *AutoStyle* test, which encourages courts to embrace circumstantial considerations beyond the terms of the instrument in question. Whereas courts applying the *AutoStyle* test have sometimes warned against placing too much weight on factors predicated on the express terms of the

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instrument,[123] the four-corners approach holds that these are the only relevant factors. For example, while courts applying the *AutoStyle* framework often give considerable weight to such factors as capitalization of the debtor at the time of the advance, the debtholder's practical likelihood of repayment, and the putative debtholder's insider status, the four-corners view accords these factors no weight at all. Thus, for example, an existing equity holder's rescue loan to a highly distressed borrower made on an unsecured or junior-lien basis might face considerable recharacterization risk under the *AutoStyle* test, but, if memorialized in conventional loan documentation, setting forth periodic interest payments, a stated maturity date, and so forth, would face little risk under the four-corners framework.

Conclusion

While the overarching premise of debt recharacterization—that substance should prevail over form and that a transaction that substantively amounts to a contribution of capital to a debtor should be treated as such in bankruptcy, regardless of its label—is simple, its practical application is fraught with controversy. Multifactor approaches adapted from tax law cases have been adopted by the majority of circuits in the bankruptcy context, but two circuits have more recently questioned the legal basis for adopting a federal multifactor test, looking instead to state law approaches for differentiating between debt and equity. Courts applying a multifactor approach have taken care to weigh the various factors according to the circumstances at hand, and this has resulted in certain factors losing relevance due to the particularities of lending transactions involving distressed companies. Ultimately, courts applying a multifactor approach have focused on the fundamental question of whether the parties to the transaction in question intended to create a fixed right of repayment. Because the states have developed varying approaches—if at all—to the issue of recharacterizing debt to equity, the ultimate outcome of the minority state law approach is not clear. Some states use multifactor approaches analogous to the federal multifactor test, while others use a common law contractual interpretation approach, whereby recharacterization becomes less likely. Regardless of the approach taken by courts, contracting parties can mitigate the risk of recharacterization by ensuring they properly document their intent to create a borrower-lender relationship and maintain formalities throughout their course of dealing to further demonstrate this intent.

NOTES:

[1]In re SubMicron Systems Corp., 432 F.3d 448, 456, 45 Bankr. Ct. Dec. (CRR) 232, 55 Collier Bankr. Cas. 2d (MB) 1077, Bankr. L. Rep. (CCH) P 80436 (3d Cir. 2006).

[2]SubMicron, 432 F.3d at 454; In re Hedged-Investments Associates, Inc., 380 F.3d 1292, 1299, 43 Bankr. Ct. Dec. (CRR) 145, Bankr. L. Rep. (CCH) P 80151 (10th Cir. 2004); cf. Matter of Yoga Smoga, Inc., 76 Collier Bankr. Cas. 2d (MB) 1706, 2016 WL 8943849, at *6 (Bankr. S.D. N.Y. 2016) (analogizing debt recharacterization to cases involving the

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characterization of a transaction as a sale, a true lease, or a financing, irrespective of the label placed on the transaction by the transacting parties).

[3]11 U.S.C.A. § 502.

[4]See Taylor v. Standard Gas & Elec. Co., 306 U.S. 307, 306 U.S. 618, 59 S. Ct. 543, 83 L. Ed. 669 (1939); Pepper v. Litton, 308 U.S. 295, 60 S. Ct. 238, 84 L. Ed. 281 (1939); Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 61 S. Ct. 904, 85 L. Ed. 1293 (1941); Comstock v. Group of Institutional Investors, 335 U.S. 211, 68 S. Ct. 1454, 92 L. Ed. 1911 (1948).

[5]11 U.S.C.A. § 510(c).

[6]Initial drafts of the bill that would codify Section 510(c) contained a blanket subordination of all claims held by insiders of a debtor. See H.R. 31, 94th Cong. (1976); S. 236, 94th Cong. (1975). Congress ultimately rejected blanket subordination of insider claims and affirmed that Section 510 was intended to codify the power equitable subordination consistent with prevailing case law, specifically mentioning Pepper v. Litton. H.R. 95-595, at 359 (1978); see also James M. Wilton & William A. McGee, The Past and Future of Debt Recharacterization, 74 Bus. Law. 91, 93 & n.7 (2019).

[7]Pepper, 308 U.S. at 309–10.

[8]See, e.g., Diasonics, Inc. v. Ingalls, 121 B.R. 626, 631, 24 Collier Bankr. Cas. 2d (MB) 1138 (Bankr. N.D. Fla. 1990); In re Fett Roofing & Sheet Metal Co., Inc., 438 F. Supp. 726, 729, 15 C.B.C. 43 (E.D. Va. 1977), aff'd, 605 F.2d 1201 (4th Cir. 1979) and aff'd, 605 F.2d 1201 (4th Cir. 1979); In re PCH Associates, 949 F.2d 585, 597, 25 Collier Bankr. Cas. 2d (MB) 1393, Bankr. L. Rep. (CCH) P 74350 (2d Cir. 1991); In re Cold Harbor Associates, L.P., 204 B.R. 904, 915, 30 Bankr. Ct. Dec. (CRR) 336, 37 Collier Bankr. Cas. 2d (MB) 753 (Bankr. E.D. Va. 1997), subsequent determination, 1997 WL 33807885 (Bankr. E.D. Va. 1997); Matter of Fabricators, Inc., 926 F.2d 1458, 1469, 21 Bankr. Ct. Dec. (CRR) 809, 24 Collier Bankr. Cas. 2d (MB) 1489, Bankr. L. Rep. (CCH) P 73875 (5th Cir. 1991).

[9]See, e.g., Diasonics, 121 B.R. at 631; In re Kreisler, 546 F.3d 863, 865, 50 Bankr. Ct. Dec. (CRR) 199, Bankr. L. Rep. (CCH) P 81343 (7th Cir. 2008) ("Equitable subordination is generally appropriate only if a creditor is guilty of misconduct that causes injury to the interests of other creditors."); see also In re Baker & Getty Financial Services, Inc., 974 F.2d 712, 717–18, 27 Collier Bankr. Cas. 2d (MB) 1112, Bankr. L. Rep. (CCH) P 74813, 20 U.C.C. Rep. Serv. 2d 1008 (6th Cir. 1992) (citing Matter of Mobile Steel Co., 563 F.2d 692, 699–700, 15 C.B.C. 1 (5th Cir. 1977) (noting that, to equitably subordinate, "[t]he claimant must have engaged in some type of inequitable conduct.")).

[10]In re AutoStyle Plastics, Inc., 269 F.3d 726, 45 U.C.C. Rep. Serv. 2d 964, 2001 FED App. 0378P (6th Cir. 2001).

[11]SubMicron, 432 F.3d at 455.

[12]AutoStyle, 269 F.3d at 749.

[13]"[T]he claims of all unsecured creditors must be satisfied before holders of equity interests can recover anything from the estate." In re: Dornier Aviation (North America), Incorporated, 453 F.3d 225, 231, 46 Bankr. Ct. Dec. (CRR) 189, Bankr. L. Rep. (CCH) P 80636 (4th Cir. 2006) (citing 11 U.S.C.A. § 726(a)).

[14]See, e.g., In re NII Holdings, Inc., 536 B.R. 61, 84–85, (Bankr. S.D. N.Y. 2015) (approving settlement of dispute over recharacterization of intercompany balances under Bankruptcy Rule 9019, after finding that litigating recharacterization claims to judgment would require "considerable discovery" and "complex and lengthy litigation").

[15]See In re SGK Ventures, LLC, 521 B.R. 842, 847, 60 Bankr. Ct. Dec. (CRR) 115 (Bankr. N.D. Ill. 2014) (referencing Bankruptcy Code Sections 541(a)(1), 704(a), 1106(a), 1107(a), and 1108); In re Tara Retail Group, LLC, 595 B.R. 215, 222, 66 Bankr. Ct. Dec. (CRR) 141 (Bankr. N.D. W. Va. 2018) ("[U]nder § 1107(a), a Chapter 11 debtor has the statu-

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tory duties of a Chapter 11 trustee as stated in § 1106(a)(1), which includes the duty to examine proofs of claim and, if a purpose would be served, to object to the allowance of any claim that is improper.").

[16]See, e.g., In re General Wireless Operations Inc., 2017 WL 5462990, at *4 (Bankr. D. Del. 2017); In re DirectBuy Holdings, Inc., 2017 WL 5496218, at *7 (Bankr. D. Del. 2017); In re Cabrini Medical Center, 2009 WL 7193578, at *11 (Bankr. S.D. N.Y. 2009).

[17]SGK Ventures, 521 B.R. 842 at 847.

[18]See In re Sabine Oil & Gas Corporation, 547 B.R. 503, 566 (Bankr. S.D. N.Y. 2016), stay pending appeal denied, 548 B.R. 674, 62 Bankr. Ct. Dec. (CRR) 138 (Bankr. S.D. N.Y. 2016) and aff'd, 562 B.R. 211 (S.D. N.Y. 2016) (denying derivative standing where committee of unsecured creditors failed to assert a colorable claim for recharacterization); In re Optim Energy, LLC, 2014 WL 1924908, at *5–6 (Bankr. D. Del. 2014), order aff'd, 527 B.R. 169 (D. Del. 2015) (denying derivative standing where creditor failed to assert a colorable claim for recharacterization); SGK Ventures, 521 B.R. at 851 (granting derivative standing to committee of unsecured creditors where complaint stated a colorable claim for recharacterization).

[19]In re Tara Retail Group, LLC, 595 B.R. 215, 222, 66 Bankr. Ct. Dec. (CRR) 141 (Bankr. N.D. W. Va. 2018). Curiously, the court in *Tara Retail* described recharacterization as a type of objection to claim allowance notwithstanding the Fourth Circuit's decision in *Dornier Aviation*, which adopted the federal *AutoStyle* test.

[20]See, e.g., Tara Retail, 595 B.R. at 224; In re Eternal Enterprise, Inc., 557 B.R. 277, 281, 76 Collier Bankr. Cas. 2d (MB) 426 (Bankr. D. Conn. 2016).

[21]See, e.g., In re Fitness Holdings Intern., Inc., 714 F.3d 1141, 1148, 57 Bankr. Ct. Dec. (CRR) 243, 69 Collier Bankr. Cas. 2d (MB) 1089, Bankr. L. Rep. (CCH) P 82493 (9th Cir. 2013), for additional opinion, see, 2013 WL 1800978 (9th Cir. 2013), opinion amended and superseded on reh'g, 529 Fed. Appx. 871 (9th Cir. 2013) (noting "broad agreement" that "the Bankruptcy Code gives courts the authority to recharacterize claims in bankruptcy" and collecting circuit court cases). In *Fitness Holdings*, the Ninth Circuit acknowledged that it had previously "erred in holding" that "the Code did not authorize courts to recharacterize claims." Fitness Holdings, 714 F.3d at 1147, overruling In re Pacific Exp., Inc., 69 B.R. 112, 15 Bankr. Ct. Dec. (CRR) 629, 16 Collier Bankr. Cas. 2d (MB) 286 (B.A.P. 9th Cir. 1986).

[22]See Fitness Holdings, 714 F.3d at 1148 (collecting circuit court cases, and adopting the Fifth Circuit approach).

[23]AutoStyle, 269 F.3d at 748 (first citing Cold Harbor, 204 B.R. at 915, and then citing Fett Roofing & Sheet Metal Co., 438 F. Supp. at 729 (E.D. Va. 1977)).

[24]11 U.S.C.A. § 502(b). Section 502(b) codifies eight specific, additional bases for disallowing claims that would otherwise be enforceable against the debtor under applicable non-bankruptcy law. For example, section 502(b)(6) limits a landlord's claim for expectation damages in connection with the termination of a real-property lease. 11 U.S.C.A. § 502(b)(6). Courts have typically acknowledged that these provisions represent narrow exceptions to the general principal that applicable non-bankruptcy law determines the allowance or disallowance of claims in bankruptcy. See Travelers Cas. and Sur. Co. of America v. Pacific Gas and Elec. Co., 549 U.S. 443, 453, 127 S. Ct. 1199, 167 L. Ed. 2d 178, 47 Bankr. Ct. Dec. (CRR) 265, 57 Collier Bankr. Cas. 2d (MB) 314, Bankr. L. Rep. (CCH) P 80880 (2007) (citing F.C.C. v. NextWave Personal Communications Inc., 537 U.S. 293, 302, 123 S. Ct. 832, 154 L. Ed. 2d 863, 40 Bankr. Ct. Dec. (CRR) 200, 49 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) P 78785 (2003) ("[W]here Congress has intended to provide . . . exceptions to provisions of the Bankruptcy Code, it has done so clearly and expressly.") (holding that "[t]he absence of an analogous [502(b)] provision excluding the category of fees . . . suggests that the Code does not categorically disallow them")).

[25]"Indeed, we have long recognized that the 'basic federal rule' in bankruptcy is that state law governs the substance of claims, Congress having 'generally left the determination

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of property rights in the assets of a bankrupt's estate to state law.' " Travelers, 549 U.S. at 450–51 (first quoting Raleigh v. Illinois Dept. of Revenue, 2000-2 C.B. 109, 530 U.S. 15, 20, 120 S. Ct. 1951, 147 L. Ed. 2d 13, 36 Bankr. Ct. Dec. (CRR) 39, 43 Collier Bankr. Cas. 2d (MB) 869, Bankr. L. Rep. (CCH) P 78182, 2000-1 U.S. Tax Cas. (CCH) P 50498 (2000), and then quoting Butner, 440 U.S. at 57); see also In re Johnson, 756 F.2d 738, 741, 13 Bankr. Ct. Dec. (CRR) 431, 12 Collier Bankr. Cas. 2d (MB) 573, Bankr. L. Rep. (CCH) P 70350 (9th Cir. 1985) ("Thus, in proof of claim litigation under 11 U.S.C.A. § 502(b)(1), the validity of the claim is determined under state law."); In re Princeton Office Park, L.P., 649 Fed. Appx. 137, 140 (3d Cir. 2016) ("In fact, courts often look to state law to determine the validity of a proof of claim.").

[26]SubMicron, 432 F.3d at 454.

[27]SubMicron, 432 F.3d at 454 n.6.

[28]AutoStyle, 269 F.3d at 749.

[29]In re Lothian Oil Inc., 650 F.3d 539, 543, 55 Bankr. Ct. Dec. (CRR) 67, 66 Collier Bankr. Cas. 2d (MB) 69, Bankr. L. Rep. (CCH) P 82055 (5th Cir. 2011) ("[R]echaracterizing the claim as an equity interest is the logical outcome of the reason for disallowing it as debt."); Fitness Holdings, 714 F.3d at 1148 ("We agree with the approach adopted by the Fifth Circuit in *Lothian Oil*.").

[30]Butner v. U.S., 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979).

[31]Travelers, 549 U.S. at 450–51.

[32]Law v. Siegel, 571 U.S. 415, 422, 134 S. Ct. 1188, 188 L. Ed. 2d 146, 59 Bankr. Ct. Dec. (CRR) 43, Bankr. L. Rep. (CCH) P 82592 (2014) ("We have long held that 'whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of' the Bankruptcy Code.") (collecting cases).

[33]Lothian Oil, 650 F.3d at 543.

[34]Petition for Certiorari, at 16, In Re: Province Grande Olde Liberty, LLC, 655 Fed. Appx. 971 (4th Cir. 2016), cert. granted, 137 S. Ct. 2326, 198 L. Ed. 2d 754 (2017) and cert. dismissed as improvidently granted, 138 S. Ct. 41, 198 L. Ed. 2d 768 (2017).

[35]Travelers, 549 U.S. at 450–51; see also Butner, 440 U.S. at 57.

[36]In re HH Liquidation, LLC, 590 B.R. 211, 296 (Bankr. D. Del. 2018) (applying *AutoStyle* test); In re Lyondell Chemical Company, 544 B.R. 75, 95 (Bankr. S.D. N.Y. 2016) (same).

[37]In re N & D Properties, Inc., 799 F.2d 726, 733, 15 Bankr. Ct. Dec. (CRR) 254, 15 Collier Bankr. Cas. 2d (MB) 726 (11th Cir. 1986).

[38]N & D Properties, Inc., 799 F.2d at 733.

[39]AutoStyle, 269 F.3d at 749–750 (citing Roth Steel Tube Co. v. C.I.R., 800 F.2d 625, 630, 86-2 U.S. Tax Cas. (CCH) P 9676, 58 A.F.T.R.2d 86-5808 (6th Cir. 1986)).

[40]In re Emerald Casino, Inc., 2015 WL 1843271, at *13 (N.D. Ill. 2015) (citing several academic articles on the blurred distinctions between debt and equity in modern corporate finance and declining to recharacterize an "unfamiliar hybrid [transaction] featuring elements of both equity and debt" (namely, an "equity kicker")).

[41]SubMicron, 432 F.3d at 456; accord Dornier Aviation, 453 F.3d at 234.

[42]AutoStyle, 269 F.3d at 750; accord SubMicron, 432 F.3d at 456 ("No mechanistic scorecard suffices.").

[43]AutoStyle, 269 F.3d at 750.

[44]See, e.g., In re HH Liquidation, 590 B.R. at 296 (noting these different interpretations).

[45]See, e.g., In re HH Liquidation, LLC, 590 B.R. at 291–92 (Holding that where "[t]here are hundreds of pages of legal documents signed by PropCo Lenders, by OpCo Borrowers,

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and [intercreditor agreements] clearly announcing the PropCo Loan as debt," and "[t]he Committee concedes that both sides accounted for the investment as a loan on their books," these facts "demonstrate" the parties intended the transaction to be a loan).

[46]In re Alternate Fuels, Inc., 789 F.3d 1139, 1149–50, 61 Bankr. Ct. Dec. (CRR) 43, 73 C.B.C. 1457 (10th Cir. 2015) (declining to recharacterize notes titled "PROMISSORY NOTES" despite unfilled acceleration field on pre-printed form and a nominal amount greater than underlying consideration); accord In re HH Liquidation, 590 B.R. at 292 (declining recharacterization in part because "[c]ourts regularly interpret imperfect contracts and resolve minor ambiguities through common sense and extrinsic evidence.").

[47]In re Musicland Holding Corp., 398 B.R. 761, 776 (Bankr. S.D. N.Y. 2008) (calling loan documents executed after years of advancing funds mere "window dressing"); In re Lexington Oil and Gas Ltd., Co., 423 B.R. 353, 366, 52 Bankr. Ct. Dec. (CRR) 208 (Bankr. E.D. Okla. 2010) (heavily discounting this factor because "[t]he Court sees very little in a name").

[48]SubMicron, 432 F.3d at 457 (3d Cir. 2006)

[49]Lyondell Chem. Co., 544 B.R. at 95.

[50]AutoStyle, 269 F.3d at 750.

[51]Lyondell Chem. Co, 544 B.R. at 95.

[52]AutoStyle, 269 F.3d at 750 (warning against a "rigid application" of this factor and declining to recharacterize a demand not in part because it contained fixed interest payments). Courts have also treated contingent payment rights as indicating a loan. See, e.g., Alternate Fuels, 789 F.3d at 1151.

[53]See, e.g., Lothian Oil, 650 F.3d at 542 (applying multifactor state law test to recharacterize $150,000 investment repayable from "royalty of one percent" of "gross production of oil and gas"); Dornier Aviation, 453 F.3d at 243 (recharacterizing a claim from a parts supplier to its distributor in part because the distributor "would not be required to pay until it became profitable").

[54]See, e.g., Dornier Aviation, 453 F.3d at 230 (recharacterizing in part because parent-creditor "wrote off" certain payments); Musicland Holding Corp., 398 B.R. at 776 (recharacterizing in part because it considered certain contractual provisions "window dressing"); Matter of Oakland Physicians Medical Center, L.L.C., 596 B.R. 587, 620–21 (Bankr. E.D. Mich. 2019) (recharacterizing infusion from doctors on board of struggling hospital to the hospital in part because payments were irregular).

[55]AutoStyle, 269 F.3d at 750–51.

[56]AutoStyle, 269 F.3d at 750–51; see also In re MSP Aviation, LLC, 531 B.R. 795, 807 (Bankr. D. Minn. 2015) (same).

[57]See, e.g., In re: Aeropostale, Inc., 555 B.R. 369, 421 (Bankr. S.D. N.Y. 2016) (denying recharacterization for a supplier-creditor's $50 million zero-interest Tranche B pre-petition term loan in part because the agreement required annual $5 million principal payments and was secured by a blanket lien on the debtor's assets).

[58]AutoStyle, 269 F.3d at 750–51.

[59]See, e.g., In re Aeropostale, Inc., 555 B.R. at 421; In re HH Liquidation, LLC, 590 B.R. at 293 ("The PropCo Loan and the Intercompany Note provide that the PropCo Entities have an absolute right to payment i.e., repayment is not contingent on success of the business."); Lyondell Chem., 544 B.R. at 97 ("[T]here are no allegations that the Borrowers' [sic] *duty to repay* was dependent on Lyondell's future performance.") (emphasis in original)).

[60]Lyondell Chem. Co., 544 B.R. at 96 (citing Lexington Oil & Gas, 423 B.R. at 366).

[61]Aeropostale, 555 B.R. at 421 (holding that the fourth factor supports a loan because documents create a fixed right to repayment independent of a continued demand for

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merchandise, and citing MSP Aviation, 531 B.R. at 807 ("[W]hen the creditor has secured the transaction with a lien, courts will generally find in favor of a loan"); AutoStyle, 269 F.3d at 751 (holding that repayment out of earnings, which suggested equity, did so "only slightly" and was "balanced to some extent by the security of the lien on all of AutoStyle's assets").

[62]Lyondell Chem. Co., 544 B.R. at 96; Lexington Oil & Gas, 423 B.R. at 366; HH Liquidation, 590 B.R. at 293 (analyzing this factor in terms of likely repayment upon liquidation, but concluding it supports loan treatment where borrowers had "sufficient unencumbered collateral to pay the PropCo loan in the event of a liquidation").

[63]AutoStyle, 269 F.3d at 751.

[64]The Third Circuit has doubted *AutoStyle's* empirical premise on the ground that "[w]hen existing lenders make loans to a distressed company, they are trying to protect their existing loans and traditional factors that lenders consider (such as capitalization, solvency, collateral, ability to pay cash interest and debt capacity ratios) do not apply as they would when lending to a financially healthy company." SubMicron, 432 F.3d at 458.

[65]Dornier Aviation, 453 F.3d at 234.

[66]Alternate Fuels, 789 F.3d at 1152; Hedged-Invs, 380 F.3d at 1298 n.1; In re: Aeropostale, Inc., 555 B.R. 369, 422 (Bankr. S.D. N.Y. 2016) (noting that it would be "inappropriate" to "penalize the Term Lenders for lending to a distressed company."); In re Emerald Casino, Inc., 2015 WL 1843271, at *12 (N.D. Ill. 2015) (contrary rule would "have the 'unfortunate' effect of discouraging loans from the very persons 'who are most likely to have the motivation to salvage a floundering company").

[67]In re BH S & B Holdings LLC, 420 B.R. at 159; Matter of Yoga Smoga, Inc., 76 Collier Bankr. Cas. 2d (MB) 1706, 2016 WL 8943849, at *12, 14 (Bankr. S.D. N.Y. 2016) (while addressing the criticisms above, noting that "[o]f all the factors that courts have considered in this context, this one has always made the least sense to me").

[68]AutoStyle, 269 F.3d at 751.

[69]AutoStyle, 269 F.3d at 751.

[70]See, e.g., In re HH Liquidation, LLC, 590 B.R. at 293 (noting that this factor is now frequently used to analyze presence of voting rights); Alternate Fuels, 789 F.3d at 1152 (documents suggested debt treatment where the insider did not "increase[] his participation in the management of [the debtor] as a result of the advances"); In re Aeropostale, Inc., 555 B.R. at 422 (advance from lender with no equity holding in debtor weighs against recharacterization).

[71]Matter of Yoga Smoga, Inc., 76 Collier Bankr. Cas. 2d (MB) 1706, 2016 WL 8943849, at *12, 14 (Bankr. S.D. N.Y. 2016) ("[T]he possibility of a future conversion to equity if a Bain deal had occurred does not mean that the money was contributed as equity at the outset."); In re Radnor Holdings Corp., 353 B.R. 820, 839–40 (Bankr. D. Del. 2006) ("The mere 'right' or 'ability' to control, without exercising that control, does not constitute the level of control relevant to the issue of recharacterization . . . The fact that [lender] negotiated the acquisition of warrants of [debtor] equity should the Company fail to meet certain projected EBITDA levels is unremarkable and did not constitute 'control.' ").

[72]See, e.g., Carn v. Heesung PMTech Corp., 579 B.R. 282, 305 (M.D. Ala. 2017) (denying motion to dismiss a recharacterization action where a customer of a distressed catalytic converter supplier advanced money to such supplier to fund the supplier's working capital in part because the customer-lender had access to invoices, purchase plans, and confidential business information and, allegedly, some ability to dictate payment priority of other creditors); In re Comprehensive Power, Inc., 578 B.R. 14, 26, 94 U.C.C. Rep. Serv. 2d 413 (Bankr. D. Mass. 2017) (denying motion to dismiss a recharacterization action where an investment bank exercised its option to acquire stock and board seats as part of a financing agreement and instructed the borrower to "cease operations"); In re AtlanticRancher, Inc., 279 B.R. 411, 432–33 (Bankr. D. Mass. 2002) (permitting recharacterization where, despite lack of actual equity control, loan gave right to convert advance into 47% equity interest at any time); but

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see In re Radnor Holdings Corp., 353 B.R. at 839 (declining recharacterization despite lender's position on debtor's board and "ability" to control day-to-day operations, citing *SubMicron*).

[73]SubMicron, 432 F.3d at 458.

[74]AutoStyle, 269 F.3d at 752; SubMicron, 432 F.3d at 456 (including in its list of "easy" cases loans that "are secured"); In re MSP Aviation, LLC, 531 B.R. 795, 807 (Bankr. D. Minn. 2015) ("[W]hen the creditor has secured the transaction with a lien, courts will generally find in favor of a loan.").

[75]See, e.g., AutoStyle, 269 F.3d at 751 (even payment out of earnings weighs "only slightly in favor of equity" where the advance is secured by a lien on debtor's assets).

[76]Lyondell Chem. Co., 544 B.R. at 98 (stating that *AutoStyle's* "reasoning was questionable" on this point).

[77]In re Aeropostale, Inc., 555 B.R. at 421 (where debtors "sought out" and "in fact received financing proposals" when they accepted the current proposal, that suggests a loan); In re HH Liquidation, 590 B.R. at 295 (discounting factor significantly where "[t]he choice not to pursue outside lenders was due to 'the speed that it needed to get a loan").

[78]"In many cases, an insider will be the only party willing to make a loan to a struggling business." Dornier Aviation, 453 F.3d at 234.

[79]In re HH Liquidation, LLC, 590 B.R. at 297 (denying recharacterization of intercompany loan from real estate holding company to operating company after noting widespread creditor approval and that "[a]t its core, the PropCo Loan is the type of rescue financing that courts aim to preserve").

[80]AutoStyle, 269 F.3d at 751.

[81]See, e.g., In re Eternal Enterprise, Inc., 557 B.R. 277, 290–91, 76 Collier Bankr. Cas. 2d (MB) 426 (Bankr. D. Conn. 2016) (recharacterizing infusion from insiders of residential apartment company in part because loans, though not formally subordinated, were paid last).

[82]AutoStyle, 269 F.3d at 751; accord In re HH Liquidation, 590 B.R. at 295 (citing *AutoStyle*'s "all other creditors" language). For a recent district court case where the lack of subordination was enough to defeat recharacterization despite insider status (CEO who had deferred his salary), see Virginia Broadband, LLC v. Manuel, 538 B.R. 253, 267–68, 61 Bankr. Ct. Dec. (CRR) 197 (W.D. Va. 2015).

[83]In re Sabine Oil & Gas Corp., 547 B.R. at 567 (calling recharacterization claim against subordinated loan "frivolous"); In re Personal Communication Devices, LLC, 528 B.R. 229, 238 (Bankr. E.D. N.Y. 2015) (denying recharacterization of second lien loan because "the *AutoStyle* factors [are] overwhelmingly in favor" of the lender).

[84]AutoStyle, 269 F.3d at 752 (citations omitted).

[85]See, e.g., In re LMI Legacy Holdings, Inc., 2017 WL 1508606, at *2, *17 (Bankr. D. Del. 2017) (denying motion to dismiss recharacterization claim against majority shareholder private equity firm's $5.2 million dollar capital infusion that was used for both capital expenses and working funds).

[86]AutoStyle, 269 F.3d at 753.

[87]See, e.g., AutoStyle, 269 F.3d at 753 and In re HH Liquidation, LLC, 590 B.R. at 296; see also In re Aeropostale, Inc., 555 B.R. at 422–23 (holding that a loan secured by assets has "no need for a sinking fund," rendering this factor "irrelevant").

[88]See In re Lyondell Chemical Company, 544 B.R. 75, 101 (Bankr. S.D. N.Y. 2016) ("To the contrary, the Court wonders, based on its experience, whether sinking funds in modem corporate financings are in any way the norm (or in this day even common), and this Court would need evidence proving up the assumption as to this point before it would ever draw an inference that the absence of a sinking fund on corporate debt is in any way meaningful.").

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[89]AutoStyle, 269 F.3d at 748 (citing Roth Steel Tube Co. v. C.I.R., 800 F.2d 625, 630, 86-2 U.S. Tax Cas. (CCH) P 9676, 58 A.F.T.R.2d 86-5808 (6th Cir. 1986)).

[90]Estate of Mixon v. U.S., 464 F.2d 394, 402, 72-2 U.S. Tax Cas. (CCH) P 9537, 30 A.F.T.R.2d 72-5094 (5th Cir. 1972).

[91]O.H. Kruse Grain & Mill. v. C.I.R., 279 F.2d 123, 126, 60-2 U.S. Tax Cas. (CCH) P 9490, 5 A.F.T.R.2d 1544 (9th Cir. 1960).

[92]In re Mid-Town Produce Terminal, Inc., 599 F.2d 389, 391, 5 Bankr. Ct. Dec. (CRR) 759, 20 C.B.C. 647, Bankr. L. Rep. (CCH) P 67145 (10th Cir. 1979); see also In re Hedged-Investments Associates, Inc., 380 F.3d 1292, 1297–98, 43 Bankr. Ct. Dec. (CRR) 145, Bankr. L. Rep. (CCH) P 80151 (10th Cir. 2004) (reasoning that the multifactor analyses applied by tax courts in other circuits are merely an expansion of the analysis in *Mid-Town Produce*).

[93]AutoStyle, 269 F.3d at 749 n.12 (citing Matthew Nozemack, Note, Making Sense Out of Bankruptcy Courts' Recharacterization of Claims: Why Not Use § 501(c) Equitable Subordination?, 56 Wash. & Lee L. Rev. 689, 718 (1999) ("Some courts reject this analysis and claim that the tax court's factors concerning recharacterization are irrelevant for a determination for bankruptcy purposes.")).

[94]See Treatment of Certain Interests in Corporations as Stock or Indebtedness, 81 Fed. Reg. 72,858, 72,861 (Oct. 21, 2016) (to be codified at 26 C.F.R. pg. 1, § 1.385).

[95]Treas. Reg. § 1.385-1(c)(4).

[96]Treas. Reg. § 1.385-1(c)(2)(i).

[97]Treas. Reg. § 1.385-2(c).

[98]Treas. Reg. § 1.385-2(c)(2)(iv).

[99]Treas. Reg. § 1.385-3(b)(3).

[100]Treas. Reg. § 1.385-3(b)(3).

[101]In re Deer Valley Trucking, Inc., 569 B.R. 341, 348, 63 Bankr. Ct. Dec. (CRR) 250 (Bankr. D. Idaho 2017).

[102]In re Emerald Casino, Inc., 2015 WL 1843271, at *10 (N.D. Ill. 2015).

[103]Comptroller of Treasury v. Jalali, 235 Md. App. 369, 178 A.3d 542, 550 (2018)

[104]United Parcel Service General Services Co. v. Director, Div. of Taxation, 25 N.J. Tax 1, 18, 2009 WL 1740084 (2009), aff'd, 430 N.J. Super. 1, 61 A.3d 160 (App. Div. 2013), judgment aff'd, 220 N.J. 90, 103 A.3d 260 (2014).

[105]Lothian Oil, 650 F.3d at 544 (citing Arch Petroleum, Inc. v. Sharp, 958 S.W.2d 475, 477 n.3 (Tex. App. Austin 1997)).

[106]Truett v. Department of Revenue, 2018 WL 1306645, at *8 (Or. T.C. Magistrate Div. 2018).

[107]In re Emerald Casino, Inc., 2015 WL 1843271, at *10 (N.D. Ill. 2015).

[108]In re Emerald Casino, Inc., 2015 WL 1843271, at *10 (N.D. Ill. 2015) (citing Kramer v. McDonald's System, Inc., 77 Ill. 2d 323, 33 Ill. Dec. 115, 396 N.E.2d 504, 507–09, 28 U.C.C. Rep. Serv. 203 (1979)).

[109]Lothian Oil, 650 F.3d at 544 (citing Arch Petroleum, Inc. v. Sharp, 958 S.W.2d 475, 477 n.3 (Tex. App. Austin 1997)).

[110]In *Fitness Holdings*, a shareholder sought to defend a fraudulent transfer conveyance action by using the "reasonably equivalent value" defense. Fitness Holdings, 714 F.3d at 1146. Under that doctrine, a transfer of funds from the debtor to an insider within the preference period is not a fraudulent transfer if, as relevant here, the insider gave the debtor a fixed right to payment. Fitness Holdings, 714 F.3d at 1146. The creditors' committee in that case argued that, because certain transfers could be recharacterized as equity contributions, there

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was therefore no fixed right to payment, and therefore the "reasonably equivalent value" defense did not apply. Fitness Holdings, 714 F.3d at 1146. Although squarely holding that the bankruptcy court could in general recharacterize debts as equity, the Ninth Circuit merely vacated the district court's dismissal of the UCC's fraudulent transfer claim and remanded. Fitness Holdings, 714 F.3d at 1150.

[111] In re Fitness Holdings International, Inc., 2014 WL 12628681, at *4 (C.D. Cal. 2014), aff'd, 660 Fed. Appx. 546 (9th Cir. 2016), cert. denied, 138 S. Ct. 61, 199 L. Ed. 2d 20 (2017) (Fitness Holdings II).

[112] In re Fitness Holdings International, Inc., 2014 WL 12628681, at *4 (C.D. Cal. 2014), aff'd, 660 Fed. Appx. 546 (9th Cir. 2016), cert. denied, 138 S. Ct. 61, 199 L. Ed. 2d 20 (2017).

[113] In re Fitness Holdings International, Inc., 2014 WL 12628681, at *4 (C.D. Cal. 2014), aff'd, 660 Fed. Appx. 546 (9th Cir. 2016), cert. denied, 138 S. Ct. 61, 199 L. Ed. 2d 20 (2017).

[114] In re Fitness Holdings International, Inc., 2014 WL 12628681, at *4 (C.D. Cal. 2014), aff'd, 660 Fed. Appx. 546 (9th Cir. 2016), cert. denied, 138 S. Ct. 61, 199 L. Ed. 2d 20 (2017).

[115] In re Fitness Holdings International, Inc., 660 Fed. Appx. 546, 548 (9th Cir. 2016), cert. denied, 138 S. Ct. 61, 199 L. Ed. 2d 20 (2017).

[116] Wolfensohn v. Madison Fund, Inc., 253 A.2d 72, 75 (Del. 1969).

[117] Haveron v. Kirkpatrick, 34 A.D.3d 1297, 824 N.Y.S.2d 704, 705 (4th Dep't 2006).

[118] Greenfield v. Philles Records, Inc., 98 N.Y.2d 562, 569, 750 N.Y.S.2d 565, 780 N.E.2d 166 (2002).

[119] Schron v. Troutman Sanders LLP, 20 N.Y.3d 430, 436, 963 N.Y.S.2d 613, 986 N.E.2d 430 (2013).

[120] W.W.W. Associates, Inc. v. Giancontieri, 77 N.Y.2d 157, 565 N.Y.S.2d 440, 566 N.E.2d 639, 642 (1990).

[121] In re Fitness Holdings International, Inc., 2014 WL 12628681, at *5 (C.D. Cal. 2014), aff'd, 660 Fed. Appx. 546 (9th Cir. 2016), cert. denied, 138 S. Ct. 61, 199 L. Ed. 2d 20 (2017).

[122] See In re Fitness Holdings International, Inc., 2014 WL 12628681, at *5 (C.D. Cal. 2014), aff'd, 660 Fed. Appx. 546 (9th Cir. 2016), cert. denied, 138 S. Ct. 61, 199 L. Ed. 2d 20 (2017).

[123] See In re LMI Legacy Holdings, Inc., 2017 WL 1508606, at *14 (Bankr. D. Del. 2017). The court appeared to credit the plaintiff's argument that the *AutoStyle* factors relating to the terms of the putative debt instruments were less probative than the other *AutoStyle* factors because such terms were "dictated" by the debtor's majority shareholder. See In re LMI Legacy Holdings, Inc., 2017 WL 1508606, at *14 (Bankr. D. Del. 2017).

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Big Things Have Small Beginnings - Passive Retention of Property of the Estate Repossessed Prepetition

By Hon. John T. Gregg[*]

I. *Introduction*

Thirty-five years ago and without explanation, Congress amended section 362(a)(3) of the Bankruptcy Code to add the seemingly innocuous phrase "any act . . . to exercise control over property of the estate."[1] Section 362(a)(3) has since metastasized from its relatively small beginnings into one of the more controversial and perplexing provisions in the Bankruptcy Code.[2] Today, it is unclear whether section 362(a)(3) is violated when a creditor passively retains property of the estate repossessed prepetition.

Because section 362(a)(3) applies to cases filed under chapters 7, 11, 12 and 13, this issue manifests itself in numerous contexts, from the chapter 13 debtor who depends on his or her vehicle to travel to and from work each day, to the chapter 11 debtor in possession that relies on intangible personal property to continue as a going concern, and even to the chapter 7 trustee simply seeking to liquidate property of the estate.[3] A court's interpretation of section 362(a)(3) thus has the potential to affect not only the rehabilitation of a debtor, but also the distributions to creditors of a debtor's estate.

Courts and commentators are divided on the issue.[4] Representing the "majority approach," the Second, Seventh, Eighth, Ninth and arguably the Eleventh Circuit Courts of Appeal have held that passive retention of property of the estate repossessed prepetition constitutes a violation of section 362(a)(3).[5] The D.C. Circuit and, most recently, the Tenth Circuit Courts of Appeal disagree.[6] They adhere to the "minority approach" by reasoning, among other things, that because passive retention does not involve any affirmative post-petition act, section 362(a)(3) is not violated. Although the issue remains unaddressed in the First, Third, Fourth, Fifth and Sixth Circuit Courts of Appeal, the lower courts in those circuits are, not surprisingly, similarly divided.[7] As various decisions highlight, the issue is arguably as much about sections 541, 542 and 363 as it is about section 362.[8]

Unfortunately, this article provides no definitive answer; rather, it is intended merely as a guide to the two contrasting approaches. Unless

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[*]United States Bankruptcy Court, Western District of Michigan. This article is only intended to summarize the majority and minority approaches. Nothing contained herein should be construed as the views or opinions of the author. For more argumentative and unconstrained analyses, see infra note 4. The author appreciates the contributions of his law clerk, Elizabeth K. Lamphier, and his judicial assistant, Martha Ledezma.

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Congress or the United States Supreme Court intervenes, parties in bankruptcy cases will continue to be subject to inconsistent interpretations dependent upon the jurisdiction in which a case is filed.

II. *Statutory Overview*

A brief review of sections 362, 363, 541 and 542 is helpful, as they form an inter-related statutory scheme.[9] To begin, upon the filing of any bankruptcy case, an estate is created by operation of law.[10] Section 541 provides, with limited exceptions, that the bankruptcy estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case, regardless of where the property is located and by whom it is held.[11]

A leading treatise has explained section 541 as follows:

> By establishing the content of the bankruptcy estate, Code § 541 identifies the property which will be available to satisfy creditors' claims. In short, Code § 541's operative scheme may be summarized as follows: Any and all property rights of the debtor at the time of the commencement of the case become part of the estate, and remain property of the estate unless specifically removed from the estate.[12]

Section 541 works in tandem with other sections of the Bankruptcy Code, including section 362. Section 362, like section 541, becomes effective by operation of law upon the filing of a bankruptcy case.[13] It automatically imposes a stay of post-petition actions, with certain exceptions.[14] The legislative history to section 362 states, in pertinent part, that:

> The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.[15]

Under the version of section 362(a)(3) enacted as part of the Bankruptcy Reform Act of 1978,[16] only acts to obtain possession of property of the estate were prohibited.[17] However, Congress amended section 362(a)(3) in 1984 as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984.[18] After the 1984 amendments and continuing through the present, section 362(a)(3) states that all entities are automatically stayed from "*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*."[19] Congress provided no substantive legislative history with which to discern its intent.[20]

Section 542, which assembles a debtor's property, provides that:

> Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, 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.[21]

An entity is therefore required to "deliver" all property that the trustee is either able to use, sell or lease under section 363, unless one of the following applies:

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- the property is of inconsequential value or benefit to the estate;
- the holder of the property has transferred it in good faith without knowledge of the bankruptcy; or
- the transfer of the property occurs automatically to pay a life insurance premium.[22]

Section 363 is a significant part of the statutory scheme. To paraphrase, section 363(b) allows a trustee, with certain restrictions, to use, sell or lease property of the estate outside the ordinary course of business after notice and a hearing.[23] Section 363(c)(1), which is also subject to certain exceptions, allows a trustee to use property of the estate and to enter into transactions, including for the sale or lease of property of the estate, in the ordinary course of the debtor's business, without notice and a hearing or prior court approval, provided that the trustee is authorized to operate the debtor's business.[24]

The Bankruptcy Code provides an entity with an interest in property of the estate with a means by which to protect its interest. Section 363(e) provides in pertinent part that:

> Notwithstanding any other provision of this section, at anytime, on request of an entity that has an interest in property used, sold or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale or lease as is necessary to provide adequate protection of such interest . . .[25]

Section 363(e) arguably places the burden to seek adequate protection on the party with an interest in the property, not the trustee.[26] However, such interpretation has not been universally accepted by the courts.[27] Section 363(e) also contains no temporal restriction, meaning that a party can request, and the court may order, adequate protection "at any time."[28] The court, not the party requesting adequate protection, ultimately determines whether the adequate protection is sufficient.[29]

The relationship among sections 362, 363, 541 and 542 can be complicated. To some extent, *Whiting Pools*, a decision from the Supreme Court one year prior to the 1984 amendments, addresses this relationship:

> [Section] 541(a)(1) is intended to include in the estate any property made available to the estate by other provisions of the Bankruptcy Code. Several of these provisions bring into the estate property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced.
>
> Section 542(a) is such a provision. It requires an entity (other than a custodian) holding any property of the debtor that the trustee can use under § 363 to turn that property over to the trustee. Given the broad scope of the reorganization estate, property of the debtor repossessed by a secured creditor falls within this rule, and therefore may be drawn into the estate. While there are explicit limitations on the reach of § 542(a), none requires that the debtor hold a possessory interest in the property at the commencement of the reorganization proceedings.
>
> * * *
>
> 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 reorgani-

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zation proceedings.[30]

In the context of passive retention of property of the estate repossessed prepetition, *Whiting Pools* is important not only for what it says, but also for what it does not say. Among other things, *Whiting Pools* does not address whether the failure to deliver such property results in a violation of the automatic stay under section 362(a)(3). Although *Whiting Pools* emphasizes that its rationale applies in chapter 11 reorganizations, the Supreme Court was careful not to foreclose a different interpretation in cases under chapters 7 and 13.[31] Importantly, the Supreme Court also did not need to determine in *Whiting Pools* whether section 542(a) is self-effectuating because the debtor in possession had counter-claimed for turnover in an adversary proceeding.[32] Finally, *Whiting Pools* did not directly address whether property must be delivered to the trustee before any adequate protection determination.[33]

III. *Contrasting the Majority and Minority Approaches*

The majority and minority approaches depend primarily on their respective (and conflicting) interpretations of the following:

- the plain meaning of the phrase "any act . . . to exercise control";
- the impact of the 1984 amendments;
- the self-effectuating nature (if any) of section 542(a);
- the reach of *Whiting Pools*;
- the right to adequate protection of an entity with an interest in property sought to be used, sold or leased by a trustee as a condition to turnover; and
- the overall purpose of the Bankruptcy Code and underlying policy considerations.

Each approach has merit.

A. *The Plain Meaning Rule*

When addressing whether a creditor violates section 362(a)(3) by passively retaining property of the estate repossessed prepetition, the majority and minority approaches find support for their respective positions in the plain meaning of the statute.[34] None of the terms in the phrase, "any act . . . to exercise control over property of the estate" are defined in the Bankruptcy Code, leaving the courts to turn to the plain meaning of those words as defined in legal and general dictionaries.[35]

The majority approach focuses on the plain meaning of the phrase "to exercise control." A leading legal dictionary defines "control" as, among other things, "[t]o exercise restraining or directing influence over. To regulate; restrain; dominate; curb; to hold from action; overpower; counteract; govern."[36] A frequently cited general dictionary similarly defines "control" as "to exercise restraining or directing influence over" regulate . . . to have power over . . ."[37] Accordingly, the majority concludes that by retaining property of the estate post-petition, entities are nevertheless exercising control. After all, the majority stresses, an entity continuing to retain property of the estate, even without doing more, does do something.

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The entity deprives the trustee of the opportunity to use, sell or lease property of the estate.[38] One court has illustrated this point as follows:

> In light of that definition, we see no way to avoid the conclusion that, by keeping custody of the vehicle and refusing . . . access to or use of it, [the creditor] was "exercising control" over the object in which the estate's equitable interest lay, and its retention of the vehicle violated the stay.[39]

The minority finds a fundamental flaw with the majority's interpretation of the plain meaning of section 362(a)(3). According to courts adopting the minority approach, the majority mistakenly emphasizes the infinitive "to exercise control."[40] Instead, the plain meaning of the term "any act" must first be considered.[41] The issue is not whether any "exercise of control" occurred. It is whether "any act" occurred at all, given that the status quo does not change when a creditor continues to hold property post-petition that was repossessed prepetition.[42] The minority concludes that the correct grammatical interpretation involves only post-petition acts:

> Breaking down the sentence, "any act" is the prepositive modifier of both infinitive phrases. In other words, § 362(a)(3) prohibits "any act to obtain possession of property" or "any act to exercise control over property." "Act", in turn, commonly means to "take action" or "do something." *New Oxford American Dictionary* 15 (3d ed. 2010) (primary definition of "act"). This section, then, stays entities from doing something to obtain possession of or to exercise control over the estate's property. It does not cover "the act of passively holding onto an asset," *Thompson*, 566 F.3d at 703, nor does it impose an affirmative obligation to turnover property to the estate. "The automatic stay, as its name suggests, serves as a restraint only on acts to gain possession or control over property of the estate." Inslaw, 932 F.2d at 1474. Stay means stay, not go.[43]

In sum, under the minority approach, the exercise of control is not stayed; only *the act* to exercise control is stayed.[44]

B. *The 1984 Amendments*

Like their respective interpretations of the plain meaning of section 362(a)(3), the majority and minority disagree on the impact of the 1984 amendments. The majority concludes that the 1984 amendments expanded the scope of section 362(a)(3):

> This significant textual enlargement is consonant with our understanding and the Supreme Court's interpretation that Congress intended to prevent creditors from retaining property of the debtor in derogation of the bankruptcy procedure and the broad goals of debtor protection discussed above, without regard to what party was in possession of the property in question when the petition was filed. As the Seventh Circuit has pointed out, "Although Congress did not provide an explanation of that amendment, the mere fact that Congress expanded the provision to prohibit conduct above and beyond obtaining possession of an asset suggests that it intended to include conduct by creditors who seized an asset pre-petition.[45]

Courts adopting the minority approach are not persuaded by this interpretation, particularly because, as the majority concedes, there is no legislative history upon which to base its conclusion. The minority finds circumspect the majority's reliance on only a change in text, without more, to justify a departure from the interpretation of section 362(a)(3) that was employed

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prior to the 1984 amendments.[46] According to the minority, the scope of the automatic stay was in no way expanded by the 1984 amendments. Instead, the amendments merely clarified that affirmative acts *to gain possession* and *to gain control* after the commencement of a bankruptcy case are covered by section 362(a)(3).[47] As such, notwithstanding the 1984 amendments, section 362(a)(3) continues to apply "only to acts taken *after* the petition is filed."[48] Relatedly, the minority points out, the prefatory language "any act" was not modified by the 1984 amendments. Because Congress did not express any intent to deviate from past practices as part of the 1984 amendments, the minority holds that section 362(a)(3) continues to cover only post-petition acts.[49]

One court adopting the minority approach has explained the impact (or lack thereof) of the 1984 amendments as follows:

> The amendments are equally "consonant" with another, less sweeping conclusion. "Since an act designed to change control of property could be tantamount to obtaining possession and have the same effect, it appears that § 362(a)(3) was merely tightened to obtain full protection." *In re Bernstein*, 252 B.R. 846, 848 (Bankr. D.D.C. 2000). "[U]se of the word 'control' in the 1984 amendment to § 362(a)(3) suggests that the drafters meant to distinguish the newly prohibited 'control' from the already-prohibited acts to obtain 'possession,' in order to reach nonpossessory conduct that would nonetheless interfere with the estate's authority over a particular property interest." Ralph Brubaker, *Turnover, Adequate Protection, and the Automatic Stay (Part II): Who is "Exercising Control" Over What?*, 33 No. 9 Bankruptcy Law Letter NL 1 (September 2013).[50]

C. *The Self-Effectuating Nature of 11 U.S.C. § 542(a)*

Not surprisingly, the majority and minority analyze the relationship between sections 362 and 542(a) quite differently. The majority relies on the allegedly self-effectuating nature of section 542(a), an interpretation disputed by the minority. The majority reasons that because section 542(a) is self-effectuating, an entity in possession of property repossessed prepetition has an affirmative obligation to "deliver" the property to the trustee upon commencement (or at least notice) of a bankruptcy case, provided that the condition precedent is satisfied and none of the three exceptions applies.[51] If it does not satisfy this obligation, the entity violates section 362(a)(3) by not delivering the property, which itself is an act to exercise control over property.

According to the majority, the self-effectuating nature of section 542(a) is apparent from its text. The statute uses the term "shall deliver," indicating that the obligation to turn over property that may be used, sold or leased under section 363 is mandatory.[52] Moreover, if Congress meant to require an order as a condition to turnover, it arguably would have prefaced section 542(a) with "after notice a hearing," as it did in section 542(e).[53] It did not.

One court adopting the majority approach has explained the turnover process as follows:

> A creditor who possesses property of the estate on the date the bankruptcy peti-

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> tion is filed has an obligation to turn that property over to the debtor or to the trustee . . . [T]he onus to return estate property is place[d] upon the possessor . . .
>
> . . . A creditor who requires possession in order to achieve or maintain perfection has the right to file a motion for relief from the stay and request adequate protection such that its lien rights are preserved. However, the creditor must tender the goods or face sanctions for violation of the stay. The creditor has a right to and may request terms of adequate protection while simultaneously returning the goods. However, while the creditor may suggest terms of adequate protection, it may not unilaterally condition the return of the property on its own determination of adequate protection. If the creditor and the debtor cannot agree on what constitutes adequate protection, the creditor can request a hearing, with the debtor having the burden of proving that the creditor's rights will be adequately protected. If the creditor is concerned that its interest will be irreparably harmed if the property is turned over before the motion for relief [from] stay can be heard, it may request an emergency hearing under § 362(f). In all cases, however, any prerequisite to turnover is determined by the bankruptcy court, not by the creditor.[54]

The minority finds that the majority approach fails to sufficiently reconcile the allegedly self-effectuating nature of section 542(a) with *Whiting Pools*. Because *Whiting Pools* identified a condition precedent and three exceptions to turnover, the minority maintains that section 542(a) is not self-effectuating.[55] By deeming turnover to be self-effectuating, the minority reasons that the majority approach inexplicably negates the defenses (i.e., the condition precedent and three exceptions) identified in *Whiting Pools*.[56] Moreover, the minority notes that *Whiting Pools* favorably referred to pre-Bankruptcy Code practice, whereby a court "could order" turnover.[57]

One court has suggested the better reading is that section 542(a) only provides a procedure for a trustee to request turnover.[58] Other courts adopting the minority approach conclude that Rule 7001(1) of the Federal Rules of Bankruptcy Procedure requires an adversary proceeding to effectuate turnover under section 542(a).[59] As such, section 362(a)(3) is violated only where an entity fails to deliver property after entry of a turnover order. Finally, other courts adopting the minority approach take it a step further. They conclude that because no "textual link" exists between sections 362 and 542, an entity that fails to comply with a turnover order is subject to sanctions under section 105(a) for violating a turnover order, not sanctions under section 362 for violating the automatic stay.[60]

D. *Adequate Protection Under 11 U.S.C. § 363(e)*

The relationship between sections 362(a)(3) and 542(a) is further complicated by an entity's right to adequate protection under section 363(e). Once again, the majority and minority approaches are wholly divergent.

The majority rejects any notion that turnover is conditioned on adequate protection first being provided to an entity passively retaining property of the estate.[61] According to the majority, nothing in the Bankruptcy Code permits a creditor to retain property of the estate unless and until adequate protection is provided.[62] The majority finds support in *Whiting Pools*, where

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the Supreme Court stated that "[s]ection 542(a) simply requires the [creditor] to seek protection of its interest according to the congressionally established bankruptcy procedures, rather than by withholding the seized property from the debtor's efforts to reorganize."[63] This interpretation has been explained as follows:

> [T]here is language in *Whiting Pools* . . . which tends to indicate that the Supreme Court favored an approach whereby the creditor would first turn over the seized asset and then petition the bankruptcy court for adequate protection. The Court commented that the Bankruptcy Code "*requires* an entity (other than a custodian) holding any property of the debtor that the trustee can use under § 363 to turn that property over to the trustee . . ." It further stated that turnover is not explicitly required in only three specific situations, the lack of adequate protection not being among them . . . Further, the Court intimated that the onus is on the creditor, rather than the debtor, to seek relief in the bankruptcy court when it stated: "*At the secured creditor's insistence*, the bankruptcy court must place such limits or conditions on the trustee's power to sell, use, or lease property as are necessary to protect the creditor." This language, combined with our analysis of sections 362(a)(3) (which was not amended at the time of the *Whiting Pools* decision) and 542, shows that it is unlikely that Congress, in creating the Bankruptcy Code, intended to affirm any pre-petition convention that might have existed that allowed a creditor to retain possession of an asset properly belonging to a debtor's bankruptcy estate while awaiting an adequate protection determination . . .[64]

The minority approach rejects the majority's rationale. First, courts adopting the minority approach note that the statements in *Whiting Pools* upon which the majority relies are *dictum*, not holdings.[65] Second, section 542(a) specifically cross-references section 363, meaning that the two sections must be read as part of a larger statutory scheme:

> The Court observed in *Whiting Pools* . . . that one of the "explicit limitations on § 542(a) is that "Section 542 provides that the property be usable under § 363 . . ." Property "usable under § 363" necessarily includes the limitation of § 363(e) that, "[n]otwithstanding any other provision of that section," any proposed use is subject to the trustee's obligation to comply with any order issued by the court for adequate protection. As observed in Brubaker, *Part II* at 5:
>
> > Of course, the most prominent among the explicit limitations on the reach of § 542(a)" that the Supreme Court specifically highlighted in *Whiting Pools* is "that property be usable under § 363." By express incorporation of § 363, then, when the estate seeks turnover of property "*proposed* to be used, sold, or leased, by the trustee, the court . . . *shall prohibit or condition* such use, sale, or lease as is necessary to *provide adequate protection*" of the secured creditor's lien rights.[66]

E. *Underlying Purpose and Policy Considerations*

The final point of tension between the majority and minority approaches involves policy considerations. The majority relies on the following practical considerations to support its view: (i) bankruptcy reorganizations are premised on allowing a debtor to use its assets for rehabilitative purposes, (ii) creditors should not be able to hold property of the estate hostage to the detriment of the debtor and creditors on the whole, and (iii) the debtor (and, indirectly, the creditor constituency) would be economically harmed if a

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debtor is required to assemble property of the estate piecemeal.[67] Although a creditor may also be harmed if, for example, the creditor's collateral depreciates or is destroyed, the majority reasons that a creditor can address any such concerns by filing an emergency motion for relief from the automatic stay and, alternatively, adequate protection.[68]

The minority disagrees. The minority stresses that practical considerations should have little relevance, if any, because the plain meaning of the statute controls. However, even if policy and purpose play a role, the minority suggests that they should balance the interests of the estate and the entity with an interest in property, as illustrated by one court:

> The minority rule wisely balances both sides. The minority rule still prohibits creditors from taking post-petition action that would give them possession or control over qualifying property. This ensures that the property will remain a part of the estate and allows for a bankruptcy court to distribute those assets to all claimants in an orderly and just manner. It also still allows damages for wrongful post-petition conduct. [Debtors] may still request a creditor to return property repossessed pre-petition and may still move for a turnover of the property before a bankruptcy court. This allows a bankruptcy court to fully consider a creditor's defenses to turnover before a creditor has to turnover property to the estate.[69]

The practical considerations are perhaps best understood by a fairly common hypothetical. Prepetition, a secured creditor repossesses an individual debtor's vehicle. Before the creditor can fully divest the debtor of any property interest under applicable non-bankruptcy law, the debtor files for relief under chapter 13. The debtor immediately provides the creditor with notice of the bankruptcy. The creditor declines. Instead, the creditor files an emergency motion for relief from the automatic stay and requests adequate protection, including proof of insurance, which the debtor to date has not provided. The debtor then files a one-page motion asserting that the automatic stay has been violated but does not request turnover in the motion. The court is thus confronted with the following questions, among others, on an expedited basis:

- Is the requirement of turnover self-effectuating, meaning that the property may be used, sold, leased or exempted, and none of the three exceptions apply? Or, does the court need to order turnover?
- Assuming that turnover is self-effectuating, when was the automatic stay violated? Is it when the creditor failed to immediately/promptly deliver the vehicle after the creditor received notice of the bankruptcy? Or, does the debtor first need to make an informal demand for turnover?
- If the court grants relief from the automatic stay, has the creditor nonetheless violated the automatic stay by not delivering the vehicle upon receiving notice of the bankruptcy? Or, should the court order annulment of the automatic stay?
- Should the court condition turnover on adequate protection?
- Is the requirement that the creditor deliver the vehicle mutually exclusive from the debtor's obligation to provide adequate protection, including proof of insurance?

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- Is the automatic stay violated if the creditor refused to return the vehicle solely because the vehicle was not insured?
- What if the debtor damages or destroys the vehicle and it is uninsured?
- What if the debtor is a serial filer who has previously voluntarily dismissed his case(s) immediately after the creditor delivers the vehicle, thereby requiring the creditor to repossess the vehicle again?
- Should the debtor be deprived of the ability to use, sell or lease property of his or her estate that is needed for work while the court considers the creditor's motion for relief from the automatic stay and request for adequate protection?
- Should the court fashion an interim order requiring, at the very least, proof of insurance as a condition to turnover pending a final hearing?

In theory, a bankruptcy court should adhere to either the majority or minority approach, or maybe even a hybrid of the two. In reality, however, the practical considerations in light of the facts and circumstances of each case likely weigh on bankruptcy courts. Courts are, in essence, confronted with a catch-22 policy debate, especially in chapter 13 cases. On the one hand, unless a creditor is required to relinquish possession of the vehicle, a chapter 13 debtor is in many instances unable to travel to work to fund his or her repayment plan. On the other hand, because chapter 13 is a voluntary process, nothing prevents a debtor from dismissing his or her case immediately after the vehicle is delivered.[70] The temptation is to consider the facts and circumstances of each case, keeping in mind the overall purpose of bankruptcy.[71] Yet, as the minority stresses, reliance on practical considerations may be inconsistent with Congress's statutory directives.[72]

IV. *Illustrative Decisions (Majority Approach)*

As noted above, the majority approach is endorsed by five circuit courts of appeal as well as numerous other lower courts.[73] The following decisions illustrate the majority approach and provide context with which to better understand its interpretation of section 363(a)(3).[74]

A. *Eighth Circuit*

The Eighth Circuit Court of Appeals was the first circuit court to hold that passive retention of property of the estate constitutes a violation of the automatic stay under section 362(a)(3).[75] In *Knaus*, a sheriff seized the debtor's equipment pursuant to a writ of execution.[76] Before any disposition of the equipment under applicable non-bankruptcy law and while it was still in the possession of the sheriff, the debtor filed a voluntary petition for relief under chapter 11.[77] When the creditor refused to instruct the sheriff to turn over the equipment, the debtor requested that the bankruptcy court compel turnover.[78] The bankruptcy court held that the creditor violated section 362(a)(3) by refusing to voluntarily relinquish possession of the equipment post-petition.[79] On appeal, the district court reversed, and a further appeal ensued.[80]

Affirming the bankruptcy court, the Eighth Circuit rejected the creditor's contention that the automatic stay is violated only when property of the

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estate is seized after the petition date.[81] Rather, according to the court, section 542(a) requires turnover regardless of when the creditor first exercises control over property of the estate.[82] The duty arises when the creditor learns of the bankruptcy and does not require intervention by the bankruptcy court or even a demand by the trustee.[83] Concluding that section 362(a)(3) was violated when the property was not delivered, the Eighth Circuit favorably quoted the bankruptcy court:

> The principle is simply this: that a person holding property of a debtor who files bankruptcy proceedings becomes obligated, upon discovering the existence of the bankruptcy proceedings, to return that property to the debtor (in chapter 11 or 13 proceedings) or his trustee (in chapter 7 proceedings). Otherwise, if persons who could make no substantial adverse claim to a debtor's property in their possession could, without cost to themselves, compel the debtor or his trustee to bring suit as a prerequisite to returning the property, the powers of a bankruptcy court and its officers to collect the estate for the benefit of creditors would be vastly reduced. The general creditors, for whose benefit the return of property is sought, would have needlessly to bear the cost of its return. And those who unjustly retain possession of such property might do so with impunity.[84]

Knaus is not a highly analytical decision, but it does establish the relationship between sections 542(a) and 362(a)(3) at a circuit court level. Moreover, *Knaus* seems to rely heavily on the policy considerations underlying the majority approach. *Knaus* did not, however, consider whether adequate protection is a prerequisite to turnover, or even distinguish between pre- and post-petition acts under section 362(a)(3). Instead, based on its own prior interpretation, the Eighth Circuit relied on the broad scope of section 362(a)(3) after the 1984 amendments.

B. *Ninth Circuit*

Seven years after *Knaus*, the Ninth Circuit Court of Appeals was confronted with the same issue, albeit with quite different (and somewhat convoluted) facts in a chapter 7 case.[85] In *Del Mission Ltd*., the chapter 7 trustee sought to sell a liquor license.[86] The State of California, however, refused to approve the sale until all outstanding taxes and interest were paid by the trustee.[87] After paying the taxes under protest in order to obtain the State's consent and consummate the sale, the trustee commenced an adversary proceeding seeking repayment.[88] The bankruptcy court concluded that the State's demand violated section 362(a)(3) and ordered repayment.[89] The State appealed.[90]

Because the State refused to repay the taxes while the appeal was pending, the trustee filed a motion to hold the State in contempt.[91] On appeal, the Ninth Circuit considered whether the State's continued retention of the tax payment constituted an act to exercise control over property of the estate in violation of section 362(a)(3).[92]

The Ninth Circuit first noted that although the clause "to exercise control over property of the estate" was added as part of the 1984 amendments, Congress provided no explanation with respect to the amendment.[93] The

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Ninth Circuit nonetheless concluded, like in *Knaus*, that section 362(a)(3) should be given an extremely broad scope.

The Ninth Circuit further observed that "to effectuate the purpose of the automatic stay, the onus to return estate property is placed on the possessor; it does not fall on the debtor to pursue the possessor."[94] Finally, the Ninth Circuit inferred that from a policy perspective, Congress did not intend to burden the bankruptcy estate with the expense of multiple turnover actions.[95] The court therefore held that if property is not delivered pursuant to section 542(a), an entity violates section 362(a)(3).

Other than embracing the majority approach, *Del Mission Ltd.* provides limited discussion. Although it is a chapter 7 case, it does not address whether *Whiting Pools'* rationale is equally applicable in liquidations. In fact, it does not even mention *Whiting Pools*. Instead, it relies on *Knaus* in large part. *Del Mission Ltd.* may also rely on dictum. *Del Mission Ltd.* cites to *Abrams*, a decision from the bankruptcy appellate panel several years earlier.[96] In *Abrams*, the issue was whether the creditor's *post-petition* repossession of a leased vehicle violated section 362(a)(3).[97] In a footnote citing to *Knaus*, the *Abrams* court summarily stated there is no difference between pre- and post-petition acts for purposes of section 362(a)(3).[98] *Del Mission Ltd.* therefore indirectly relies on *Knaus*, which in turn relied on prior Eighth Circuit precedent to support its conclusion. For various reasons, *Del Mission Ltd.* may have its detractors.[99]

C. *Eleventh Circuit*

In a short per curiam opinion, the Eleventh Circuit Court of Appeals has similarly held in a chapter 13 case that a creditor violates the automatic stay when it refuses to return property of the estate that was lawfully repossessed prepetition.[100] Before the debtor filed his chapter 13 petition, the creditor repossessed the debtor's vehicle.[101] Because title to the vehicle remained with a debtor until disposition by the creditor under applicable non-bankruptcy law, the vehicle was property of the debtor's estate.[102] The Eleventh Circuit therefore held the creditor willfully violated the automatic stay by refusing to return the vehicle promptly upon demand by the chapter 13 debtor.[103]

Rozier does not refer to section 362(a)(3) or any other subsection of section 362. It also never mentions *Whiting Pools*. Nonetheless, in contrast to *Knaus* and *Del Mission Ltd.*, both of which require prompt turnover without any formal demand, *Rozier* highlights an inconsistency among courts adopting the majority approach. *Rozier* seems to say that a creditor must turn over property of the estate only upon informal demand by the chapter 13 trustee. Given its limited discussion and lack of cited authority, *Rozier's* precedential value may be limited.[104]

D. *Seventh Circuit*

In a case with a classic set of facts, the Seventh Circuit considered whether a secured creditor violated the automatic stay by retaining possession of the vehicle post-petition.[105] The secured creditor repossessed the vehicle after

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default.[106] Before any foreclosure or other disposition of the collateral occurred, the debtor filed for relief under chapter 13.[107]

Relying on two intra-district decisions, the bankruptcy court denied the debtor's motion for sanctions and thereafter certified the matter for direct appeal.[108] The Seventh Circuit identified the underlying issues as (i) whether the creditor exercised control over property of the estate, and (ii) if so, whether the creditor was required to return the property before the court makes any determination with respect to adequate protection under section 363(e).[109]

With respect to the first issue, the Seventh Circuit relied on the plain meaning of "control," which is defined as "to exercise restraining or directing influence over" or "to have power over."[110] According to the court, "[h]olding onto an asset, refusing to return it, and otherwise prohibiting a debtor's beneficial use of an asset all fit within this definition, as well as within the commonsense meaning of the word."[111]

The Seventh Circuit was also persuaded by the 1984 amendments. According to the Seventh Circuit, Congress's decision to include acts to exercise control over property of the estate logically suggests that even property seized prepetition falls within the expanded scope of section 362(a)(3).[112]

Finally, the Seventh Circuit found support in the primary purpose of bankruptcy reorganizations:

> [T]o hold that "exercising control" over an asset encompasses only selling or otherwise destroying the asset would not be logical given the central purpose of reorganization bankruptcy. The primary goal of reorganization bankruptcy is to group *all* of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts; this necessarily extends to all property, even property lawfully seized prepetition . . . An asset actively used by a debtor serves a greater purpose to both the debtor and his creditors than an asset sitting idle on a creditor's lot.[113]

The Seventh Circuit dissected the second issue as follows: (i) whether a creditor must turn over property of the estate and then seek adequate protection, or (ii) whether the creditor may retain possession of property of the estate, thereby placing the burden on the trustee to commence a turnover action.[114] Citing to several appellate court decisions from other jurisdictions, the court acknowledged that the majority of courts require the former.[115] The Seventh Circuit noted that the majority approach is supported by section 363(e) (in conjunction with section 542(a)), *Whiting Pools*, and policy considerations.

According to the Seventh Circuit, section 363(e) places the burden on the creditor to request adequate protection.[116] As such, the court reasoned, a creditor has no incentive to request adequate protection if it already has possession of the property.[117] Congress, therefore, must have intended that property be turned over to the estate, regardless of whether the creditor has requested adequate protection.[118]

The Seventh Circuit also noted that section 542(a) is mandatory, not permissive, as it uses the term "shall deliver":

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> The right of possession is incident to the automatic stay. A subjectively perceived lack of adequate protection is not an exception to the stay provision and does not defeat this right . . . Instead, section 362(d) "works in tandem with § 542(a) to provide creditors with what amounts to an affirmative defense to the automatic stay . . ." First, the creditor must return the asset to the bankruptcy estate. Then, if the debtor fails to show that he can adequately protect the creditor's interest, the bankruptcy court is empowered to condition the right of the estate to keep possession of the asset on the provision of certain specified adequate protections to the creditor.[119]

Expanding *Whiting Pools*, the Seventh Circuit could discern no distinction between chapters 11 and 13, as the principle is the same - to facilitate reorganization while maximizing the distribution to creditors.[120] The court also emphasized that its holding is entirely consistent with *Whiting Pools*, because none of the three exceptions to turnover were at issue.[121] Focusing on the phrase, "[a]t the secured creditor's insistence" in *Whiting Pools*, the Seventh Circuit reiterated that the burden to request adequate protection under section 363(e) rests with the creditor, not the debtor.[122]

The Seventh Circuit appears to be ground zero for section 362(a)(3). The City of Chicago has taken an aggressive position with respect to impounded vehicles for, among other things, unpaid parking tickets. As such, *Thompson* continues to be at the forefront of numerous decisions from the Bankruptcy Court for the Northern District of Illinois.[123] The Seventh Circuit Court of Appeals has granted a direct consolidated appeal of four decisions addressing the exception to the automatic stay under section 362(b)(3), thus implicating *Thompson's* interpretation of section 362(a)(3).[124]

E. *Second Circuit*

More recently, the Second Circuit Court of Appeals adopted the majority approach in a case with facts similar to those in *Thompson* and *Knaus*.[125] Prepetition, the secured creditor repossessed the debtor's vehicle due to a default.[126] Four days later, the debtor filed for relief under chapter 13, notice of which was provided to the creditor.[127]

Notwithstanding the debtor's post-petition written demand for turnover of the vehicle, the creditor initially refused.[128] The creditor later returned the vehicle after the debtor commenced an adversary proceeding for turnover.[129] The debtor, however, continued to pursue damages due to his inability to use the vehicle for approximately two months.[130] The bankruptcy court found in favor of the creditor, the district court reversed, and the creditor appealed to the Second Circuit.[131]

After concluding the debtor's vehicle was property of the estate, the Second Circuit observed that section 542(a) is self-executing.[132] The court rejected the creditor's contention that a debtor must formally request turnover before a creditor is required to relinquish property of the estate in its possession.[133] By requiring a formal request for turnover, the debtor or the trustee would have the burden of assembling property of the estate through a series of time consuming and costly adversary proceedings.[134] The creditor thus had an obligation to turn over the property without court intervention.

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The court next addressed the plain meaning of section 362(a)(3). Relying on an ordinary dictionary definition, the Second Circuit noted that "control" means "[t]o exercise authority over; direct; command."[135] According to the court, the creditor's decision to maintain possession while refusing the debtor access to or use of the vehicle was an exercise of control that violated the automatic stay.[136]

Finally, the Second Circuit was not persuaded that a trustee is required to provide adequate protection as a condition precedent to turnover. Unlike section 542(a), section 363(e) is not self-executing.[137] The party asserting an interest in the property subject to turnover has the burden of requesting adequate protection, which must be approved by the court.[138] In other words, the Second Circuit concluded, the lack of adequate protection is not an exception to the effectiveness of section 362(a)(3), much like it is not an exception to turnover identified by the Supreme Court in *Whiting Pools*.

Weber may be viewed as a persuasive adoption of the majority approach. However, if *Weber* has a flaw, it is, like *Thompson* and other similar decisions, the failure to address the minority's interpretation of the plain meaning by explaining why the starting point is "to exercise control" and not "any act." The utility of decisions like *Weber* may be subject to scrutiny in other jurisdictions, particularly after *Cowen*.

F. *Other Notable Decisions*

The Bankruptcy Appellate Panel for the Sixth Circuit has issued one of the more comprehensive decisions adopting the majority approach.[139] *Sharon* involved facts similar to those in *Thompson*, *Weber*, *Knaus*, and *Cowen*. Prepetition, a secured creditor repossessed the debtor's vehicle.[140] Less than two weeks later and prior to any disposition under applicable non-bankruptcy law, the debtor filed for chapter 13 bankruptcy.[141] Over the next two days, the debtor's attorney requested that the creditor return the vehicle.[142] The creditor refused.[143]

With little alternative, the debtor filed a motion seeking to hold the creditor in contempt for violating the automatic stay.[144] The creditor countered by filing a motion for relief from the automatic stay, as well as an objection to the debtor's motion.[145] The creditor also requested, as a condition to turnover, adequate protection payments and proof of insurance.[146] The bankruptcy court ordered that the creditor turn over the vehicle to the debtor and held that the creditor's failure to do so upon the commencement of the debtor's case constituted a violation of the automatic stay.[147] The creditor appealed.[148]

Identifying *Whiting Pools* as the starting point, the bankruptcy appellate panel found that the debtor's vehicle was property of the estate.[149] Accordingly, the court noted, a creditor is required to turn over property unless the condition precedent or one of the three exceptions identified in *Whiting Pools* applies.[150] The court explained, "[o]nce defined as 'property of the estate,' the statutory consequence under § 362(a) is application of the automatic stay. The [d]ebtor's right to possession of the car was protected by the

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automatic stay."[151]

The court next turned to the 1984 amendments. Citing to *Del Mission Ltd.* and relying on a previous interpretation of section 362(a)(3) from the Sixth Circuit, the court explained that the 1984 amendments broadened the scope of section 362(a)(3).[152] To that end, the court concluded that "[w]ithholding possession of property from a bankruptcy estate is the essence of 'exercising control' over possession."[153]

The court rejected the creditor's contention that the right to adequate protection under section 363(e) creates an exception to turnover under section 542(a). Relying again on *Whiting Pools*, the court explained:

> Nothing in § 362 itself suggests the "adequate protection" exception to the automatic stay argued by [the creditor]. As demonstrated above, the presence of "property of the estate" triggers the proscription in § 362(a)(3). There is no "exception" to property of the estate for property with respect to which a creditor claims a right of adequate protection." To the contrary, as recognized by the Supreme Court in *Whiting Pools*, §§ 541 and 542 of the Code work together to draw back into the estate a right of possession that is claimed by a lien creditor pursuant to a prepetition seizure; the Code then substitutes "adequate protection" for possession as one of the lien creditor's rights in the bankruptcy case . . . [T]he creditor's "adequate protection" right does not defeat the statutory obligation in § 542(a) that [the creditor] "shall deliver" possession of property of the estate.[154]

The court further noted that Congress has established procedures for requesting adequate protection, none of which were followed by the creditor.[155] Although the creditor may be entitled to adequate protection, the possibility of such request or even a request for relief from the automatic stay does not excuse turnover.[156] To hold otherwise, the court stressed, would improperly elevate a creditor's subjective judgment regarding adequate protection over a chapter 13 debtor's right to possess and use property of the estate under sections 363, 541 and 542(a).[157]

Finally, the court commented that a creditor subject to section 542(a) still has a means by which to protect itself. Section 362(f) expressly authorizes a court to grant relief from the automatic stay on an expedited or even emergency basis.[158] Thus, the creditor could have filed its motion for relief from the automatic stay upon learning of the bankruptcy case.[159] Yet, the court commented, section 362(d) is not an exception to the automatic stay, meaning that the creditor is not excused from section 362(a) by filing a motion for relief from the automatic stay.[160] Because the creditor did not deliver the vehicle promptly upon receiving notice of the debtor's bankruptcy, the court ultimately found that the creditor had improperly exercised control over property of the estate in violation of section 362(a)(3).[161]

A strongly-worded dissent in *Sharon* suggested the majority was "bludgeoning" creditors by depriving them of a hearing, as section 542(a) is not self-effectuating.[162] The dissent also found circumspect the majority's conclusion that a trustee need not provide adequate protection prior to turnover.[163] Instead, the dissent emphasized the need to maintain the status

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quo pending a determination of adequate protection.[164] Finally, the dissent was unpersuaded by the majority's interpretation of section 362(a)(3). According to the dissent, no "act" occurred, because the creditor had done nothing post-petition.[165]

V. *Illustrative Decisions (Minority Approach)*

Although only the Tenth and D.C. Circuit Courts of Appeal have adopted the minority approach, numerous other lower courts have also found its rationale persuasive.[166] The recent trend seems to favor the minority approach, as these decisions highlight.

A. *D.C. Circuit*

The first circuit-level decision to adopt the minority approach, *Inslaw*, involves a strange set of facts.[167] Prior to seeking relief under chapter 11, the debtor agreed to develop and provide software to the United States government pursuant to written contract.[168] Subsequently, the government requested that the debtor also provide it with all computer programs and supporting documentation related to the contract without further payment.[169] The debtor acquiesced.[170]

Approximately six months after filing for bankruptcy, the debtor filed a claim against the government alleging that it had refused to pay for certain software enhancements that were not subject to the original contract.[171] The contracting officer, as the adjudicative body under 41 U.S.C. §§ 601 to 613, ruled in favor of the government.[172]

Later, the debtor commenced an adversary proceeding alleging that the government had willfully violated section 362(a) by continuing to use property without the debtor's consent.[173] The bankruptcy court agreed, enjoined the government's further use of the enhanced software, and awarded damages.[174]

After the district court affirmed in part, the D.C. Circuit Court of Appeals considered whether the government committed any act to exercise control over property of the estate. The court first concluded that the debtor had no right to possession of certain property because the government not only possessed the property, but it also asserted that it owned the property outright.[175] In other words, the condition precedent that the debtor be able to use, sale or lease the property under section 363 was not satisfied. The court therefore concluded that the debtor could not use the turnover provision under section 542(a) to liquidate a contractual dispute.[176]

The court next considered whether the government nonetheless exercised control over property of the estate by continuing to use the software subject to the dispute.[177] The court first noted that a bankruptcy court would impermissibly expand its jurisdiction to non-core disputes if it adjudicated a debtor's contract claims against third parties.[178] Moreover, if the debtor's interpretation of section 362(a)(3) was correct, any dispute regarding property of the estate could be turned into a violation of the automatic stay subjecting the non-debtor to damages.[179] To put it another way, a creditor would argu-

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ably be foreclosed from contesting issues of title to property because by doing so, the creditor would per se violate section 362(a)(3).

Finally, the D.C. Circuit commented that the bankruptcy court was guilty of having "left the words of [section 362(a)(3)] in the dust."[180] According to the court, the automatic stay restrains only acts "to gain possession or control" over property of the estate.[181] As the text of section 362(a)(3) makes clear, the act must have taken place post-petition.[182] Because the dispute over the government's use of the property arose prepetition, no post-petition "act" occurred.

Inslaw is at times hard to follow given the procedural posture of the dispute. However, it highlights the problem with requiring turnover where parties dispute title to property, particularly where the non-debtor has a good faith belief that the estate holds no interest whatsoever.

B. *Tenth Circuit*

The Tenth Circuit's decision adopting the minority approach has recently dominated discussion because it is somewhat factually, but certainly not legally, similar to *Knaus*, *Thompson* and *Weber*.[183] *Cowen* duels with the majority and revives the minority approach on a circuit level after over twenty years of dormancy.

In *Cowen*, the debtor's two vehicles were repossessed prepetition by his secured creditors.[184] Upon filing for chapter 13, the debtor notified the creditors of his bankruptcy and requested the immediate return of both vehicles.[185] The creditors refused.[186] One creditor claimed that by allegedly changing the title of the vehicle to the creditor's name prepetition, the debtor did not maintain any interest in the vehicle as of the petition date.[187] The other creditor contended that he sold the vehicle before the petition date, so he had nothing to turn over.[188]

Approximately one month later, the debtor filed a motion for an order to show cause why the creditors should not be held in contempt for their alleged willful violations of the automatic stay.[189] The bankruptcy court entered orders requiring the creditors to immediately turn over the vehicles.[190] The creditors, however, did nothing, precipitating the debtor's commencement of an adversary proceeding for violation of the automatic stay.[191] In response, the creditors contended that because the debtor's rights in the vehicles had been terminated prior to the bankruptcy, it was legally impossible for them to have violated the automatic stay.[192] The bankruptcy court was not persuaded, finding that the creditors forged documents, perjured themselves, and failed to comply with applicable non-bankruptcy law with respect to the disposition of the vehicles.[193] As such, the bankruptcy court concluded that the creditors had violated section 362(a)(3) by failing to deliver the vehicles to the debtor.[194] After the creditors appealed, the district court affirmed.[195]

The Tenth Circuit reversed. Although the Tenth Circuit recognized that the bankruptcy court's holding was consistent with the majority approach, it was unpersuaded by those courts' policy-driven considerations.[196] The Tenth Circuit analyzed the plain meaning of the statute by grammatically diagram-

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ming the phrase, "any act . . . to exercise control over property of the estate."[197] It concluded that emphasis should be placed on "any act," not "to exercise control."[198]

The Tenth Circuit also criticized the majority approach for relying on non-existent legislative history. Returning to an oft-quoted remark from the Supreme Court, the court observed that "Congress does not 'hide elephants in mouseholes.' "[199] The Tenth Circuit thus reasoned that if Congress meant such a radical departure from pre-amendment practice, it would have said so. According to the Tenth Circuit, the clause "to exercise control over property of the estate" in section 362(a)(3) should be read as consistent with the statute in existence prior to the 1984 amendments.[200] It reasoned that because an act to change control of property "could be tantamount to obtaining possession and have the same effect, it appears that § 362(a)(3) was merely tightened to obtain full protection."[201] In other words, by adding the phrase "to exercise control," Congress was simply distinguishing "control" from "possession" in order to include non-possessory post-petition conduct that would similarly interfere with an estate's particular interest in property.[202]

As further support for its interpretation, the Tenth Circuit identified examples of acts that " 'exercise control' over but do not 'obtain possession of, the estate's property," such as a creditor in possession who sells property of the estate or a creditor who has control over intangible personal property.[203] Accordingly, the Tenth Circuit explained:

> If Congress had meant to add an affirmative obligation - to the automatic *stay* provision no less, as opposed to the *turnover* provision - to turn over property belonging to the estate, it would have done so explicitly. The majority rule finds no support in the text or its legislative history.[204]

Finally, the Tenth Circuit was not persuaded that sections 362 and 542 work in tandem. Instead, the court noted, those sections are bereft of any "textual link" to one another.[205] Moreover, the Tenth Circuit explained that section 362 is not needed to enforce turnover under section 542(a) in light of the broad equitable powers available to bankruptcy courts under section 105(a).[206] As such, the Tenth Circuit concluded that only post-petition acts to gain possession of, or to exercise control over, property of the estate violates section 362(a)(3).[207]

Cowen acts as the foil to the majority approach on a circuit level. It provides counter-arguments to *Thompson* and *Weber* in particular and highlights what they fail to address - the meaning of the term "any act." Since *Cowen*, courts in the Tenth Circuit have dutifully, but perhaps reluctantly, followed it.[208] *Cowen* could potentially be considered by the Supreme Court, albeit indirectly. A petition for certiorari was filed but denied in another case after the Tenth Circuit applied *Cowen's* plain meaning interpretation to section 362(a)(4).[209]

C. *Other Notable Decisions*

In another decision illustrative of the recent trend, the District Court for the District of New Jersey held that section 362(a)(3) is not violated when a

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creditor passively retains property of the estate post-petition.[210] In *Denby-Peterson*, a secured creditor repossessed the debtor's vehicle prepetition, thus causing the debtor lose her job.[211] Less than a month after the vehicle was repossessed, the debtor filed for relief under chapter 13.[212] When the creditor would not return the vehicle despite the debtor's demands, the debtor filed a motion for turnover under section 542(a), which included a request for sanctions due to the creditor's alleged violation of the automatic stay.[213] The bankruptcy court first found that a written waiver of the redemption period executed by the debtor was unenforceable.[214] As such, the debtor had a possessory interest in the vehicle as of the petition date.[215] Nonetheless, the bankruptcy court concluded no violation of the automatic stay occurred because the creditor had a right to preserve the status quo by retaining possession while the bankruptcy court determined whether the waiver was enforceable (i.e., the property was subject to use, sale or lease under section 363).[216]

On appeal, the district court affirmed.[217] Although the act of exercising control over property of the estate is prohibited under section 362(a)(3), the court distinguished a prospective, post-petition act from an act that takes place entirely prepetition.[218] Similar to *Cowen*, the court noted that nothing in the 1984 amendments counseled against adhering to past practices under section 362(a)(3), which only applied to post-petition acts.[219]

Relatedly, the court observed that Congress expressed numerous affirmative duties in the text of the Bankruptcy Code, but did not do so with respect to section 362(a)(3) when it amended that section in 1984:

> Congress could have stated under § 362(a) that creditors must turnover property in their possession upon institution of the automatic stay . . . Instead, it added language to broaden prohibitions on actions taken post-petition that do not reach the level of possession but still amount to an exercise of control.[220]

Favorably citing *Cowen*, the court also explained that the majority approach impermissibly broadens the scope of section 362(a)(3) without any clear statutory directive or even legislative history.[221]

From a policy perspective, the court was persuaded that the minority approach appropriately balances between the rights of debtors and creditors in chapter 13 cases.[222] The creditor is prohibited from taking any post-petition action but the rights of the parties as of the petition date are preserved while any disputes regarding turnover are adjudicated.[223] Somewhat incongruously, however, the court seems to have created an exception to its holding where property is insured:

> If the creditor demands proof of insurance for a vehicle, naming it as loss payee, and the debtor complies, the creditor will be in violation of the automatic stay unless the vehicle is returned to the debtor. This protects both the interest of the debtor and creditor, as it assures both that in case of accident, insurance will cover the loss.[224]

Denby-Peterson is currently on appeal to the Third Circuit.[225] It provides a circuit court with the opportunity to consider the plain meaning of section

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362(a)(3) for the first time since *Cowen*. If the Third Circuit affirms, the divide between the majority and the minority approaches will only intensify.

The Bankruptcy Court for the District of Columbia has given perhaps the most impassioned adoption of the minority approach.[226] In *Hall*, the debtor owned a condominium unit, which included a storage area accessed only through use of a security code.[227] To collect certain charges due prepetition, the property's manager and homeowners' association withheld from the debtor the access code to the storage area.[228]

Despite the debtor's requests upon the bankruptcy filing, the association did not provide the access code for two weeks.[229] The debtor sought sanctions, arguing that the delay in providing the access code and continued retention of his personal property was a violation of section 362(a)(3).[230] Citing to *Inslaw* as binding precedent, the court that found that the creditor had not violated the automatic stay because no affirmative act occurred post-petition.[231] Nevertheless, the court engaged in an extensive critique of the majority approach.[232]

The court explained that courts adopting the majority approach have erroneously deemed turnover under section 542(a) to be self-executing based upon *Whiting Pools*.[233] The court noted that prior to enactment of the Bankruptcy Code in 1978, turnover was conditioned upon adequate protection.[234] According to the court, section 542(a) was enacted to codify this pre-Bankruptcy Code practice, not to convert the concept of turnover into a self-executing injunctive order.[235]

As further support for its interpretation, the court noted that section 542(a) and section 542(b) both use the word "shall." However, unlike section 542(a), section 542(b) has not been interpreted by the courts to be self-executing.[236] Moreover, even if use of the term "shall" in section 542(a) could be seen as self-executing, it is not when read in the context of the Bankruptcy Code on the whole.[237] The court explained that interpreting section 542(a) as self-executing would be inconsistent with section 363(e), which requires a trustee to provide adequate protection where the trustee proposes to use, sell or lease property of the estate and an entity that has an interest in such property requests adequate protection.[238] A trustee cannot use, sell or lease property under section 363(b) or (c)(1) without first providing an entity with adequate protection because section 363(e) states "notwithstanding any other provision of this section." The court reasoned that turnover is excused under such circumstances because the condition precedent in *Whiting Pools* (i.e., a trustee's ability to use, sell or lease property under section 363) is not satisfied. As such, the court concluded, a creditor should not be held in contempt for disputing the condition precedent expressed in section 542(a).[239] Otherwise, creditors with legitimate defenses to turnover would be compelled to capitulate to a trustee's demand for fear of being found in contempt.[240]

The court similarly explained that by requiring immediate turnover without a court order, a creditor's right to adequate protection would be severely diminished if not eliminated by subjecting it to contempt for pursu-

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ing such right.[241] For example, the court noted, a creditor could suffer harm if uninsured collateral is damaged or if the creditor is forced to relinquish a possessory or garnishment lien.[242]

The court also rejected the majority's interpretation of the 1984 amendments. Prior to the 1984 amendments, section 542(a) allowed for the assertion of defenses prior to turnover.[243] Because Congress did not express any intention to overturn existing practice, the phrase "to exercise control over property of the estate" captures only post-petition acts of control as a companion to post-petition acts of possession.[244] Unlike section 521(a)(6), which explicitly states that a debtor shall not retain certain property unless he or she takes certain actions, section 362(a)(3) does not state that a creditor shall not retain possession of collateral seized prepetition.[245] According to the court, section 362(a)(3) was amended to reach nonpossessory conduct that would nonetheless interfere with the estate's interest in property, such as intangible property interests in causes of action or contract rights.[246]

Moreover, the court noted, even if the plain meaning of section 362(a)(3) could be read as ambiguous, the majority approach conflicts with loose principles of statutory interpretation.[247] In this respect, the minority notes that "the act cannot be held to destroy itself."[248] The court observed that if the majority interpretation is adopted, a secured creditor's rights to (i) contest turnover, and (ii) request adequate protection would be negated.[249] Moreover, the court insisted that the majority approach leads to an absurd result.[250] For example, if turnover is not required because the condition precedent under section 363 is not satisfied or one of the three exceptions identified in *Whiting Pools* applies, an entity in possession of property repossessed prepetition will nonetheless have technically violated section 362(a)(3) before these issues have yet to be adjudicated by a bankruptcy court.[251]

Departing from *Whiting Pools*, the court explained that when a creditor retains possession of property it validly seized prepetition, it does so without interfering with property of the estate.[252] Under section 541(a)(1), possession is not an interest that comes into the estate upon filing.[253] Rather, only upon entry of a turnover order is the estate's possessory interest under sections 541(a)(3) and 541(a)(7) triggered.[254] The court questioned *Whiting Pools'* reliance on legislative history regarding property included in the estate under section 541(a)(1).[255] According to the court, section 542(a) does not provide an estate with a right to actual possession on the petition date. Instead, a turnover action is required so as to adjudicate any defenses that a creditor may have.[256]

Hall contains some fairly complicated and intense counter-arguments to the majority approach. *Hall's* discussion regarding turnover only upon satisfaction of the condition precedent in section 542(a) should not be discounted, as it provides a plausible basis for a creditor to assert adequate protection as a defense to turnover. *Hall's* discussion of pre-Bankruptcy Code practice is also notable in light of the Supreme Court's similar comments in *Whiting Pools*.

VI. *Conclusion*

Whether an entity violates section 362(a)(3) by passively retaining prop-

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erty of the estate repossessed prepetition should be a relatively straightforward issue. It is not. Unless and until Congress or the Supreme Court addresses the issue, uncertainty will persist. If the Supreme Court eventually grants certiorari, the Court's decision has the potential to profoundly impact bankruptcy cases regardless of whether they are filed under chapter 7, 11, 12 or 13.

NOTES:

[1]11 U.S.C.A. § 362(a)(3). The Bankruptcy Code is set forth in 11 U.S.C.A. §§ 101 et seq. Specific sections of the current Bankruptcy Code are identified as "section __." The term "trustee" as used herein generally refers to trustee under chapters 7, 11, and 12, a debtor in possession in chapters 11 and 12, and a debtor in chapter 13. See 11 U.S.C.A. §§ 704, 1107, 1202, 1303; see also 11 U.S.C.A. §§ 1104, 1204.

[2]In the 1962 film, *Lawrence of Arabia*, Mr. Dryden proclaims to General Murray that "[b]ig things have small beginnings." *Lawrence of Arabia* (Horizon Pictures 1962). In *Prometheus*, a less heralded film released fifty years after *Lawrence of Arabia*, the android David admiringly quotes Mr. Dryden as he embarks on a rather sinister endeavor. *Prometheus* (20th Century Fox 2012).

[3]11 U.S.C.A. § 103(a). The majority of decisions arise in chapter 13 cases, and in some instances chapter 11 cases. Although published decisions regarding chapter 7 cases are few in comparison, nothing suggests that the statutory authority should be any different in chapter 7 cases.

[4]Commentary on the issue is abundant. See, e.g., Anne Zoltani & Hon. Janice Miller Karlin, Examining § 362(a)(3): When "Stay" Means Stay, 36 Am. Bankr. Inst. J. 20 (May 2017); Alvin C. Harrell, Casenote: In re Jared Trenton Cowen: Does the Bankruptcy Automatic Stay Require Turnover of Collateral Repossessed Prepetition, 71 Consumer Fin. L. Quarterly Rep. 92 (2017); Dennis J. LeVine, Creditor Must Return Repossessed Vehicle Post-Chapter 13 Filing, 33 Am. Bankr. Inst. J. 16 (June 2014); Kathleen Bardsley, Collateral Repossessed Prepetition and the Automatic Stay After In re Weber, 22 Norton J. Bankr. L. & Prac. 6 (Nov. 2013); Hon. Lawrence S. Walter, Passive Retention of Repossessed Collateral is a Stay Violation: A Developing Trend Among Appellate Courts, 8 Norton Bankr. L. Adviser 1 (Aug. 2009); David Gray Carlson, Turnover of Collateral in Bankruptcy: Must a Secured Party-in-Possession Volunteer?, 6 Norton J. Bankr. L. & Prac. 483 (July/Aug. 1997); John C. Chobot, Some Bankruptcy Stay Metes and Bounds, 99 Comm. L.J. 301 (Fall 1994); see also Paul R. Hage et al., 27th Annual Conrad B. Duberstein National Bankruptcy Moot Court Competition Problem, 28 Norton J. Bankr. L. & Prac. 1 (Feb. 2019).

Over the last several years, two well-respected scholars have engaged in an ever-evolving, highly intellectual debate in which they explore the outer limits of the issue. Ralph Brubaker, Turnover, Adequate Protection, and the Automatic Stay (Part I): Origins and Evolution of the Turnover Power, 33 Bankr. L. Letter 8 (Aug. 2013); Ralph Brubaker, Turnover, Adequate Protection, and the Automatic Stay (Part II): Who is "Exercising Control" Over What?, 33 Bankr. L. Letter 9 (Sept. 2013) [hereinafter Brubaker, Turnover Part II]; Hon. Eugene R. Wedoff, The Automatic Stay Under § 362(a)(3) - One More Time, 38 Bankr. L. Letter 7 (July 2018) [hereinafter Wedoff, Automatic Stay]; Ralph Brubaker, Turnover, Adequate Protection, and the Automatic Stay: A Reply to Judge Wedoff, 38 Bankr. L. Letter 11 (Nov. 2018); see Hon. Eugene R. Wedoff, Return of Vehicles Seized Before a Chapter 13 Filing, Am. Bankr. Inst. J. (April 2019). The author is not attempting to join this debate.

[5]In re Weber, 719 F.3d 72, 69 Collier Bankr. Cas. 2d (MB) 1168, Bankr. L. Rep. (CCH) P 82484 (2d Cir. 2013); Thompson v. General Motors Acceptance Corp., LLC, 566 F.3d 699, 61 Collier Bankr. Cas. 2d (MB) 1611, Bankr. L. Rep. (CCH) P 81490 (7th Cir. 2009); In re

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Colortran, Inc., 165 F.3d 35 (9th Cir. 1998); In re Del Mission Ltd., 98 F.3d 1147, 29 Bankr. Ct. Dec. (CRR) 1155, 36 Collier Bankr. Cas. 2d (MB) 1658, Bankr. L. Rep. (CCH) P 77176, 36 Fed. R. Serv. 3d 512 (9th Cir. 1996); In re Knaus, 889 F.2d 773, 19 Bankr. Ct. Dec. (CRR) 1691, Bankr. L. Rep. (CCH) P 73117 (8th Cir. 1989); see In re Rozier, 376 F.3d 1323, Bankr. L. Rep. (CCH) P 80137 (11th Cir. 2004) (per curiam).

[6]In re Cowen, 849 F.3d 943, 63 Bankr. Ct. Dec. (CRR) 211, 77 Collier Bankr. Cas. 2d (MB) 438 (10th Cir. 2017); U.S. v. Inslaw, Inc., 932 F.2d 1467, 21 Bankr. Ct. Dec. (CRR) 1077, Bankr. L. Rep. (CCH) P 74056, 37 Cont. Cas. Fed. (CCH) P 76104 (D.C. Cir. 1991); see In re Garcia, 740 Fed. Appx. 163, Bankr. L. Rep. (CCH) P 83317 (10th Cir. 2018), cert. denied, 2019 WL 266858 (U.S. 2019) (applying rationale of Cowen in context of section 362(a)(4)).

[7]First Circuit: In re Carrigg, 216 B.R. 303, 31 Bankr. Ct. Dec. (CRR) 1324, Bankr. L. Rep. (CCH) P 77657 (B.A.P. 1st Cir. 1998) (majority); In re A & J Auto Sales, Inc., 210 B.R. 667, 97-1 U.S. Tax Cas. (CCH) P 50472, 79 A.F.T.R.2d 97-3037 (Bankr. D. N.H. 1997), aff'd, 223 B.R. 839, 98-1 U.S. Tax Cas. (CCH) P 50416, 81 A.F.T.R.2d 98-2002 (D.N.H. 1998) (finding violation under either majority or minority); In re Hilera, 1997 WL 34842743 (B.A.P. 1st Cir. 1997) (majority).

Third Circuit: In re Denby-Peterson, 576 B.R. 66, 93 U.C.C. Rep. Serv. 2d 1367 (Bankr. D. N.J. 2017), order aff'd, appeal dismissed, 595 B.R. 184 (D.N.J. 2018); In re APF Co., 274 B.R. 408 (Bankr. D. Del. 2001) (minority); In re U.S. Physicians, Inc., 235 B.R. 367, 34 Bankr. Ct. Dec. (CRR) 743 (Bankr. E.D. Pa. 1999), order aff'd, 2002 WL 31866247 (E.D. Pa. 2002) and order aff'd, 2002 WL 32364524 (E.D. Pa. 2002) (minority).

Fourth Circuit: In re Brown, 237 B.R. 316 (Bankr. E.D. Va. 1999) (majority); In re Massey, 210 B.R. 693 (Bankr. D. Md. 1997) (minority); In re Barrett, 62 Collier Bankr. Cas. 2d (MB) 601, 2009 WL 2058225 (Bankr. N.D. W. Va. 2009) (majority); In re Dillard, 2001 WL 1700026 (Bankr. M.D. N.C. 2001) (minority).

Fifth Circuit: Mitchell v. BankIllinois, 316 B.R. 891 (S.D. Tex. 2004) (majority); Nissan Motor Acceptance Corp. v. Baker, 239 B.R. 484 (N.D. Tex. 1999) (majority); In re Zaber, 223 B.R. 102 (Bankr. N.D. Tex. 1998) (majority); In re Richardson, 135 B.R. 256 (Bankr. E.D. Tex. 1992) (minority); Toyota Motor Credit Corporation v. Brinkley, 2019 WL 317446 (N.D. Tex. 2019) (majority); In re Parker, 2014 WL 35913 (Bankr. S.D. Miss. 2014) (majority); In re Foust, 36 Bankr. Ct. Dec. (CRR) 167, 2000 WL 33769159 (Bankr. S.D. Miss. 2000) (majority).

Sixth Circuit: In re Sharon, 234 B.R. 676, 1999 FED App. 0009P (B.A.P. 6th Cir. 1999) (majority); In re Kolberg, 199 B.R. 929 (W.D. Mich. 1996) (minority); In re Barringer, 244 B.R. 402, 43 Collier Bankr. Cas. 2d (MB) 1615 (Bankr. E.D. Mich. 1999) (minority); In re Cepero, 226 B.R. 595 (Bankr. S.D. Ohio 1998) (majority); In re Caffey, 2014 WL 3888318 (Bankr. N.D. Ohio 2014) (majority); see also In re Harchar, 393 B.R. 160, Bankr. L. Rep. (CCH) P 81303, 2008-2 U.S. Tax Cas. (CCH) P 50448, 102 A.F.T.R.2d 2008-5274 (Bankr. N.D. Ohio 2008), aff'd, 435 B.R. 480, Bankr. L. Rep. (CCH) P 81841, 2010-2 U.S. Tax Cas. (CCH) P 50579, 106 A.F.T.R.2d 2010-5954 (N.D. Ohio 2010), aff'd, 694 F.3d 639, 68 Collier Bankr. Cas. 2d (MB) 219, Bankr. L. Rep. (CCH) P 82341, 2012-2 U.S. Tax Cas. (CCH) P 50563, 110 A.F.T.R.2d 2012-5892 (6th Cir. 2012) (IRS did not exercise control by processing tax return).

[8]Tangentially, sections 349(b)(2), 522 and 554 are also worth considering.

[9]See U.S. v. Whiting Pools, Inc., 1983-2 C.B. 239, 462 U.S. 198, 202–203, 103 S. Ct. 2309, 76 L. Ed. 2d 515, 10 Bankr. Ct. Dec. (CRR) 705, 8 Collier Bankr. Cas. 2d (MB) 710, Bankr. L. Rep. (CCH) P 69207, 83-1 U.S. Tax Cas. (CCH) P 9394, 52 A.F.T.R.2d 83-5121 (1983) (explaining relationship among sections 541, 542 and 363, but not section 362); accord In re Weber, 719 F.3d at 78 (discussing relationship among sections 541, 542, 362 and 363); contra In re Cowen, 849 F.3d at 950 (noting no textual link exists between sections 362 and 542).

[10]11 U.S.C.A. § 541(a).

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[11]11 U.S.C.A. § 541(a)(1).

[12]Norton Bankr. L. & Prac. § 61:1 (3d ed. 2018).

[13]11 U.S.C.A. § 362(a).

[14]Compare 11 U.S.C.A. § 362(a) with e.g., 11 U.S.C.A. § 362(b).

[15]H.R. Rep. No. 95-595, at 340-41 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963, 6296-97; see Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection, 474 U.S. 494, 503, 106 S. Ct. 755, 88 L. Ed. 2d 859, 13 Bankr. Ct. Dec. (CRR) 1262, 13 Bankr. Ct. Dec. (CRR) 1269, 13 Collier Bankr. Cas. 2d (MB) 1355, 23 Env't. Rep. Cas. (BNA) 1913, Bankr. L. Rep. (CCH) P 70923, 16 Envtl. L. Rep. 20278 (1986) (citations omitted).

[16]Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

[17]11 U.S.C.A. § 362(a)(3) (1978).

[18]Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).

[19]11 U.S.C.A. § 362(a)(3) (2019) (emphasis added).

[20]The legislative history states that:

> This amendment makes it clear that . . . the automatic stay against acts to obtain possession of property of or from the estate also encompasses acts to exercise control over such property without the need for actually obtaining such property.

H.R. Rep. No. 96-1195, at 10 (1980).

[21]11 U.S.C.A. § 542(a).

[22]Whiting Pools, 462 U.S. at 207 n.12.

[23]11 U.S.C.A. § 363(b).

[24]11 U.S.C.A. § 363(c)(1); cf. 11 U.S.C.A. § 363(c)(2) (use of cash collateral).

[25]11 U.S.C.A. § 363(e) (emphasis added); see 11 U.S.C.A. § 361.

[26]See, e.g., Matter of Kain, 86 B.R. 506, 512, 17 Bankr. Ct. Dec. (CRR) 816, 18 Collier Bankr. Cas. 2d (MB) 1236 (Bankr. W.D. Mich. 1988) ("[I]f you don't ask for it, you won't get it."); see also Whiting Pools, 462 U.S. at 204 ("at the secured creditor's insistence," the bankruptcy court must limit or condition a trustee's ability to use, sell or lease property by requiring adequate protection); cf. 11 U.S.C.A. § 1326(a)(1)(C) (requiring debtor to make adequate protection payments). Once adequate protection has been requested, the trustee has the burden to prove that the adequate protection proposed in response to the request is sufficient to prevent a diminution in the value of property to be used, sold or leased. 11 U.S.C.A. § 363(p)(1).

[27]See, e.g., In re Bernstein, 252 B.R. 846, 849–51, 36 Bankr. Ct. Dec. (CRR) 211, 45 Collier Bankr. Cas. 2d (MB) 297 (Bankr. D. D.C. 2000); Matter of Brown, 210 B.R. 878, 884–85 (Bankr. S.D. Ga. 1997).

[28]11 U.S.C.A. § 363(e).

[29]11 U.S.C.A. § 363(e) ("the court, with or without a hearing, shall prohibit or condition . . .").

[30]462 U.S. at 205–207. At least one commentator has questioned the efficacy of *Whiting Pools*, describing it as "dead wrong" and "one of the most troubling decisions in bankruptcy." Thomas E. Plank, The Creditor in Possession Under the Bankruptcy Code: History, Text, and Policy, 59 Md. L. Rev. 253 (2000); Thomas E. Plank, The Outer Boundaries of the Bankruptcy Estate, 47 Emory L.J. 1193, 1234 (Fall 1998); see also Brubaker, Turnover Part II, supra note 4 (criticizing *Whiting Pools'* "dangerously misleading dictum"). Employing a "bundle of sticks" analogy, some courts and commentators contend that a debtor's interest in property as of the petition date is limited to those property rights available to the debtor under applicable

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non-bankruptcy law (e.g., a right of redemption). See, e.g., In re Barringer, 244 B.R. at 406–407; Brubaker, Turnover Part II, supra note 4 (citation omitted).

[31]Whiting Pools, 462 U.S. at 208 n.17. The same can be said for cases under chapter 12, which was enacted three years after *Whiting Pools*. See Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 255, 100 Stat. 3088 (1986).

[32]Whiting Pools, 462 U.S. at 201. Section 542(a) states that an entity must deliver to the trustee property that is in its control "during the case." This appears to be the only temporal limitation.

[33]See Whiting Pools, 462 U.S. at 201. Commentators have suggested tension exists between Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 116 S. Ct. 286, 133 L. Ed. 2d 258, 28 Bankr. Ct. Dec. (CRR) 97, 33 Collier Bankr. Cas. 2d (MB) 869, Bankr. L. Rep. (CCH) P 76666A (1995), a decision from the Supreme Court twelve years after *Whiting Pools*. See, e.g., Brubaker, Turnover Part II, supra note 4. In *Strumpf*, the court held that the trustee's right to turnover under section 542(b) is subject to the creditor's setoff rights under section 553. *Strumpf*, 516 U.S. at 20. Therefore, the trustee's right to turnover under section 542(a) is similarly subject to the creditor's right to adequate protection under section 363(e). Brubaker, Turnover Part II, supra note 4. *Strumpf*, which does not mention *Whiting Pools* even once, may be of limited relevance in the context of passive retention of property of the estate because only a promise to pay was at issue. See Strumpf, 516 U.S. at 21; see also Wedoff, Automatic Stay, supra note 4.

[34]See, e.g., Connecticut Nat. Bank v. Germain, 503 U.S. 249, 253–54, 112 S. Ct. 1146, 117 L. Ed. 2d 391, 22 Bankr. Ct. Dec. (CRR) 1130, 26 Collier Bankr. Cas. 2d (MB) 175, Bankr. L. Rep. (CCH) P 74457A (1992) (starting point of statutory interpretation is plain meaning of statute itself); U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 240–41, 109 S. Ct. 1026, 103 L. Ed. 2d 290, 18 Bankr. Ct. Dec. (CRR) 1150, Bankr. L. Rep. (CCH) P 72575, 89-1 U.S. Tax Cas. (CCH) P 9179, 63 A.F.T.R.2d 89-652 (1989) (same).

[35]See, e.g., Lamar, Archer & Cofrin, LLP v. Appling, 138 S. Ct. 1752, 1759, 201 L. Ed. 2d 102, 65 Bankr. Ct. Dec. (CRR) 194, Bankr. L. Rep. (CCH) P 83247 (2018) (citation omitted).

[36]Black's Law Dictionary 329 (6th ed. 1990).

[37]Webster's New Collegiate Dictionary 247 (1977).

[38]See, e.g., Thompson, 566 F.3d at 702.

[39]In re Weber, 719 F.3d at 79; see Thompson, 566 F.3d at 702; In re Sharon, 234 B.R. at 682.

[40]In re Cowen, 849 F.3d at 949.

[41]In re Cowen, 849 F.3d at 949; accord Ransom v. FIA Card Services, N.A., 562 U.S. 61, 70, 131 S. Ct. 716, 178 L. Ed. 2d 603, 54 Bankr. Ct. Dec. (CRR) 34, 64 Collier Bankr. Cas. 2d (MB) 1123, Bankr. L. Rep. (CCH) P 81914 (2011) (citation omitted) (all words of a statute must be given effect whenever possible).

[42]See, e.g., Denby-Peterson, 595 B.R. at 191.

[43]In re Cowen, 849 F.3d. at 949.

[44]See, e.g., Denby-Peterson, 595 B.R. at 190.

[45]In re Weber, 719 F.3d at 80 (citing Thompson, 566 F.3d at 702).

[46]Denby-Peterson, 595 B.R. at 190 (citation omitted) (quoting Penn. Dep't of Pub. Welfare v. Davenport, 495 U.S. 522, 563 (1990) ("[T]he Supreme Court has observed that a court should 'not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.' ")); see Lamar, ___ U.S. ___, 138 S.Ct. at 1762 (citations omitted); but see Hartford Underwriters Ins. Co. v. Union Planters Bank,

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N.A., 530 U.S. 1, 10, 120 S. Ct. 1942, 147 L. Ed. 2d 1, 36 Bankr. Ct. Dec. (CRR) 38, 43 Collier Bankr. Cas. 2d (MB) 861, Bankr. L. Rep. (CCH) P 78183 (2000) (citation omitted) ("[w]hile pre-Code practice 'informs our understanding of the language of the Code,' it cannot overcome that language.").

[47]Inslaw, 932 F.2d at 1474; contra Wedoff, Automatic Stay, supra note 4 (*Inslaw* incorrectly displaces "exercising" with "gaining").

[48]Inslaw, 932 F.2d at 1474 (citations omitted); see In re Giles, 271 B.R. 903, 906, 38 Bankr. Ct. Dec. (CRR) 262, 47 Collier Bankr. Cas. 2d (MB) 1213 (Bankr. M.D. Fla. 2002) (citing Strumpf, 516 U.S. at 20–21) (creditor's refusal to release garnishment to the detriment of prepetition lien rights acquired prepetition did not violate section 362(a)(3)); but see In re Bailey, 428 B.R. 694, 699 (Bankr. N.D. W. Va. 2010) (garnishing creditor violates section 362(a)(3) by not acting to release garnishment); In re Roche, 361 B.R. 615, 622, 55 Collier Bankr. Cas. 2d (MB) 1210 (Bankr. N.D. Ga. 2005) (same).

[49]Denby-Peterson, 595 B.R. at 190–91; accord Dewsnup v. Timm, 502 U.S. 410, 419, 112 S. Ct. 773, 116 L. Ed. 2d 903, 22 Bankr. Ct. Dec. (CRR) 750, 25 Collier Bankr. Cas. 2d (MB) 1297, Bankr. L. Rep. (CCH) P 74361A (1992) (citation omitted) (when Congress amends the Bankruptcy Code, it does not write "on a clean slate").

[50]In re Cowen, 849 F.3d at 949–50 (emphasis in original); see Denby-Peterson, 595 B.R. at 190–91.

[51]See, e.g., In re Weber, 719 F.3d at 75; Thompson, 566 F.3d at 706 (citations omitted).

[52]Compare 11 U.S.C.A. § 542(a) ("shall") with 11 U.S.C.A. § 542(e) ("may"). See, e.g., In re Del Mission Ltd., 98 F.3d at 115; see also S. Rep. No. 95-989, 95th Cong., 2d Sess. 84 (1978); H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 369 (1977).

[53]Compare 11 U.S.C.A. § 542(a) with 11 U.S.C.A. § 542(e). The term "after notice and a hearing" is defined as "after such notice as is appropriate under the circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances." 11 U.S.C.A. § 102(1)(A). However, an actual hearing need not occur where, among other things, "there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act." 11 U.S.C.A. § 102(1)(B)(ii).

[54]In re Sharon, 234 B.R. at 686 (quoting In re Colortran, Inc., 210 B.R. at 827).

[55]In re Hall, 502 B.R. at 668 (under section 541(a)(7), estate has equitable, not possessory, interest until court enters turnover order).

[56]In re Hall, 502 B.R. at 667–68.

[57]See Whiting Pools, 462 U.S. at 208 (citations omitted).

[58]In re Hall, 502 B.R. at 654–59; see In re Young, 193 B.R. 620, 625–26 (Bankr. D. D.C. 1996). The *Hall* court raises an interesting point. The majority generally fails to address the means by which to adjudicate the condition precedent and the three exceptions. It is unclear whether an entity in possession or control of property faces an all or nothing proposition - either prevail or be found to have violated the automatic stay. Neither the majority nor the minority devote much attention to what role, if any, section 554 plays, given that sections 542(a) and 554(a)-(b) refer to property with an "inconsequential value or benefit to the estate."

[59]See, e.g., In re Barringer, 244 B.R. at 410; In re Richardson, 135 B.R. at 259–60; cf Schwab v. Reilly, 560 U.S. 770, 779 n.5, 130 S. Ct. 2652, 177 L. Ed. 2d 234, 53 Bankr. Ct. Dec. (CRR) 78, Bankr. L. Rep. (CCH) P 81787 (2010) (Federal Rules of Bankruptcy Procedure must be read in light of Bankruptcy Code and "yield in the event of a conflict").

[60]See, e.g., In re Cowen, 849 F.3d at 950 (citations omitted); Denby-Peterson, 595 B.R. at 194. Section 105(a) provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions, . . ." of the Bankruptcy Code. 11 U.S.C.A. § 105(a)."

[61]See, e.g., Thompson, 566 F.3d at 703–706.

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[62]In re Weber, 719 F.3d at 81–82.

[63]See, e.g., In re Sharon, 234 B.R. at 683 (citing Whiting Pools, 462 U.S. at 211–12).

[64]Thompson, 566 F.3d at 706 (citations omitted) (emphasis in original).

[65]In re Hall, 502 B.R. at 668.

[66]In re Hall, 502 B.R. at 659–660 (citations omitted) (emphasis in original); see In re Massey, 210 B.R. at 695–96 (explicit purpose of section 362(a)(3) is to maintain status quo until court can consider parties' respective rights in property); In re Dillard, 2001 WL 1700026, at *3 (Bankr. M.D. N.C. 2001) (creditor entitled to retain possession until chapter 13 debtor provides adequate protection in form of proof of insurance and first plan payment).

[67]Thompson, 566 F.3d at 706–707.

[68]Thompson, 566 F.3d at 707; In re Sharon, 234 B.R. at 685; see also 11 U.S.C.A. § 554(b).

[69]Denby-Peterson, 595 B.R. at 192.

[70]The Bankruptcy Code seems to address the latter by vacating turnover. See 11 U.S.C.A. § 349(b)(2) (dismissal vacates any order for turnover under section 542). However, section 349(b)(2) refers to an "order" under section 542, perhaps indicating that section 542(a) is not as self-effectuating as the majority contends. Moreover, the fact that an order is vacated does not remedy the reality - while a trustee will likely adhere to section 349(b)(2), a chapter 13 debtor may not be so inclined. Or, maybe that is simply an inherent risk of any secured creditor.

[71]In re Thompson, 566 F.3d at 706–707.

[72]See, e.g., In re Cowen, 849 F.3d at 948–49; accord Hartford Underwriters, 530 U.S. at 13–14 (citations omitted) (court should not "assess the relative merits of different approaches to various bankruptcy problems," but must instead accept the natural reading of a statute and leave the task of achieving a better policy outcome to Congress); see also Davis v. Michigan Dept. of Treasury, 489 U.S. 803, 808 n.3, 109 S. Ct. 1500, 103 L. Ed. 2d 891, 10 Employee Benefits Cas. (BNA) 2097, 89-2 U.S. Tax Cas. (CCH) P 9456, 63 A.F.T.R.2d 89-1174 (1989) (court should review legislative history and purpose only if statute ambiguous).

[73]See supra notes 5 and 7.

[74]To some extent, the summary of decisions is unavoidably redundant.

[75]In re Knaus, 889 F.2d at 773.

[76]In re Knaus, 889 F.2d at 774.

[77]In re Knaus, 889 F.2d at 774.

[78]In re Knaus, 889 F.2d at 774.

[79]In re Knaus, 889 F.2d at 774.

[80]In re Knaus, 889 F.2d at 774.

[81]In re Knaus, 889 F.2d at 775.

[82]In re Knaus, 889 F.2d at 775 (citations omitted).

[83]In re Knaus, 889 F.2d at 775 (citation omitted).

[84]In re Knaus, 889 F.2d at 775.

[85]In re Del Mission Ltd., 98 F.3d at 1147.

[86]In re Del Mission Ltd., 98 F.3d at 1149.

[87]In re Del Mission Ltd., 98 F.3d at 1149.

[88]In re Del Mission Ltd., 98 F.3d at 1149.

[89]In re Del Mission Ltd., 98 F.3d at 1149–50.

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[90]In re Del Mission Ltd., 98 F.3d at 1150.

[91]In re Del Mission Ltd., 98 F.3d at 1150.

[92]In re Del Mission Ltd., 98 F.3d at 1151.

[93]In re Del Mission Ltd., 98 F.3d at 1151.

[94]In re Del Mission Ltd., 98 F.3d at 1151 (citation omitted).

[95]In re Del Mission Ltd., 98 F.3d at 1151–52. Notably, the Ninth Circuit rejected and characterized as "frivolous" the State's argument that it did not repay the estate because the trustee failed to make a demand. In re Del Mission Ltd., 98 F.3d at 1152.

[96]In re Abrams, 127 B.R. 239, 21 Bankr. Ct. Dec. (CRR) 1283, 25 Collier Bankr. Cas. 2d (MB) 15, Bankr. L. Rep. (CCH) P 74023 (B.A.P. 9th Cir. 1991).

[97]In re Abrams, 127 B.R. at 241–42.

[98]In re Abrams, 127 B.R. at 242 (citing Knaus, 889 F.2d 775).

[99]See, e.g., In re Fitch, 217 B.R. 286, 290–91, 32 Bankr. Ct. Dec. (CRR) 152 (Bankr. S.D. Cal. 1998) (distinguishing Del Mission Ltd. and concluding that the right to possess collateral was not property of estate, thus entitling creditor to adequate protection as condition to turnover).

[100]In re Rozier, 376 F.3d at 1323; contra In re Lewis, 137 F.3d 1280, 1284, 32 Bankr. Ct. Dec. (CRR) 488, Bankr. L. Rep. (CCH) P 77671, 35 U.C.C. Rep. Serv. 2d 740 (11th Cir. 1998) (debtor's interest in property limited to right of redemption); cf. In re Kalter, 292 F.3d 1350, 1360, 39 Bankr. Ct. Dec. (CRR) 186, 48 Collier Bankr. Cas. 2d (MB) 474, Bankr. L. Rep. (CCH) P 78668, 48 U.C.C. Rep. Serv. 2d 411 (11th Cir. 2002) (title to vehicles passed upon repossession prepetition under applicable non-bankruptcy law).

[101]In re Rozier, 376 F.3d at 1324.

[102]In re Rozier, 376 F.3d at 1324.

[103]In re Rozier, 376 F.3d at 1324.

[104]See In re Stephens, 495 B.R. 608, 614 (Bankr. N.D. Ga. 2013) (noting that the Eleventh Circuit has not addressed the issue but generally citing to *Rozier* in a footnote).

[105]Thompson, 566 F.3d at 699.

[106]Thompson, 566 F.3d at 701.

[107]Thompson, 566 F.3d at 701.

[108]Thompson, 566 F.3d at 701 (citing In re Nash, 228 B.R. 669 (Bankr. N.D. Ill. 1999); In re Spears, 223 B.R. 159 (Bankr. N.D. Ill. 1998)).

[109]Thompson, 566 F.3d at 701.

[110]Thompson, 566 F.3d at 702 (citing Merriam-Webster's Collegiate Dictionary (11th ed. 2013)).

[111]Thompson, 566 F.3d at 702.

[112]Thompson, 566 F.3d at 702–703.

[113]Thompson, 566 F.3d at 702 (internal citations omitted).

[114]Thompson, 566 F.3d at 703.

[115]Thompson, 566 F.3d at 703 (citing In re Knaus, 889 F.2d at 773; In re Yates, 332 B.R. 1, 7, 54 Collier Bankr. Cas. 2d (MB) 1901, 8 A.L.R. Fed. 2d 837 (B.A.P. 10th Cir. 2005); In re Sharon, 234 B.R. at 685; In re Abrams, 127 B.R. at 239).

[116]Thompson, 566 F.3d at 703–704.

[117]Thompson, 566 F.3d at 704.

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[118]Thompson, 566 F.3d at 704.

[119]Thompson, 566 F.3d at 704 (citations omitted). The court declined to apply pre-Bankruptcy Code procedure that required a trustee to offer adequate protection prior to the court ordering turnover. In re Thompson, 566 F.3d at 705–706 (citations omitted).

[120]Thompson, 566 F.3d at 705.

[121]Thompson, 566 F.3d at 706.

[122]Thompson, 566 F.3d at 706 (citation omitted).

[123]Compare e.g., In re Avila, 566 B.R. 558, 77 Collier Bankr. Cas. 2d (MB) 709 (Bankr. N.D. Ill. 2017) with e.g., In re Cross, 584 B.R. 833 (Bankr. N.D. Ill. 2018).

[124]In re Fulton, 588 B.R. 834 (Bankr. N.D. Ill. 2018); In re Shannon, 590 B.R. 467 (Bankr. N.D. Ill. 2018); In re Peake, 588 B.R. 811 (Bankr. N.D. Ill. 2018); In re Howard, 585 B.R. 252 (Bankr. N.D. Ill. 2018), appeal filed, No. 18-2527 (7th Cir. July 13, 2018).

[125]In re Weber, 719 F.3d at 72.

[126]In re Weber, 719 F.3d at 74.

[127]In re Weber, 719 F.3d at 74.

[128]In re Weber, 719 F.3d at 74.

[129]In re Weber, 719 F.3d at 74.

[130]In re Weber, 719 F.3d at 74–75.

[131]In re Weber, 719 F.3d at 75. The district court declined to follow its prior decision in another case that provided a basis for the creditor's refusal to turn over property of the estate absent a turnover order. See In re Alberto, 271 B.R. 223 (N.D. N.Y. 2001).

[132]In re Weber, 719 F.3d at 79 (citing Collier on Bankruptcy § 542.02 (16th ed. 2012)). *Weber* states that turnover is self-effectuating, "without condition," so long as the trustee can use, sell or lease the property. In re Weber, 719 F.3d at 79. However, a fair reading of *Weber* reveals that the three exceptions were implicitly recognized by the Second Circuit's citation to *Whiting Pools*. See In re Weber, 719 F.3d at 77–78 (citing Whiting Pools, 462 U.S. at 205–206).

[133]In re Weber, 719 F.3d at 80.

[134]In re Weber, 719 F.3d at 80.

[135]In re Weber, 719 F.3d at 79 (citation omitted).

[136]In re Weber, 719 F.3d at 79.

[137]In re Weber, 719 F.3d at 81–82.

[138]In re Weber, 719 F.3d at 81–82.

[139]In re Sharon, 234 B.R. at 676.

[140]In re Sharon, 234 B.R. at 680.

[141]In re Sharon, 234 B.R. at 680.

[142]In re Sharon, 234 B.R. at 680.

[143]In re Sharon, 234 B.R. at 680.

[144]In re Sharon, 234 B.R. at 680.

[145]In re Sharon, 234 B.R. at 680.

[146]In re Sharon, 234 B.R. at 680.

[147]In re Sharon, 234 B.R. at 681.

[148]In re Sharon, 234 B.R. at 681.

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[149]In re Sharon, 234 B.R. at 681.

[150]In re Sharon, 234 B.R. at 681. Because section 1303 provides a chapter 13 debtor with certain rights of a trustee under section 363, the court concluded that section 1303 "supplies the 'usable under § 363' predicate" under *Whiting Pools*. In re Sharon, 234 B.R. at 681–82, 687; but see In re Brown, 210 B.R. at 882–88 (because section 1303 does not grant chapter 13 debtor rights under section 542, debtor's right to use, sell or lease property of estate under sections 1306(b) and 363 is subject to creditor's right of adequate protection under section 363(e)).

[151]In re Sharon, 234 B.R. at 682.

[152]In re Sharon, 234 B.R. at 682 (citing In re Del Mission Ltd., 98 F.3d at 1151; In re Javens, 107 F.3d 359, 368, 30 Bankr. Ct. Dec. (CRR) 541, 37 Collier Bankr. Cas. 2d (MB) 950, 1997 FED App. 0065P (6th Cir. 1997)).

[153]In re Sharon, 234 B.R. at 682 (citations omitted).

[154]In re Sharon, 234 B.R. at 683 (citing Whiting Pools, 462 U.S. at 211–12).

[155]In re Sharon, 234 B.R. at 683–84.

[156]In re Sharon, 234 B.R. at 684.

[157]In re Sharon, 234 B.R. at 685.

[158]In re Sharon, 234 B.R. at 685; see 11 U.S.C.A. § 362(f) (relief from automatic stay may be granted "with or without a hearing . . . to prevent irreparable damage").

[159]In re Sharon, 234 B.R. at 685.

[160]In re Sharon, 234 B.R. at 684.

[161]In re Sharon, 234 B.R. at 686.

[162]In re Sharon, 234 B.R. at 688–89 (Stosberg, J., dissenting); see In re Barringer, 244 B.R. at 409 (disagreeing with Sharon).

[163]In re Sharon, 234 B.R. at 689.

[164]In re Sharon, 234 B.R. at 689.

[165]In re Sharon, 234 B.R. at 690.

[166]See supra notes 6 and 7.

[167]932 F.2d at 1467.

[168]Inslaw, 932 F.2d at 1469.

[169]Inslaw, 932 F.2d at 1469.

[170]Inslaw, 932 F.2d at 1469.

[171]Inslaw, 932 F.2d at 1470.

[172]Inslaw, 932 F.2d at 1470.

[173]Inslaw, 932 F.2d at 1470.

[174]Inslaw, 932 F.2d at 1470–71. As part of the debtor's separate request, the court found that the government had further violated the automatic stay when the Department of Justice urged the Office of the United States Trustee to request conversion of the case to chapter 7. Inslaw, 932 F.2d at 1471.

[175]Inslaw, 932 F.2d at 1472.

[176]Inslaw, 932 F.2d at 1472; see In re U.S. Physicians, Inc., 235 B.R. 367, 376, 34 Bankr. Ct. Dec. (CRR) 743 (Bankr. E.D. Pa. 1999), order aff'd, 2002 WL 31866247 (E.D. Pa. 2002) and order aff'd, 2002 WL 32364524 (E.D. Pa. 2002) (entity's failure to return prepetition receivables violated underlying contract, not automatic stay).

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[177]Inslaw, 932 F.2d at 1472.

[178]Inslaw, 932 F.2d at 1472–73 (citations omitted).

[179]Inslaw, 932 F.2d at 1473.

[180]Inslaw, 932 F.2d at 1474.

[181]Inslaw, 932 F.2d at 1474.

[182]Inslaw, 932 F.2d at 1474.

[183]In re Cowen, 849 F.3d at 945–46.

[184]In re Cowen, 849 F.3d at 945.

[185]In re Cowen, 849 F.3d at 946.

[186]In re Cowen, 849 F.3d at 946.

[187]In re Cowen, 849 F.3d at 946.

[188]In re Cowen, 849 F.3d at 946.

[189]In re Cowen, 849 F.3d at 946.

[190]In re Cowen, 849 F.3d at 946.

[191]In re Cowen, 849 F.3d at 946.

[192]In re Cowen, 849 F.3d at 946.

[193]In re Cowen, 849 F.3d at 946.

[194]In re Cowen, 849 F.3d at 946.

[195]In re Cowen, 849 F.3d at 946–47.

[196]In re Cowen, 849 F.3d at 948–49.

[197]In re Cowen, 849 F.3d at 949.

[198]In re Cowen, 849 F.3d at 949.

[199]In re Cowen, 849 F.3d at 949 (citing Whitman v. American Trucking Associations, 531 U.S. 457, 468, 121 S. Ct. 903, 149 L. Ed. 2d 1, 51 Env't. Rep. Cas. (BNA) 2089, 31 Envtl. L. Rep. 20512 (2001)).

[200]In re Cowen, 849 F.3d at 949.

[201]In re Cowen, 849 F.3d at 949 (citing In re Bernstein, 252 B.R. at 848).

[202]In re Cowen, 849 F.3d at 949–50 (citing Brubaker, Turnover Part II, supra note 4).

[203]In re Cowen, 849 F.3d at 950 (citing In re Hall, 502 B.R. at 665).

[204]In re Cowen, 849 F.3d at 950 (emphasis in original).

[205]In re Cowen, 849 F.3d at 950.

[206]In re Cowen, 849 F.3d at 950.

[207]In re Cowen, 849 F.3d at 950.

[208]See In re Garcia, 2017 WL 2951439 (Bankr. D. Kan. 2017), aff'd, 740 Fed. Appx. 163, Bankr. L. Rep. (CCH) P 83317 (10th Cir. 2018), cert. denied, 2019 WL 266858 (U.S. 2019); In re Waldrop, 2017 WL 1183937 (Bankr. W.D. Okla. 2017).

[209]In re Garcia, 740 Fed. Appx. 163, Bankr. L. Rep. (CCH) P 83317 (10th Cir. 2018), cert. denied, 2019 WL 266858 (U.S. 2019)

[210]Denby-Peterson, 595 B.R. at 192.

[211]Denby-Peterson, 595 B.R. at 187.

[212]Denby-Peterson, 595 B.R. at 187.

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[213]Denby-Peterson, 595 B.R. at 187.

[214]Denby-Peterson, 595 B.R. at 187.

[215]Denby-Peterson, 595 B.R. at 187.

[216]Denby-Peterson, 576 B.R. at 82–83.

[217]Denby-Peterson, 595 B.R. at 190. While the appeal was pending, the debtor's bankruptcy case was dismissed. Because damages under section 362(k) were at issue, the court concluded that the appeal was not moot. Denby-Peterson, 595 B.R. at 188 (citations omitted).

[218]Denby-Peterson, 595 B.R. at 190.

[219]Denby-Peterson, 595 B.R. at 190.

[220]Denby-Peterson, 595 B.R. at 190–91.

[221]Denby-Peterson, 595 B.R. at 191.

[222]Denby-Peterson, 595 B.R. at 191–92.

[223]Denby-Peterson, 595 B.R. at 192.

[224]Denby-Peterson, 595 B.R. at 192, 194 n.10. The court did not thoroughly explain the legal basis for this exception, which seems to require turnover if adequate protection in the form of insurance is provided.

[225]Denby-Peterson v. NU2U Autoworld, No. 18-3562 (3d Cir. Nov. 28, 2018).

[226]In re Hall, 502 B.R. at 650. *Hall* is part of a trilogy of decisions from the Bankruptcy Court for the District of Columbia. See In re Bernstein, 252 B.R. at 846; In re Young, 193 B.R. at 620. *Barringer* might be considered a companion to this trilogy, as it similarly presents counter-arguments to the majority approach. See In re Barringer, 244 B.R. at 406–410.

[227]In re Hall, 502 B.R. at 652.

[228]In re Hall, 502 B.R. at 652.

[229]In re Hall, 502 B.R.at 652.

[230]In re Hall, 502 B.R. at 652.

[231]In re Hall, 502 B.R. at 653.

[232]In re Hall, 502 B.R. at 654–72; see In re Bernstein, 252 B.R. at 849–51.

[233]In re Hall, 502 B.R. at 654–55.

[234]In re Hall, 502 B.R. at 656 (citing R. F. C. v. Kaplan, 185 F.2d 791 (1st Cir. 1950)); accord Whiting Pools, 462 U.S. at 208 (citing Kaplan, 185 F.2d at 796).

[235]In re Hall, 502 B.R. at 657.

[236]In re Hall, 502 B.R. at 658 (citations omitted). The court relied on the principle of statutory construction that words in a statute should be given the same meaning. In re Hall, 502 B.R. at 658 n.18 (citations omitted). Because section 542(b) also includes the term "shall" and is interpreted permissively, the court concluded section 542(a) should be interpreted similarly. In re Hall, 502 B.R. at 658–59; cf. Strumpf, 516 U.S. at 20 (identifying section 553 as exception in section 542(b) but making no mention of the permissive nature of section 542(b)).

[237]In re Hall, 502 B.R. at 659 (citations omitted).

[238]In re Hall, 502 B.R. 659.

[239]In re Hall, 502 B.R. at 663.

[240]In re Hall, 502 B.R. at 663. The court suggested that any illegitimate defenses are more appropriately addressed under Rule 9011 of the Federal Rules of Bankruptcy Procedure. In re Hall, 502 B.R. at 663.

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[241] In re Hall, 502 B.R. at 660.

[242] In re Hall, 502 B.R. at 660–61. The court highlighted a perceived flaw in the majority approach because some courts have inexplicably created an exception to turnover where possessory liens are involved. In re Hall, 502 B.R. at 661 (citing In re WEB2B Payment Solutions, Inc., 488 B.R. 387, 393, 57 Bankr. Ct. Dec. (CRR) 202, Bankr. L. Rep. (CCH) P 82449 (B.A.P. 8th Cir. 2013)).

[243] In re Hall, 502 B.R. at 664.

[244] In re Hall, 502 B.R. at 664–65.

[245] In re Hall, 502 B.R. at 665 (citation omitted).

[246] In re Hall, 502 B.R. at 663 (citations omitted).

[247] In re Hall, 502 B.R. at 665–66; see Conn. Nat'l Bank, 503 U.S. at 253–54 (court should consider canons of construction prior to legislative history).

[248] In re Hall, 502 B.R. 650, 666, 59 Bankr. Ct. Dec. (CRR) 6 (Bankr. D. D.C. 2014) (quoting Strumpf, 516 U.S. at 20).

[249] In re Hall, 502 B.R. at 660.

[250] In re Hall, 502 B.R. at 666.

[251] In re Hall, 502 B.R. at 666.

[252] In re Hall, 502 B.R. at 667; accord In re Barringer, 244 B.R. at 407 n.4 (majority "misconstrues" Whiting Pools).

[253] In re Hall, 502 B.R. at 667; contra Whiting Pools, 462 U.S. at 205–209.

[254] In re Hall, 502 B.R. at 667.

[255] In re Hall, 501 B.R. at 668 (citation omitted); cf. Wedoff, Automatic Stay, supra note 4 (noting that other than Hall, no judicial decision adopts such position with respect to property of the estate); but see also In re Barringer, 244 B.R. at 407.

[256] In re Hall, 502 B.R. at 669. The court criticized the majority's reliance on section 362(f) as misplaced. In re Hall, 502 B.R. at 669–71.