SECTIONS 542 AND 543—TURNOVER OF PROPERTY OF THE ESTATE

By Bruce Grohsgal and Gregory J. Flasser[1]

I. INTRODUCTION

Section 542 of the Bankruptcy Code generally requires a noncustodial entity who has possession, custody, or control of property of the estate that the trustee may use, sell, or lease under § 363, or that the debtor may exempt under § 522, to deliver to the trustee the property or the value of the property, and to account for such property.[1] Section 543 similarly requires a custodian with knowledge of the commencement of the case to deliver such property and the proceeds of such property to the trustee and account for such property.[2] This paper reports on opinions regarding turnover published since the 2016 Annual Survey.[3]

II. JURISDICTION AND AUTHORITY OF THE BANKRUPTCY COURTS

Jurisdiction and Authority — Generally

Bankruptcy jurisdiction is essentially *in rem*, based on the district court's exclusive jurisdiction over all property, wherever located, of the debtor's estate.[4] The court's jurisdiction begins on the filing of the bankruptcy case and for most purposes ends when the property is transferred from the

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[1]11 U.S.C.A. § 542.

[2]11 U.S.C.A. § 543.

[3]The opinions considered in this update are mostly from early 2016 through early 2017.

[4]*Central Virginia Community College v. Katz*, 546 U.S. 356, 126 S. Ct. 990, 995, 163 L. Ed. 2d 945, 45 Bankr. Ct. Dec. (CRR) 254, 54 Collier Bankr. Cas. 2d (MB) 1233, Bankr. L. Rep. (CCH) P 80443 (2006).

estate or revests in the debtor[5] or the case is dismissed.[6] The bankruptcy court stands in the district court's shoes with respect to its jurisdiction over estate property, by virtue of the standing order of reference from its district court, and has exclusive jurisdiction over property of the debtor's estate.[7]

The statutory framework for this jurisdiction is set forth in 28 U.S.C. § 157. Section 157(b) gives bankruptcy judges the statutory authority to enter final judgments on certain "core" matters arising under or arising in the bankruptcy case. "Core" matters expressly include "orders to turn over property of the estate."[8]

By comparison, the bankruptcy judge does not have authority under § 157 to enter a final judgment on a matter that is not core but is merely "related to" the bankruptcy case. A ubiquitous example of a non-core action is a suit by a debtor to recover a disputed prepetition account receivable. The bankruptcy judge may hear such a non-core, "related to" matter, but it cannot enter final judgment on it unless the parties have consented to the bankruptcy court's authority to enter final judgment. Absent such consent, the bankruptcy judge may only submit his proposed findings of fact and conclusions of law to the district court. The district judge following her *de novo* consideration of both the facts and the law, then enters or declines to enter the final judgment.[9]

The Supreme Court threw this statutory regime into Constitutional chaos when it issued its 2011 opinion in *Stern v. Marshall*.[10] *Stern* held that because the bankruptcy courts are established under Article I rather than Article III of the Constitution, and bankruptcy judges do not have lifetime tenure as required for Article III judges, a bankruptcy judge may have statutory authority but not the Constitutional authority

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[5] *In re Wellesley Realty Associates, LLC*, 2015 WL 2261680, *13 (Bankr. D. Mass. 2015).

[6] *In re Goldsmith*, 2012 WL 3201840, *2-3 (Bankr. W.D. Pa. 2012) (effect of dismissal).

[7] 28 U.S.C.A. § 1334(c).

[8] 28 U.S.C. § 157(b)(2)(E).

[9] 28 U.S.C. § 157(c).

[10] *Stern v. Marshall*, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011).

to enter a final order on some matters defined as "core" in § 157(b). The Supreme Court would later describe this type of proceeding as "a so-called '*Stern* claim,' that is, 'a claim designated for final adjudication in the bankruptcy court as a statutory matter, but prohibited from proceeding in that way as a constitutional matter.' "[11]

The proper characterization of any specific turnover claim for jurisdictional purposes was problematic before *Stern*, and has become more so since that case was decided. The bankruptcy court's authority to enter a final judgment on the turnover count of a complaint depends entirely on whether the turnover action involves a straightforward surrender of estate property — which is a "core" proceeding — or is more properly characterized as another kind of dispute, such as a prepetition contract claim, that is only "related to" the bankruptcy case. Only the former proceeding is "Constitutionally core," on which the bankruptcy can court enter final judgment. Accordingly, turnover complaints continue to be closely scrutinized, especially in the wake of the Supreme Court's *Stern* decision.

The Seventh Circuit in *In re Tolomeo* suggested that a case in which turnover of property from an alter ego is sought can be both Constitutionally and statutorily "core." The debtor's creditors in *Tolomeo* filed an adversary complaint, for a determination that the debtor's principals were alter egos of the debtor. The creditors asked the court to direct those principals to turn over certain assets to the chapter 7 trustee to be liquidated for distribution of the proceeds to the creditors. The bankruptcy court recommended to the district court that judgment on the pleadings should be granted and the district court did so, noting that the undisputed facts substantially showed that the defendants were alter egos of the debtor, the corporate veils should be pierced, and the assets "brought into the Debtor's bankruptcy estate." The defendants appealed. The Seventh Circuit dismissed the appeal, noting that the "turnover of the defendants' assets to the debtor's estate, and the liquidation of the assets for the benefit of the defendants, is a core proceeding, see 28 U.S.C. § 157(b)(2)(E), based therefore on bankruptcy law, and so the limitations on the bankruptcy

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[11] *Wellness Intern. Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1941-1942, 191 L. Ed. 2d 911, 61 Bankr. Ct. Dec. (CRR) 32, 73 C.B.C. 1575, Bankr. L. Rep. (CCH) P 82806 (2015).

court's authority that are imposed by section 157(c)(1)" — limiting the bankruptcy court's authority to enter a final judgment — "are irrelevant, because those limitations are applicable only to a bankruptcy court's administration of non-core proceedings."[12]

The district court in *Reed v. Nathan*, also discussed in § VII below, held that the bankruptcy court had not exceeded its authority when it determined that the property that the trustee sought to have turned over was property of the estate, and then entered its final order directing that the property be turned over. The district court affirmed the bankruptcy court's turnover order. In the alternative, the district court treated the turnover order as proposed findings of fact and conclusions of law, which it adopted as its own findings of fact and conclusions of law, and granted its own turnover order.[13]

The liquidating trustee in *In re Patriot Coal Corp.*, further discussed below in this § II and in § X, filed a complaint against a state taxing authority seeking the bankruptcy court's determination of the bankruptcy estate's tax refunds. The bankruptcy court held that the complaint did not sufficiently set forth an undisputed right to the tax refunds, and thus did not state a proper claim for turnover.[14]

Claims Allowance

The district court in *In re FKF 3, LLC* held that a party's filing of a proof of claim can give rise to the bankruptcy court's final adjudicative authority over the chapter 7 trustee's turnover and state law conversion claim against the same party. The creditor filed proofs of claim in the case. The trustee filed his complaint against the creditor seeking turnover and judgment against the creditor under a state law conversion theory. The trustee conceded that "conversion is a common-law claim that generally must be finally adjudicated by an Article III court." The trustee also argued, however, that the conversion claim sought recovery of the "exact same funds" as those sought through the trustee's turnover and fraudulent conveyance claims." Thus, the conversion claim would "necessarily

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[12] *In re Tolomeo*, 832 F.3d 815, 816-817, 62 Bankr. Ct. Dec. (CRR) 249 (7th Cir. 2016).

[13] *Reed v. Nathan*, 558 B.R. 800, 804, 820 (E.D. Mich. 2016).

[14] *In re Patriot Coal Corporation*, 562 B.R. 632, 646 (Bankr. E.D. Va. 2016).

be determined by the Bankruptcy Court inconnection with [the] various turnover and avoidance actions implicated by § 502(d)." Code section 502(d) provides that "the court shall disallow any claim of any entity from which property is recoverable under" Code sections 542 or 543.

The district court agreed. The creditor's filing of a proof of claim automatically triggered the claims-allowance process. As part of that process, Code § 502(d) required resolution of the trustee's turnover claim under § 542. Under New York law, two key elements of conversion are the plaintiff's possessory right or interest in the property and the defendant's dominion over the property or interference with it, in derogation of the plaintiff's rights. Because of the "complete overlap in the elements of each claim," the court found that the resolution of the turnover claim, which would need to be resolved as part of the claims allowance process triggered by the creditor's proofs of claim, would "necessarily resolve" the trustee's conversion claim. Accordingly, the bankruptcy court had final adjudicative authority over the trustee's conversion claim.[15]

Rooker-Feldman

The debtor in *In re LB Steel, LLC*, also discussed in § XIII below, filed its complaint seeking turnover of funds on deposit with the Clerk of the Illinois Circuit Court in connection with a construction project. The Rooker-Feldman doctrine prevents "lower federal courts from exercising jurisdiction over cases brought by state-court losers challenging state-court judgments rendered before the [federal] court proceedings commenced." Another party claiming the fund argued that the bankruptcy court's awarding relief on the turnover claim would require the court to review and ultimately overrule the state court judgment that established the fund and thus would violate the Rooker-Feldman doctrine.[16] The bankruptcy court determined that the debtor was properly seeking review of the state court order through a state court appeal, and was not challenging that order through the turnover complaint. Rather, the debtor by its turnover action contended that the fund was "property of the bankruptcy estate *pursuant to* the

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[15] *In re FKF 3, LLC*, 2016 WL 4540842, *13 (S.D. N.Y. 2016).

[16] *In re LB Steel, LLC*, 547 B.R. 790, 794-795, 76 Collier Bankr. Cas. 2d (MB) 835 (Bankr. N.D. Ill. 2016), quoting *Lance v. Dennis*, 546 U.S. 459, 460, 126 S. Ct. 1198, 163 L. Ed. 2d 1059 (2006).

Judgment Order." Thus, the Rooker-Feldman doctrine did not deprive the bankruptcy court of jurisdiction over the turnover complaint.[17]

The chapter 7 trustee in *In re Philadelphia Entm't and Dev. Partners, L.P.*, further discussed under "Sovereign Immunity" in this § II and also discussed in §§ VII and X below, sought turnover of a $50 million fee that the debtor had paid to the Pennsylvania Gaming Board for a gaming license that was later revoked by the Board prior to the debtor's bankruptcy case. The Board moved to dismiss, including on ground that the action was not a true turnover action and that the court was precluded by the Rooker-Feldman doctrine from considering the dispute. The court held that a debtor's alleged interest in a gaming license "could not be considered a *res* to which" the court's "*in rem* jurisdiction may attach."[18] The court further rejected the chapter 7 trustee's efforts to find a way around Rooker-Feldman — by framing the complaint as one for compensation for the loss of the value of the gaming license, rather than for restoration of the license. The bankruptcy court noted if it was to determine that the debtor held an interest in the gaming license or some right to be compensated for its value, it would necessarily be required to review the merits of the earlier state court decisions. Accordingly, Rooker-Feldman precluded the bankruptcy court's determination of the claim.[19]

Sovereign Immunity

Another area in which difficulties persist is where a turnover proceeding implicates the sovereign immunity from suit of the federal government or a state under the 11th Amendment pursuant to *Seminole Tribe of Fla. v. Florida* and its progeny.[20] Neither the bankruptcy court nor the district court has jurisdiction if the defendant is a sovereign that has not

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[17] In re LB Steel, LLC, 547 B.R. at 796 (emphasis in original).

[18] *In re Philadelphia Entertainment and Development Partners, L.P.*, 549 B.R. 103, 126 (Bankr. E.D. Pa. 2016), opinion aff'd, 2017 WL 1160790 (E.D. Pa. 2017).

[19] In re Philadelphia Entm't and Dev. Partners, L. P., 549 B.R. at 139–142.

[20] *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed. 2d 252, 34 Collier Bankr. Cas. 2d (MB) 1199, 42 Env't. Rep. Cas. (BNA) 1289, 67 Empl. Prac. Dec. (CCH) P 43952 (1996) (Congress does not

consented to suit or agreed in the plan of the Constitutional Convention or by later joining the federal union not to assert a sovereign immunity defense with respect to certain matters in a bankruptcy proceeding. The Supreme Court in *Katz* held that sovereign immunity does not bar suit by chapter 7 trustee against a state to avoid and recover an alleged preferential transfer because the state agreed in the plan of the Convention or by later joining the federal union "not to assert any sovereign immunity defense they might have had in proceedings brought pursuant to 'Laws on the subject of Bankruptcies.' "[21] But that consent does not extend to all matters on which a state might be sued in a bankruptcy case.

The bankruptcy court in *In re Patriot Coal Corp.*, also discussed above and in § X below, held that a state had not waived its sovereign immunity with respect to the liquidating trustee's tax refund suit. The court distinguished *Katz*, conceding that the debtors would have had a viable turnover action if the complaint had alleged facts that established the existence of an undisputed right of one of the debtors to the claimed tax refunds. But because the liquidating trustee's turnover count required the bankruptcy court to determine the amount of the tax refunds, rather than the turnover of a preferential transfer or a liquidated sum, it was "beyond the scope of the 'consent by ratification' doctrine set forth in *Katz*." Accordingly, the state's sovereign immunity barred the liquidating trustee's suit against it.[22]

The bankruptcy court in *In re Philadelphia Entm't and Dev. Partners, L.P.*, also discussed in this § II above and in §§ VII and X below, noted the case law split on the issue of whether the "consent by ratification" reasoning of *Katz*, which involved a preferential transfer, also applied to the turnover of an alleged fraudulent transfer. The court declined to rule on the issue because any determination that it made on the issue of sovereign immunity would ultimately be subject to *de novo*

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have the power under Article I of the Constitution to abrogate a state's sovereign immunity from suit).

[21] *Central Virginia Community College v. Katz*, 546 U.S. 356, 126 S. Ct. 990, 1204, 163 L. Ed. 2d 945, 45 Bankr. Ct. Dec. (CRR) 254, 54 Collier Bankr. Cas. 2d (MB) 1233, Bankr. L. Rep. (CCH) P 80443 (2006).

[22] *In re Patriot Coal Corporation*, 562 B.R. 632, 640–647 (Bankr. E.D. Va. 2016).

review by the district court.[23] The bankruptcy court did not doubt that the trustee possessed a reasonable basis to believe that, pursuant to the state law claims set forth in the complaint, the estate was entitled to a refund of the fee for the gaming license. However, the court continued, each of these causes of action were premised on the debtor's alleged rights under applicable state law and were "not within the surrender of sovereign immunity resulting from the [state's] ratification of the Constitution."[24]

Jurisdiction after Chapter 11 Plan Confirmation

Some courts have held that § 542(a) is "inapplicable" once property has revested in the reorganized debtor pursuant to a chapter 11 plan "because there is no longer a trustee (or debtor-in-possession) to whom property can be delivered and the estate cannot benefit."[25] In *In re Irwin*, the liquidating agent for a confirmed chapter 11 plan sought turnover of distributions made prior to confirmation, asserting that those distributions were assets to be collected under the confirmed plan. The court did not consider the jurisdictional issue, but denied turnover because the liquidating agent had offered no evidence that the distributions were in existence on the effective date of the plan.[26]

III. PREEMPTION OF STATE LAW BY THE BANKRUPTCY CODE; PREEMPTION OF THE BANKRUPTCY CODE BY OTHER FEDERAL LAW

The authors are not aware of any published opinions since last year's Annual Survey addressing the issues of preemption in connection with turnover actions.

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[23]In re Philadelphia Entm't and Dev. Partners, L. P., 549 B.R. at 134–135.

[24]In re Philadelphia Entm't and Dev. Partners, L. P., 549 B.R. at 155–156.

[25]See e.g., *In re Wellesley Realty Associates, LLC*, 2015 WL 2261680, *13 (Bankr. D. Mass. 2015), citing *In re General Media, Inc.*, 335 B.R. 66, 75, 45 Bankr. Ct. Dec. (CRR) 271 (Bankr. S.D. N.Y. 2005), reported in last year's Annual Survey.

In re Goldsmith, 2012 WL 3201840, *2-3 (Bankr. W.D. Pa. 2012) (effect of dismissal).

[26]*In re Irwin*, 558 B.R. 743, 749, 63 Bankr. Ct. Dec. (CRR) 49 (Bankr. E.D. Pa. 2016).

IV. FORM OF ACTION/SERVICE

Federal Rule of Bankruptcy Procedure 7001(1)[27] includes in the list relief requiring the commencement of an adversary proceeding, "a proceeding to recover money or property, other than a proceeding to compel the debtor to deliver property to the trustee." Thus, a request for turnover of estate property from a debtor,[28] and a turnover action for recorded information under § 542(e),[29] may be brought by motion, while Rule 7001(1) requires an action for turnover of property that is not a document, against a third party who is not the debtor, under § 542(a) and (b) and § 543(a) to be commenced by an adversary proceeding.[30]

Courts nonetheless have granted turnover relief sought by motion against a third party. In *In re Alpha Natural Res., Inc.*, the chapter 11 debtors sought to terminate a deferred compensation plan by motion rather than by adversary proceeding. The plan participants objected. The bankruptcy court granted the motion, and the plan participants moved for reconsideration, asserting that an adversary proceeding was required because the motion to terminate the plan included a request for turnover of property. The objectors further asserted that the procedural shortcoming was in a manifest error of law that required the court to alter or amend the termination order under Bankruptcy Rule 9023.[31] The bankruptcy court held that no adversary proceeding was required because the party holding the property had con-

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[27] Fed. R. Bankr. P. 7001(1).

[28] See e.g., *In re McCrory*, 2011-2 U.S. Tax Cas. (CCH) P 50626, 108 A.F.T.R.2d 2011-6299, 2011 WL 4005455, *3 (Bankr. N.D. Ohio 2011) (Bankr.N.D.Ohio); *In re Rogove*, 443 B.R. 182 (Bankr. S.D. Fla. 2010).

[29] See e.g., *In re MV Pipeline Co.*, 2007 WL 1452591, *8 (Bankr. E.D. Okla. 2007). A turnover action against a debtor may also be brought by adversary proceeding. *In re McKenzie*, 2011 WL 4600407, *6 (Bankr. E.D. Tenn. 2011), aff'd, 476 B.R. 515 (E.D. Tenn. 2012), decision aff'd, 716 F.3d 404, 57 Bankr. Ct. Dec. (CRR) 280 (6th Cir. 2013).

[30] See e.g., *In re MF Global Inc.*, 531 B.R. 424, 431, 61 Bankr. Ct. Dec. (CRR) 27, Comm. Fut. L. Rep. (CCH) P 33487, Comm. Fut. L. Rep. (CCH) P 33488 (Bankr. S.D. N.Y. 2015); *In re Spence*, 2009 WL 3756621 (Bankr. W.D. Tex. 2009); *In re Hodge*, 2009 WL 3645172 (Bankr. W.D. Tex. 2009); and *In re Clark*, 2009 WL 2849785 (Bankr. D. D.C. 2009).

[31] *In re Alpha Natural Resources, Inc.*, 554 B.R. 787, 798 (Bankr. E.D. Va. 2016).

sented to turnover. The court emphasized that it had long encouraged consensual agreement as a means of resolving disputes and saving estate resources, and that parties are permitted (and expected) to voluntarily comply with § 542.[32]

In *Reed v Nathan*, also discussed in § II above, the chapter 7 trustee filed a motion seeking turnover of assets from a non-debtor party, KWF, that the trustee alleged was an alter ego of the debtor. The bankruptcy court ordered turnover. KWF argued on appeal that the bankruptcy court had erred because an adversary complaint was required. The district court rejected this argument and affirmed, on two grounds. First, there was a real question as to whether Rule 7001 applied at all because "the evidence overwhelmingly establishe[d] that Reed [the debtor] had so commingled his own affairs with KWF that there was no distinction between the two." Thus, though the turnover motion was "nominally directed at KWF," it reasonably could be characterized "as 'a proceeding to compel *the debtor* to deliver property to the trustee,' which need not take the form of an adversary proceeding." Second, the error, if any, was harmless.[33]

The bankruptcy court in *In re Archdiocese of Saint Paul and Minneapolis* held that "substantive consolidation" — by which the court can order the assets liabilities of technically distinct corporate entities to be pooled purposes of distributions in a bankruptcy case — "is an equitable, judicial remedy that is distinct from the express, statutory remedies of turnover or other recovery actions. Substantive consolidation is traditionally sought by motion."[34]

Further, most recent decisions hold that § 542(a) is "self-effectuating." The bankruptcy court in *In re Irish Bank Resolution Corp. Ltd.* characterized the turnover requirement as "an affirmative duty that arises upon the filing of the bankruptcy petition. By its express terms, section 542(a) is self-executing and does not require the trustee to take any action,

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[32] In re Alpha Natural Res., Inc., 554 B.R. at 799.

[33] *Reed v. Nathan*, 558 B.R. 800, 821–822 (E.D. Mich. 2016) (emphasis in original).

[34] *In re Archdiocese of Saint Paul and Minneapolis*, 553 B.R. 693, 700, 62 Bankr. Ct. Dec. (CRR) 269, 75 Collier Bankr. Cas. 2d (MB) 1807 (Bankr. D. Minn. 2016), order aff'd, appeal dismissed, 562 B.R. 755, Bankr. L. Rep. (CCH) P 83044 (D. Minn. 2016).

commenced a proceeding or obtain a court order to compel the turnover."[35] The bankruptcy court in *In re CMTD Contractor, Corp.* reached the same interpretation, stating that the "obligation to turn over property to the trustee under Section 542 is self-operative and does not require a motion by the trustee."[36] The bankruptcy court in *In re McKeever* held that the "turnover requirement under section 542(a) is self-executing and no demand by a trustee is required."[37] The bankruptcy court in *In re Sann* quoted the Ninth Circuit BAP's pronouncement: "The trustee is not required to make any demand for turnover of estate property."[38] And in *In re Inelcont Corp.*, the bankruptcy court held that: "The obligation to turn over property to the trustee under Section 542 is self-operative and does not require a motion by the trustee."[39]

Nonetheless, precision in pleading can be determinative. The chapter 7 trustee in *In re Turner Grain Merch., Inc.*, also discussed in § X below, sought turnover of the funds in the debtor's bank account pursuant to the more general provisions of section 542(a), rather than section 542(b), which requires turnover of a matured debt that is property of the estate. The court characterized a debtor's bank account as a matured debt payable by the bank to the debtor on demand. The court then held that, though turnover was warranted under section 542(b), the trustee had not raised that ground, and "must give notice and a reasonable opportunity for the parties to respond" before the court would grant summary judgment.[40]

A party's obligation to turn over property under § 542(a) is further subject to the "good faith" exception, set forth in § XI below.

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[35] *In re Irish Bank Resolution Corporation Limited (in Special Liquidation)*, 559 B.R. 627, 643, 63 Bankr. Ct. Dec. (CRR) 88 (Bankr. D. Del. 2016).

[36] *In re CMTD Contractor, Corp.*, 2016 WL 1411718, *3 (Bankr. D. P.R. 2016).

[37] *In re McKeever*, 567 B.R. 652, 663 (Bankr. N.D. Ga. 2017).

[38] *In re Sann*, 555 B.R. 721, 741 (Bankr. D. Mont. 2016), quoting *In re Treasures, Inc.*, 2015 WL 925957, *21 (B.A.P. 9th Cir. 2015) (holding that turnover requirement of § 542 is "self-executing)

[39] *In re Inelcont Corp.*, 2016 WL 5400394, *4 (Bankr. D. P.R. 2016).

[40] *In re Turner Grain Merchandising, Inc.*, 557 B.R. 147, 150-151 (Bankr. E.D. Ark. 2016).

V. STANDING

A debtor in possession, whether under chapter 11 or chapter 13,[41] and a chapter 7 or 11 trustee, each has standing to bring an action under Code § 542.[42] Most courts have held that a chapter 7 debtor — whose property is under the authority of the trustee — lacks standing.

The bankruptcy court in *In re Wenzel* noted that in a chapter 7 case, § 542 "requires turnover to the trustee, not the debtor. Accordingly, the trustee, not [the debtor], has standing to bring a complaint under its provisions."[43]

The statutory regime described above can present a quandary to a chapter 13 trustee, whose supervisory role may necessitate his requesting turnover of property that rightfully should be made available to the estate for distribution to creditors. The chapter 13 trustee in *In re Roberts* moved to reopen the case based on his belief that the debtor had settled an undisclosed prepetition personal injury lawsuit during the pendency of the case, the proceeds of which were being held by the law firm that had represented the debtor.[44] The debtor's lawyer correctly asserted that under Code § 1302, a chapter 13 trustee does not have the powers of a chapter 7 trustee under §§ 323 and 704(a)(1) to sue and be sued. Fifth Circuit precedent, in the court's view, was somewhat inconsistent. The court resolved the matter by holding that the chapter 13 trustee had standing to sue the debtor's law firm for settling the law suit without obtaining court approval of the settlement in accordance with Bankruptcy Rule 9019. The court further held that, though the chapter 13 trustee lacked authority to seek turnover, a chapter 7 trustee had such authority. Thus, to avoid any possible conflict with § 1302 the court also entered a separate order to show cause

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[41] *In re Shapphire Resources, LLC*, 2016 WL 320823, *5 (Bankr. C.D. Cal. 2016) (chapter 11 debtor in possession); *In re Roberts*, 556 B.R. 266, 282-283 (Bankr. S.D. Miss. 2016), subsequent determination, 2017 WL 1628882 (Bankr. S.D. Miss. 2017) (chapter 13 debtor).

[42] See e.g., *In re Flanagan*, 415 B.R. 29, 36 (D. Conn. 2009) ("turnover is not a cause of action available to debtors at the time they file for bankruptcy. The language of statute clearly demonstrates that it is a claim available only to trustees after a bankruptcy petition has been filed.").

[43] *In re Wenzel*, 554 B.R. 861, 863 (Bankr. W.D. Wis. 2016).

[44] *In re Roberts*, 556 B.R. 266 (Bankr. S.D. Miss. 2016), subsequent determination, 2017 WL 1628882 (Bankr. S.D. Miss. 2017).

as to why the debtor's case should not be converted to chapter 7 so that a chapter 7 trustee could pursue the turnover claim. The court deferred ruling on the law firm's motion to dismiss the chapter 13 trustee's turnover action pending its decision on whether to convert the case.[45]

VI. BURDEN OF PROOF

The party seeking turnover has the burden of proof,[46] and "must prove that the subject property constitutes property of the estate and that the defendant is in possession of that property."[47] "Importantly, to support a cause of action for turnover, the trustee has the burden of proof, by a preponderance of the evidence, to establish that, *inter alia*, the property constitutes property of the estate."[48]

VII. SECTION 542(A)—PROPERTY OF THE ESTATE THAT THE DEBTOR MAY USE, LEASE, SELL, OR EXEMPT

Generally — Property of the Estate

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[45] *In re Aycock*, 2014 WL 1047803 (Bankr. W.D. La. 2014).

[46] *In re Hunt*, 540 B.R. 438, 443, 87 U.C.C. Rep. Serv. 2d 1259 (Bankr. D. Idaho 2015); In re *In re Millette*, 539 B.R. 396, 400, 2015 BNH 08 (Bankr. D. N.H. 2015); *In re Tate*, 535 B.R. 914, 920 (Bankr. S.D. Ga. 2015); *In re Shapphire Resources, LLC*, 2016 WL 320823, *5 (Bankr. C.D. Cal. 2016); *In re Scotchel*, 491 B.R. 739, 743, 69 Collier Bankr. Cas. 2d (MB) 1133 (Bankr. N.D. W. Va. 2013), aff'd, Bankr. L. Rep. (CCH) P 82598, 2014 WL 823379 (N.D. W. Va. 2014), aff'd, 585 Fed. Appx. 187 (4th Cir. 2014); *Segarra-Miranda v. Perez-Padro*, 482 B.R. 59, 74 (D.P.R. 2012); *In re Mobley*, 2012 WL 6086878, *1 (Bankr. N.D. Ohio 2012); *In re Miller*, 2011 WL 3741846, *2 (Bankr. N.D. Ohio 2011); *In re Asif*, 455 B.R. 768, 797 (Bankr. D. Kan. 2011); *In re McCrory*, 2011-2 U.S. Tax Cas. (CCH) P 50626, 108 A.F.T.R.2d 2011-6299, 2011 WL 4005455, *3 (Bankr. N.D. Ohio 2011); *In re Crump*, 467 B.R. 532 (Bankr. M.D. Ga. 2010); *In re Brubaker*, 426 B.R. 902, 905 (Bankr. M.D. Fla. 2010), decision aff'd, 443 B.R. 176 (M.D. Fla. 2011); *In re Schneider*, 417 B.R. 907, 919 (Bankr. N.D. Ill. 2009).

[47] In re Hunt, 540 B.R. at 443; In re Millette, 539 B.R. at 400; In re Tate, 535 B.R. at 920; *In re Shapphire Resources, LLC*, 2016 WL 320823, *5 (Bankr. C.D. Cal. 2016); In re Scotchel, 491 B.R. at 743; *In re McCrory*, 2011-2 U.S. Tax Cas. (CCH) P 50626, 108 A.F.T.R.2d 2011-6299, 2011 WL 4005455, *3 (Bankr. N.D. Ohio 2011); *In re Rogove*, 443 B.R. 182 (Bankr. S.D. Fla. 2010). See also, In re Brubaker, 426 B.R. at 905 and *In re Green*, 423 B.R. 867, 869 (Bankr. W.D. Ark. 2010).

[48] In re Irish Bank Resolution Corp. Ltd., 559 B.R. at 643–644.

"It is crucial to the trustee's claim that the asset to be turned over is property of the estate."[49]

Property rights generally are determined by state law.[50] If under the applicable state law, the debtor has no interest in the property turnover of which is sought, then the court will deny turnover.

Courts have struggled with cases involving disputed title.

The district court in *Fraterfood Serv., Inc. v. DOR Del Sol LLC*, also discussed in § XVIII below, reversed in part the bankruptcy court's decision reported in last year's Annual Survey, based on its interpretation of a lease between the debtor and its landlord. The district court held that if the chapter 11 debtor in possession could demonstrate that the power generator at issue could be removed without damaging the property or its improvements, then pursuant to the terms of the lease between the debtor and the landlord, the generator was property of the estate subject to turnover.[51]

The bankruptcy court in *In re Chesley* held that a motorcycle that the debtor acquired shortly before the bankruptcy filing, but which was not titled in the debtor's name until eight months after the petition date, was property of the estate subject to turnover.[52] The court found that the debtor had inspected the motorcycle and made the decision to buy it, had paid the entire consideration in cash, had taken possession of both the motorcycle and an endorsed certificate of title, and

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[49] *In re Hoerr*, 2004 WL 2926156, *2 (Bankr. C.D. Ill. 2004). "Federal law determines what property is included in the estate, while state law controls whether the debtor has a legal or equitable interest in the property at the time the bankruptcy case is filed." *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. 139, 157, 54 Bankr. Ct. Dec. (CRR) 131 (Bankr. W.D. Ark. 2011), order aff'd, 2012 WL 1078345 (W.D. Ark. 2012), aff'd, 509 Fed. Appx. 578 (8th Cir. 2013); *In re Miller*, 66 Collier Bankr. Cas. 2d (MB) 1855, 2011 WL 6217342, *2 (Bankr. D. Colo. 2011), citing *Butner v. U.S.*, 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979).

[50] *Nobelman v. American Sav. Bank*, 508 U.S. 324, 113 S. Ct. 2106, 2110, 124 L. Ed. 2d 228, 24 Bankr. Ct. Dec. (CRR) 479, 28 Collier Bankr. Cas. 2d (MB) 977, Bankr. L. Rep. (CCH) P 75253A (1993) (1978 Code case); *Butner v. U.S.*, 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979) (1898 Act case).

[51] *Fraterfood Service, Inc. v. DDR Del Sol LLC*, 2016 WL 1604702, *7 (D.P.R. 2016).

[52] *In re Chesley*, 550 B.R. 903 (Bankr. M.D. Fla. 2016).

had brought the motorcycle to his residence, where he kept it for some time and made repairs on it. The seller, though still the registered holder of title on the petition date, had made no claim that the sale was not completed before the petition date or should be rescinded. The debtor asserted that he had purchased the motorcycle for his father, notwithstanding that eight months later he applied for title in his own name with the Florida DMV, stating that he was the purchaser of the motorcycle.[53] The court held that the debtor "may not receive the benefit of marketable title to the Motorcycle, arising from the pre-petition transaction, while taking the inconsistent position that he did not own the Motorcycle" until he obtained the title from the DMV. The court concluded that the debtor was the beneficial owner of the motorcycle from the prepetition date of purchase and ordered turnover.[54]

The district court in *Reed v. Nathan*, also discussed in § II above, held that, "[t]o begin, there is no doubt that a bankruptcy court has core jurisdiction to determine what constitutes property of the estate."[55] A bona fide dispute over the ownership of assets subject to the turnover request might render the turnover action non-core. But since the defendant's claim to the assets was "entirely baseless," the bankruptcy court's entry of the turnover order was core.[56]

See also the cases discussed in this § VII, under the heading "Alter Ego Claims."

The Property Must be Property That the Debtor May Use, Lease, Sell or Exempt

Property that the Debtor May Use, Lease or Sell

The property, to be subject to turnover, must be property that the debtor may use, lease or sell under section 363, which generally means that it is property of the estate under Code § 541.[57]

A court nonetheless may delay turnover. In *In re Labbee*, the debtor, years before he filed his chapter 7 petition, had

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[53] In re Chesley, 550 B.R. at 907–908, 913–914.

[54] In re Chesley, 550 B.R. at 914–915.

[55] *Reed v. Nathan*, 558 B.R. 800, 815 (E.D. Mich. 2016).

[56] Reed v. Nathan, 558 B.R. at 816–817.

[57] *In re Vaughan Company, Realtors*, 61 Bankr. Ct. Dec. (CRR) 101, 2015 WL 4498748, *3 (Bankr. D. N.M. 2015).

moved out of a residence that he jointly owned with the defendant, his former paramour, who was legally blind. The defendant still lived in the residence, and relied on her children, who lived locally, for assistance. The chapter 7 trustee sought turnover of, and authority to sell, the residence.[58] The court authorized the sale. But "under these facts," did not order immediate turnover, on condition that the defendant grant the chapter 7 trustee full access to the property, and otherwise cooperate with him, in his efforts to obtain a sale.[59]

Property that the Debtor May Exempt

The application of the turnover provisions to property asserted by the debtor to be exempt is somewhat peculiar, because even though § 542 requires turnover to the trustee of property that the debtor may exempt, the debtor's exemption would appear to put the exempt property beyond a trustee's reach.

The chapter 7 trustee in *In re Montemayor* sought turnover of the proceeds of the debtor's homestead, asserting that the debtor had failed to reinvest the proceeds in another homestead within the six-month period required by the Texas homestead statute.[60] The court found that the debtor had sold his homestead, which had been properly exempted under Texas law. The exemption had become final when the trustee failed to object to it. Thus, the debtor's "exempted homestead, and necessarily its proceeds," were withdrawn from the estate and its creditors.[61]

Property that the debtor seeks to exempt, but which the court ultimately determines is not exempt, is of course subject to turnover to the trustee.[62]

Types of Property Interests Subject to Turnover

Several opinions in the last year have made the threshold determination of whether the property sought was estate property, with respect to myriad types of property interests, as set forth in the following subsections of this § VII.

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[58] *In re Labbee*, 550 B.R. 854, 855-857, 75 Collier Bankr. Cas. 2d (MB) 973 (Bankr. D. Idaho 2016).

[59] In re Labbee, 550 B.R. at 859.

[60] *In re Montemayor*, 547 B.R. 684 (Bankr. S.D. Tex. 2016).

[61] In re Montemayor, 547 B.R. at 713.

[62] *In re Crutch*, 565 B.R. 36, 119 A.F.T.R.2d 2017-1428 (Bankr. E.D. N.Y. 2017).

Alter Ego Claims

In *Reed v. Nathan*, also discussed in § II above, the district court affirmed the bankruptcy court's finding that the debtor had so commingled his own affairs with those of its alleged alter ego, KWF, that there was no distinction between the debtor and KWF. Thus, though the turnover motion was nominally directed at KWF, "it could reasonably be seen as 'a proceeding to compel *the debtor* to deliver property to the trustee.' "[63]

The bankruptcy court in *Tellico Lake Props., L.P.*, also discussed in § VIII below, similarly required turnover of antique cars that a third party had purchased from a principal of the debtor, because the principal had acquired the cars with the debtor's funds.[64]

The chapter 11 trustee in *In re Abell* filed an adversary complaint against the debtor, his wife, and certain related entities, alleging that the defendants had engaged in a massive real estate and asset concealment scheme to hide millions of dollars of assets from creditors and from the bankruptcy court. The trustee sought a declaratory judgment that certain assets were estate property, and turnover of those assets. The defendants moved to dismissed the complaint, including the turnover count because the assets had not been determined to be property of the estate. The bankruptcy court conceded that turnover actions "are limited to recovery of assets that are property of the bankruptcy estate." However, that proposition was not applicable because the trustee had not brought the turnover claims "as standalone claims, but instead as ancillary claims to the declaratory judgment claims." The court denied the motion to dismiss and stated that the turnover claims could be determined after the court resolved the declaratory judgment claims.[65]

And in *In re Ortega T.*, the chapter 7 trustee sought turnover of assets allegedly concealed and improperly shielded from creditors as part of a "complex, fraudulent scheme." The debtor argued that trustee was not entitled to turnover un-

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[63] *Reed v. Nathan*, 558 B.R. 800, 821–822 (E.D. Mich. 2016) (emphasis in original).

[64] *In re Tellico Lake Properties, L.P.*, 548 B.R. 800, 803 (Bankr. E.D. Tenn. 2016).

[65] *In re Abell*, 549 B.R. 631, 654–655 (Bankr. D. Md. 2016).

less and until the court found that the property transferred to the debtor was property of the estate. The trustee countered, correctly in the court's view, "that turnover can be sought in the same complaint that seeks to establish that the property subject to turnover is property of the estate." The trustee further sought a declaration that the alleged altered ego entities themselves were property of the debtor, and therefore were property of the estate. The court held that, if the trustee succeeded on either of these counts, then "the conditions precedent for relief under the turnover count" would be met. Accordingly, the court denied the debtor's motion to dismiss the turnover count of the complaint.[66]

Avoidable Transfers

Avoided transfers are subject to turnover. The bankruptcy court in *In re Cilwa* avoided a postpetition transfer, pursuant to Code section 549, that the debtor had made without obtaining court authorization. The undisputed evidence established that the debtor's interest in certain real property held in a trust was property of the debtor's bankruptcy estate, and that the debtor had caused the trust to sell the property postpetition without authorization under the Code or from the bankruptcy court. The debtor used the sale proceeds to purchase other real property in the debtor's name, which the debtor then sold to his son for $10, retaining for himself a life estate in the property. The court held that the trustee was entitled to turnover of both the debtor's and his son's interest in the property.[67]

Causes of Action

A cause of action that existed on the date on which a chapter 7 case was commenced is "property of the estate." The chapter 7 trustee in *In re Harber*, also discussed in § IX below, reopened the case and filed a motion to compel the debtors to turnover Mrs. Harber's products liability claim regarding her

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[66] *In re Ortega T.*, 562 B.R. 538, 542–543, 63 Bankr. Ct. Dec. (CRR) 104 (Bankr. S.D. Fla. 2016).

[67] *In re Cilwa*, 2016 WL 1576242, *3-4 (Bankr. D. S.C. 2016), aff'd, 2016 WL 7403958 (D.S.C. 2016), aff'd, 2017 WL 1531984 (4th Cir. 2017); *In re Cilwa*, 2016 WL 1579081, *6-7 (Bankr. D. S.C. 2016), aff'd, 2016 WL 7403958 (D.S.C. 2016), aff'd, 2017 WL 1531984 (4th Cir. 2017).

hip replacement, as an alleged asset of the estate.[68] The uncontested evidence showed that Mrs. Harber was aware "of the potential for a problem with her left hip replacement long before the commencement of her bankruptcy case, but she did not manifest in injury until after the case was closed. Without an actual injury or damages, neither Mrs. Harber nor the Trustee could have successfully pursued" the personal injury claim on the date the bankruptcy case was filed. The court further found that, "in the absence of any injury or symptoms in the years leading up to the bankruptcy filing, the claim was not 'sufficiently rooted' in the pre-bankruptcy past." For these reasons, the court held that the personal injury claim was not property of the estate and denied the trustee's turnover motion.[69]

Conversion to a Different Chapter of the Code

The debtors in *In re Exume* owned a 2006 Toyota when they filed their chapter 13 petition, $2,695 of the value of which they claimed as exempt. They totaled the car in a postpetition accident. A month later, the debtors converted their chapter 13 case to chapter 7, shortly after receiving the insurance proceeds for the car. The debtors then used the proceeds to buy a 2008 Honda. They then reconverted their case to chapter 13, and a few months after that, reconverted, again, to chapter 7. The debtors in their chapter 7 case did not disclose receipt of the insurance proceeds or their purchase of the 2008 Honda.

The chapter 7 trustee filed a motion for turnover of the proceeds and the value of the replacement car.[70] The debtors argued that, under section 348(f)(1)(A), "property of the estate in the converted case shall consist of property of the estate, as of the date of filing the petition, that remains in the possession of or is under the control of the debtor on the date of conversion." The debtors argued that the insurance policy that they owned on the original petition date had lapsed postpetition, and that they renewed the policy by a payment from their postpetition income. Thus, the "renewal policy" was not part of the bankruptcy estate on the original petition

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[68] *In re Harber*, 553 B.R. 522 (Bankr. W.D. Pa. 2016).

[69] In re Harber, 553 B.R. at 536.

[70] *In re Exume*, 76 Collier Bankr. Cas. 2d (MB) 1456, 2016 WL 7076982, *1 (Bankr. M.D. Fla. 2016).

date, and the proceeds from the policy were not part of the chapter 7 estate. The court reasoned that the 2006 Toyota was property of the estate on the petition date, as was the insurance policy on it and the debtors' right to the proceeds of that policy.[71] Thus, "[t]o the extent that the proceeds went into Debtors' bank account before the date of conversion, and can be traced to the purchase of the 2008 Honda (the replacement car) and any other assets, such assets would be property of the Chapter 7 estate under § 348(f)(1)(A)." The court ordered turnover of the non-exempt value of the 2008 Honda, the remaining insurance proceeds from the loss of the 2006 Toyota, and any assets purchased from those proceeds to the extent that they were not spent prior to the first conversion to chapter 7.[72]

The debtor in *In re Lincoln* filed his individual chapter 11 case. On the date that he converted his case to chapter 7, he had $6,008 in a debtor-in-possession bank account. The Chapter 7 trustee sought turnover of the amount in the account.[73] The bankruptcy court noted that — pursuant to Code section 348(f) as interpreted by the Supreme Court in *Harris v. Viegelahn* — a "debtor's postpetition wages, including undispersed funds in the hands of the trustee, ordinarily do not become part of the Chapter 7 estate created by conversion." Absent a bad-faith conversion, section 348(f) "limits a converted Chapter 7 estate to property belonging to the debtor 'as of the date' the original Chapter 13 petition was filed. Postpetition wages, by definition, do not fit that bill." Thus, postpetition wages held by the Chapter 13 trustee at the time of conversion must be returned to the debtor.[74]

The Supreme Court in *Harris v. Viegelahn*, though, had not considered whether a *chapter 11* debtor's postpetition wages were property of the estate on conversion to chapter 7. The

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[71] *In re Exume*, 76 Collier Bankr. Cas. 2d (MB) 1456, 2016 WL 7076982, *2 (Bankr. M.D. Fla. 2016).

[72] *In re Exume*, 76 Collier Bankr. Cas. 2d (MB) 1456, 2016 WL 7076982, *3 (Bankr. M.D. Fla. 2016).

[73] *In re Lincoln*, 63 Bankr. Ct. Dec. (CRR) 193, 2017 WL 535259, *1 (Bankr. E.D. La. 2017).

[74] *In re Lincoln*, 63 Bankr. Ct. Dec. (CRR) 193, 2017 WL 535259, *1-2 (Bankr. E.D. La. 2017), quoting *Harris v. Viegelahn*, 135 S. Ct. 1829, 1834, 191 L. Ed. 2d 783, 61 Bankr. Ct. Dec. (CRR) 11, 73 C.B.C. 1530, Bankr. L. Rep. (CCH) P 82799 (2015).

bankruptcy court in *Lincoln* cited to Fifth Circuit precedent interpreting Code section 1115(a)(1) (enacted as part of BAPCPA in 2005) for the proposition that "property specified in section 541 that is acquired by the debtor postpetition but preconversion is property of the estate. Section 541(a)(7) provides that property of the estate includes '[a]ny interest in property that the estate acquires after the commencement of the case.' "[75] The rule set forth in section 348(f) was limited to chapter 13. The bankruptcy court "presume[d] that Congress knew that it was enacting section 348(f)(1)(A) to address conversion of Chapter 13 cases, and that it intentionally chose not to add a similar provision for individual Chapter 11 cases." Because the debtor acquired the funds in his bank account postpetition but pre-conversion, they were property of the estate and the court ordered turnover.[76]

Licenses

The bankruptcy court in *In re Philadelphia Entm't and Dev. Partners, L.P.*, also discussed in § II above and in § X below, held that a state-gaming license is not a vested right or a *res* to which a bankruptcy court's *in rem* jurisdiction can attach.[77] Thus, the bankruptcy court could not "restore the License or its alleged value to the Debtor."[78] Accordingly, the court dismissed the turnover count of the complaint.[79]

Postpetition Receipts for Prepetition Services

Sylvia was a lawyer, who filed a chapter 7 case. He received $10,000 from a client postpetition for legal services provided to his client prepetition. The chapter 7 trustee in *In re Sylvia* sought turnover of the $10,000. Amounts owing to a debtor under existing contracts are property of the estate, while

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[75] *In re Lincoln*, 63 Bankr. Ct. Dec. (CRR) 193, 2017 WL 535259, *2 (Bankr. E.D. La. 2017), citing *In re Cantu*, 784 F.3d 253, 60 Bankr. Ct. Dec. (CRR) 259, Bankr. L. Rep. (CCH) P 82812 (5th Cir. 2015), cert. denied, 136 S. Ct. 417, 193 L. Ed. 2d 317 (2015).

[76] *In re Lincoln*, 63 Bankr. Ct. Dec. (CRR) 193, 2017 WL 535259, *3 (Bankr. E.D. La. 2017).

[77] *In re Philadelphia Entertainment and Development Partners, L.P.*, 549 B.R. 103, 125 (Bankr. E.D. Pa. 2016), opinion aff'd, 2017 WL 1160790 (E.D. Pa. 2017).

[78] In re Philadelphia Entm't and Dev. Partners, L.P., 549 B.R. at 126.

[79] In re Philadelphia Entm't and Dev. Partners, L.P., 549 B.R. at 113, 156

earnings by an individual debtor for services performed after the commencement of a chapter 7 case are not property of the estate.[80] The bankruptcy court found that the credible evidence supported the conclusion that the payments were for prepetition services provided by the debtor and ordered turnover.[81]

Proceeds and Escrows

The chapter 7 debtor in *In re Whittick*, further discussed in this § VII below and in §§ VIII and IX below, applied for a loan against his public employees' retirement system retirement plan, and the application was approved prepetition. The chapter 7 trustee brought an adversary proceeding to compel turnover of the proceeds of the loan. The bankruptcy court held that, because the debtor had an interest in the loan on the petition date, the proceeds of the loan that were dispersed postpetition were property of the debtor's bankruptcy estate. Further, though the debtor's interest in his retirement plan, if ERISA-qualified, was excluded from property of the estate, that exclusion did not apply to loan proceeds obtained by the debtor's borrowing against the plan.[82]

The chapter 7 trustee in *In re Brizinova*, also discussed in §§ VIII, IX and XIX below, alleged that the debtors continued to operate their auto parts business through the internet, generating sale proceeds that constituted property of the debtors' estate. The trustee further alleged that the bankruptcy estate was the rightful owner of the auto parts business. The bankruptcy court agreed.[83]

Property of Others

Kentucky law provides that a fee paid to a lawyer may be designated as a non-refundable retainer, rather than a prepayment of unearned legal fees. In *In re Bruner* the Sixth Circuit bankruptcy appellate panel noted that the chapter 7 trustee had not presented evidence sufficient to determine to what extent the counsel's fees paid prepetition to the debtor's criminal defense counsel was an "earned upon receipt" legal fee, which would not be subject to turnover, as opposed to a

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[80] *In re Sylvia*, 556 B.R. 16 (Bankr. D. Mass. 2016).

[81] In re Sylvia, 556 B.R. at 22.

[82] *In re Whittick*, 547 B.R. 628, 635 (Bankr. D. N.J. 2016).

[83] *In re Brizinova*, 554 B.R. 64, 74 (Bankr. E.D. N.Y. 2016)

prepayment of unearned legal fees, which would be subject to turnover. The BAP accordingly affirmed the bankruptcy court's denial of the chapter 7 trustee's turnover motion.[84]

The principal of the debtor in *In re Q-Piedmont Rests., LLC*, during the pendency of the debtor's chapter 11 case, caused to be transferred $105,000 from an account maintained with his personal counsel to an account maintained by the chapter 11 debtor's counsel. The transfer was made contemporaneously with an email that the principal caused his daughter to send to the debtor's counsel, confirming that he had transferred his "right, title and interest" in the $105,000 to the debtor, to be held "in trust for the sole benefit" of the debtor. The case converted to chapter 7 and the trustee sought turnover. The principal and the chapter 11 debtor's counsel objected, claiming that the principal still owned the funds. At trial, the principal argued the funds were held in trust by the debtor's counsel for his benefit on the condition that the court confirmed a plan of reorganization that required the funds to be used for the principal's contribution of new value for an equity interest in the reorganized debtor.[85] Applying state law, the bankruptcy court held that a transfer of funds is sufficient to transfer ownership, and that third-parties are entitled to rely upon their resulting possession of the funds. The court ruled that the balance of the funds in the account were estate assets and ordered turnover.[86]

Retirement Accounts and Plans

The bankruptcy court in *In re Whittick*, also discussed in this § VII above and in §§ VIII and IX below, held that "section 541(c)(2) only excludes from property of the estate the trust assets themselves, not the distributions" from an ERISA-qualified pension plan. "Certainly if distributions do not retain the fund's status as not included in property of the estate, proceeds of a loan" made against the retirement plan

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[84] *In re Bruner*, 561 B.R. 397, 408–409, 63 Bankr. Ct. Dec. (CRR) 137, 77 Collier Bankr. Cas. 2d (MB) 30, Bankr. L. Rep. (CCH) P 83053 (B.A.P. 6th Cir. 2017).

[85] *In re Q-Piedmont Restaurants, LLC*, 2017 WL 562433 (Bankr. M.D. N.C. 2017).

[86] *In re Q-Piedmont Restaurants, LLC*, 2017 WL 562433, *2-5 (Bankr. M.D. N.C. 2017).

trust assets "would not."[87] The court did not order the debtor to turn over the loan proceeds, though, pending its determination of whether the debtor had attempted a transfer in fraud of his creditors, and thus should be denied an exemption under Code section 522(g).[88]

The district court in *In re Chilson* stated that it was undisputed that the debtor and her ex-spouse had entered into a separation agreement with the intent to give the debtor an interest a TIAA-CREF account as of the date of their divorce, and that the state court entered a domestic relations order incorporating the parties' agreement and awarding the debtor a portion of that account. "Accordingly, notwithstanding the absence of a 'qualified' domestic relations order, the Debtor obtained a legal and equitable ownership interest in the ERISA-qualified TIAA-CREF account as of the date of her divorce from Mr. Chilson." Because the account was ERISA-qualified, the debtor's interest in the account was, "by its nature, excluded from the bankruptcy estate and thereby not subject to turnover." It also was undisputed that the Chilsons entered into a separation agreement with the intent to give the debtor an interest in an IRA account as of the date of their divorce, and that the state court's domestic relations order incorporated the Chilsons' agreement and awarded the debtor a portion of that account. Thus, the debtor obtained a legal and equitable ownership interest in the IRA account as of the date of her divorce from Mr. Chilson, and "that interest was, by its nature, part of the bankruptcy estate but potentially exemptible." For these reasons, the district court held, the bankruptcy court's order denying turnover was correct.[89]

The chapter 7 trustee in *In re Hawk* sought turnover of the proceeds from a postpetition liquidation of the debtor's individual retirement account (IRA), after the debtors failed to reinvest those proceeds in and another exempt retirement account within the time required by the Texas exemption statute. The bankruptcy court granted the trustee's motion, and denied reconsideration. The district court affirmed.[90]

Spousal Support

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[87] In re Whittick, 547 B.R. at 637.

[88] In re Whittick, 547 B.R. at 639–640, 643.

[89] *In re Chilson*, 2016 WL 1079149, *6 (W.D. N.C. 2016).

[90] *In re Hawk*, 556 B.R. 788, 800–801 (S.D. Tex. 2016).

The bankruptcy court in *In re Brack* held, as a matter of law, when the debtor filed her chapter 7 petition, "all of her assets, including the right to recover $60,486.00 in spousal support arrearages, became property of" her bankruptcy estate. The trustee was authorized to collect amounts owed to the debtor on the petition date. The well-pleaded facts in the turnover count of the trustee's complaint thus showed that the debtor was required to turn over to the trustee the $60,486.[91]

Tax Refunds

The bankruptcy court in *In re Phomvongsa* considered the extent of a Kansas exemption for earned income tax credits (EIC). The chapter 7 trustee had sought turnover of the debtor's 2015 tax refunds. The debtor argued that she was entitled to exempt "the largest credit that any debtor with one dependent child could receive according to the EIC tables." The court disagreed, holding that the text of the Kansas statute text allowed the debtor to exempt only "the maximum federal credit allowed under the EIC table with her earned income . . ., head of household filing status, and one child," and ordered turnover of the balance of the refund.[92]

VIII. SECTION 542(A)—DELIVER TO THE TRUSTEE AND ACCOUNT FOR THE PROPERTY OR THE VALUE OF SUCH PROPERTY IN POSSESSION, CUSTODY, OR CONTROL DURING THE CASE OF THE ENTITY, OTHER THAN A CUSTODIAN, FROM WHOM TURNOVER IS SOUGHT

The bankruptcy court in *In re Elliott* followed the majority rule that the party from whom turnover is sought under § 542(a) must be "in possession, custody, or control, during

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[91] *In re Brack*, 2016 WL 5793655, *3 (Bankr. E.D. Cal. 2016).

[92] *In re Phomvongsa*, 118 A.F.T.R.2d 2016-5445, 2016 WL 4260277 (Bankr. D. Kan. 2016).

the case, of the property,"[93] that is, at some point "during the case," if the turnover action is to succeed.[94]

The debtors in *In re Brizinova*, also discussed in § VII above and in §§ XI and XIX below, owned a company name ESNI, which continued to operate and generate sale proceeds postpetition.[95] The chapter 7 trustee sought turnover of the proceeds from the debtors under section 542(a). The debtors argued that the trustee did not adequately allege the first element of section 542(a), for two reasons. First, the debtors were not "another entity" under section 542(a). The debtors argued that, "[p]rocedurally, turnover relates to third parties and not to the debtors." Second, the debtors asserted that the trustee had not adequately alleged that they had "possession, custody or control of the property sought." The court rejected those

[93]11 U.S.C.A. § 542(a). In addition, the party may not be a custodian. Turnover from a custodian is pursuant to § 543 as discussed in § XIII of this article.

[94]*In re Elliott*, 544 B.R. 421, 434 (B.A.P. 9th Cir. 2016), citing cases. See also *In re Tate*, 535 B.R. 914, 921 (Bankr. S.D. Ga. 2015), citing cases (though the trustee in Tate also established that Mrs. Tate continued to have possession of the funds turnover of which was sought throughout the case). See also, *In re JMC Telecom LLC*, 416 B.R. 738, 745 (C.D. Cal. 2009) (account into which funds, turnover of which was sought, were deposited was closed in 2000; bankruptcy case commenced in 2007; party from whom turnover was sought was never in custody, control or possession of the funds during the case); *In re Bancredit Cayman Ltd.*, 419 B.R. 898, 917, 52 Bankr. Ct. Dec. (CRR) 121, 70 U.C.C. Rep. Serv. 2d 545 (Bankr. S.D. Fla. 2009) ("Even if the Plaintiff had a viable claim against the Defendant arising from the allegedly unauthorized Funds Transfer, the Defendant never had funds in its possession that would have been subject to turnover under 11 U.S.C. § 542."); *In re Schneider*, 417 B.R. 907, 919–920 (Bankr. N.D. Ill. 2009) ("There is no evidence in the record, however, that [the defendant] was in possession of any of the Artwork and Furnishings at any time during the pendency of the bankruptcy case. Indeed, the Trustee state[d] in his post-trial brief that '[t]here is no evidence at all that the [Artwork and Furnishings] has ever been in the possession of anyone but the Debtor.' The Trustee has not shown that [the defendant] was in possession of the Artwork and Furnishings at any time since the Petition Date. The Trustee has therefore failed to demonstrate one required element of his turnover claim. Accordingly, judgment will be entered in [the defendant's] favor on Count IV."). The minority position is stated in *In re Pyatt*, 486 F.3d 423, 429, 48 Bankr. Ct. Dec. (CRR) 70, 57 Collier Bankr. Cas. 2d (MB) 136, Bankr. L. Rep. (CCH) P 80936 (8th Cir. 2007) (trustee could not compel Debtor to turn over property no longer within Debtor's control).

[95]*In re Brizinova*, 554 B.R. 64, 68–68 (Bankr. E.D. N.Y. 2016).

arguments. First, courts have found that a chapter 7 trustee may seek turnover of estate property "from any individual or entity, including a debtor, that has possession, custody, or control of estate property."[96] Second, the trustee had alleged that the bankruptcy estate was the rightful owner of ENSI at all times since the petition date and that the sale proceeds derived from ENSI's business operations postpetition business operations constituted property of the debtors' estate. Accordingly, the trustee had adequately alleged that the debtors were in possession, custody or control of estate property.[97]

In *In re Tellico Lake Props., L.P.*, also discussed in § VII above, the court found that antique cars were property of the bankruptcy estate, and that one Wolfenbarger — who had not perfected any lien in the cars under state law — held a mere possessory interest in the cars that was inferior to the estate's interest. Accordingly, the court ordered turnover of the cars to the trustee.[98]

Deliver to the Trustee Property or the Value of Such Property

The person in possession, custody or control of the property "during the case" has the duty under§ 542(a) to "deliver to the trustee, and account for, such property or the value of such property."[99] Most courts hold that "during the case" means at any time during the pendency of the bankruptcy case, and not solely at the time the turnover proceeding is commenced.[100] Further, if the property has been spent, transferred or otherwise dissipated that person in most cases remains obligated to turn over its value.

Action for Accounting

Section 542(a) also requires an entity to account for property subject to turnover.[101]

The chapter 7 trustee in *In re Whittick*, also discussed in

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[96]In re Brizinova, 554 B.R. at 76, citing *In re Schultz*, 250 B.R. 22, 28, Bankr. L. Rep. (CCH) P 78207 (Bankr. E.D. N.Y. 2000).

[97]In re Brizinova, 554 B.R. at 76–77.

[98]*In re Tellico Lake Properties, L.P.*, 548 B.R. 800, 805-806 (Bankr. E.D. Tenn. 2016).

[99]11 U.S.C.A. § 542(a) (emphasis supplied).

[100]See e.g., *In re Elliott*, 544 B.R. 421, 435 (B.A.P. 9th Cir. 2016).

[101]11 U.S.C.A. § 542(a).

§ VII above and in § IX below, sought an accounting, asserting that he might not have the records needed to identify all postpetition transfers that the trustee was seeking to avoid. The trustee provided no Code citation or other authority in support of the requested relief. The bankruptcy court held that, when "a claim for turnover is adequately pled, and accounting may also be merited." Further, the trustee "may have meant to proceed under section 542(e)," which requires any person that holds recorded information to turn over or disclose that information to the trustee. The court nonetheless did not order an accounting, pending its determination of whether the trustee was entitled to avoidance and turnover.[102]

IX. UNLESS SUCH PROPERTY IS OF INCONSEQUENTIAL VALUE OR BENEFIT TO THE ESTATE

Section 542(a) does not require turnover of "property that is of inconsequential value or benefit to the estate."[103]

The debtors in *In re Brizinova*, also discussed in §§ VII and VIII above and in § XIX below, argued "in substance, that the sale proceeds" turnover of which was sought were "inconsequential value to this bankruptcy estate because first, the Trustee is not entitled to recover them, and second, they simply do not exist." The court acknowledged that there is no single test to determine whether property is of inconsequential value to a debtor's chapter 7 estate. One method is to compare the aggregate dollar amount of claims filed in the case to the value of the property that the trustee seeks to recover. The court noted that the claims register showed that about $92,000 in unsecured claims had been filed, and when measured against the $250,000 of proceeds turnover of which was sought, the proceeds were of greater than inconsequential value to the estate "[u]nder any appropriate measure."[104]

In *In re Harber*, also discussed in § VII above, the bankruptcy court determined that causes of action that, based on the trustee's estimates, could settle for as much as $142,000, were not of inconsequential value. The court noted that such

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[102] *In re Whittick*, 547 B.R. 628, 642-643 (Bankr. D. N.J. 2016).

[103] 11 U.S.C.A. § 542(a).

[104] *In re Brizinova*, 554 B.R. 64, 78 (Bankr. E.D. N.Y. 2016).

amount was "more than sufficient to satisfy all unsecured claims against the bankruptcy estate."[105]

The bankruptcy court in *In re Whittick*, also discussed in §§ VII and VIII above, found that $13,642 was not inconsequential.[106] The bankruptcy court in *In re Martinez* found that a 2004 Hummer H2, in good condition, that had been driven 120,000 miles, and had a Kelly Blue Book private party value of $13,099, was not of inconsequential value.[107]

X. SECTION 542(B)—DEBTS MATURED OR PAYABLE ON DEMAND OR ORDER BUT § 542 NOT AVAILABLE TO LIQUIDATE DISPUTED CONTRACT CLAIMS

Bankruptcy Code § 542(b) provides that, subject to the exceptions in § 542(c) and (d) and to offset under § 553, "an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee."[108]

The bankruptcy court in *In re Turner Grain Merch., Inc.*, also discussed in § IV above, characterized the debtor's bank account as a debt owed by a bank to the depositor that was matured and payable on demand or on order, and thus was subject to turnover under § 542(b). The trustee instead had sought turnover of the bank account under § 542(a). The court found that parties were entitled to notice of the asserted grounds for turnover, and a reasonable opportunity to respond and gave them 14 days to do so.[109]

By contrast, a disputed contract claim is not subject to turnover under section 542(b). The bankruptcy court in *In re White* found that the obligation allegedly arose in connection with unproven various contract claims and that the "debt here is

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[105] *In re Harber*, 553 B.R. 522, 528 (Bankr. W.D. Pa. 2016).

[106] *In re Whittick*, 547 B.R. 628, 634 (Bankr. D. N.J. 2016).

[107] *In re Martinez*, 2016 WL 7338405, *8 (Bankr. E.D. Cal. 2016).

[108] 11 U.S.C.A. § 542(b).

[109] *In re Turner Grain Merchandising, Inc.*, 557 B.R. 147, 150–151 (Bankr. E.D. Ark. 2016).

clearly in dispute." Thus, turnover under section 542(b) was not appropriate.[110]

The chapter 7 trustee in *In re Philadelphia Entm't and Dev.Partners, L.P.*, also discussed in §§ II and VII above, sought turnover under section 542(b) of a license fee that the debtor had paid for a gaming license that the state gaming control board had later revoked. In the bankruptcy court's view, the trustee's "allegations" were "more akin to common law contract claims than bankruptcy causes of action."[111] The alleged interest in a refund for the revoked license was "subject to a bona fide dispute and therefore, the Complaint allegations" could not "establish the existence of a matured debt."[112]

The trustee's in *In re Patriot Coal Corp.*, also discussed in § II above, fell "short of establishing the existence of a 'matured debt' within the meaning of § 542(b)." The trustee's allegations that the court could determine the bankruptcy estate's right to tax refunds under Code section 505 implicitly acknowledged that the trustee was asking the court to determine such right, and that the tax refunds were "not yet the undisputed property of the estate." Thus, the trustee had failed to state a claim for turnover under section 542(b).[113]

The trustee in *In re CMTD Contractor, Corp.*, also discussed in § IV above, sought turnover under section 542(b) of $46,959 for paving work completed under a subcontract. The general contractor did not dispute that the work was completed, but alleged that a survey of the pavement installed by CMTD showed a difference between the square footage certified by CMTD and the actual pavement installed, and thus that the general contractor had overpaid the debtor by $10,066. That

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[110]*In re White*, 555 B.R. 883, 888, 63 Bankr. Ct. Dec. (CRR) 10 (Bankr. N.D. Ga. 2016).

[111]*In re Philadelphia Entertainment and Development Partners, L.P.*, 549 B.R. 103, 146 (Bankr. E.D. Pa. 2016), opinion aff'd, 2017 WL 1160790 (E.D. Pa. 2017).

[112]In re Philadelphia Entm't and Dev. Partners, L.P., 549 B.R. at 150.

[113]In re Patriot Coal Corp., 562 B.R. at 645–646.

was "enough to raise an issue of material fact that prevente[d] the court from granting summary judgment."[114]

See also In re Tomberlin (turnover proceedings are not to be used to liquidate disputed contract claims),[115] *Reed v. Nathan*, discussed in §§ II and VII above, and *In re McKeever*, also discussed in § IV ("turnover proceedings are strictly limited to actions to recover property that is indisputably part of the estate; in other words, a turnover action is not the appropriate tool for acquiring the right to use or possess property if the debtor's right to use or possess the property is subject to dispute.").[116]

The bankruptcy court in *In re Catco Recycling, LLC*, by contrast, resolved several disputed claims that arose in connection with a purchase of a business by a father from his son, and then ordered turnover — pursuant to section 542(b) — of the amount so liquidated and determined.[117]

See also In re Abell, also discussed in § II above (though turnover actions "are limited to recovery of assets that are property of the bankruptcy estate," that principle does not apply in an adversary proceeding in which the turnover claim is ancillary relief to a chapter 11 trustee's claim for declaratory judgment claims).[118]

XI. SECTION 542(C)—THE "GOOD FAITH" EXCEPTION TO TURNOVER

Bankruptcy Code section 542(c) provides that:

Except as provided in section 362(a)(7) of this title, an entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt to the debtor, in good faith an other than in the manner specified in subsection (d) of this section, to an entity other than the trustee, with the same effect as to the entity making such transfer or

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[114] *In re CMTD Contractor, Corp.*, 2016 WL 1411718, *3 (Bankr. D. P.R. 2016).

[115] *In re Tomberlin*, 77 Collier Bankr. Cas. 2d (MB) 406, 2017 WL 410337, *3 (Bankr. M.D. Ala. 2017).

[116] *In re McKeever*, 567 B.R. 652, 663 (Bankr. N.D. Ga. 2017).

[117] *In re Catco Recycling, LLC*, 559 B.R. 293, 296, 302-305, 2016 BNH 09 (Bankr. D. N.H. 2016).

[118] In re Abell, 549 B.R. at 654.

payment as if the case under this title concerning the debtor had not been commenced.[119]

The authors are not aware of any significant published opinions since last year's Annual Survey addressing issues regarding the "good faith" exception to turnover actions.

XII. SECTION 542(E)—OBLIGATION TO TURN OVER RECORDED INFORMATION

Section 542(e) of the Bankruptcy Code provides that "[s]ubject to any applicable privilege, after notice and a hearing, the court may order an attorney, accountant, or other person that holds recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs, to turn over or disclose such recorded information to the trustee."[120]

In *In re Auld*, the Tenth Circuit Bankruptcy Appellate Panel (BAP) reversed the bankruptcy court's decision (reported in last year's Annual Survey) denying the chapter 7 trustee's turnover request. The trustee sought cash from a contract receivable, vehicle titles, loan applications, and documents from the debtor, Kenneth Auld. The trustee also requested an "explanation" from Auld regarding certain property dispositions arising out of the debtor's divorce, and information about the debtor's life insurance.[121] Auld did not object and the bankruptcy court denied the trustee's motion without a hearing, finding that it "lacked sufficient detail as to some of the requested relief and, generally, that information and explanations" were "not properly the subject of a turnover proceeding."[122] Rather, the bankruptcy court held that information and explanations should be obtained either informally, or formally through the discovery process set forth in Bankruptcy Rule 2004.[123] The court also stated that the trustee had failed to demonstrate that the items requested related to, or, were property of the estate, or that Auld was currently in

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[119]11 U.S.C.A. § 542(C).

[120]11 U.S.C.A. § 542(E).

[121]*In re Auld*, 561 B.R. 512, 515, 77 Collier Bankr. Cas. 2d (MB) 15, Bankr. L. Rep. (CCH) P 83052 (B.A.P. 10th Cir. 2017).

[122]In re Auld, 561 B.R. at 517.

[123]In re Auld, 561 B.R. at 517.

"possession, custody, or control" of the items.[124] The trustee appealed.

The BAP reversed. "Present possession" is not a predicate to turnover. Rather, the plain language of Bankruptcy Code section 542(a) makes clear that a trustee need only demonstrate that a debtor had "possession, custody, or control" of the property "during the case."[125] The BAP also disagreed with the bankruptcy court's determination that "information" is not property of the estate. Finding that the use of Bankruptcy Rule 2004 is not a prerequisite to turnover, the BAP held that Code section 541(a)(4) imposes a duty of production on the debtor without the necessity of the trustee's filing a motion.[126] The BAP also took issue with the bankruptcy court's determination that there was "no legal basis" to require an "explanation" from Auld.[127] Specifically, a debtor has a duty to cooperate with the trustee and the administration of the estate under Code section 521(a)(3) and Bankruptcy Rule 4002(a)(4). Thus, the trustee could compel Auld's cooperation in turning over property of the estate, recorded information, and "other information," including "explanations."[128]

XIII. SECTION 543—TURNOVER OF PROPERTY BY A CUSTODIAN

Bankruptcy Code § 543[129] is entitled "Turnover of Property by a Custodian" and is the parallel to § 542. The party from whom the turnover is sought must be a custodian for § 543 to apply. A "custodian" is defined in Code § 101(11) as a:

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;
(B) assignee under a general assignment for the benefit of the debtor's creditors; or
(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of

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[124] In re Auld, 561 B.R. at 517.

[125] In re Auld, 561 B.R. at 519.

[126] In re Auld, 561 B.R. at 519.

[127] In re Auld, 561 B.R. at 520–21.

[128] In re Auld, 561 B.R. at 521.

[129] 11 U.S.C.A. § 543.

enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.[130]

Subsections 543(a) and (b) provide that:

(a) A custodian with knowledge of the commencement of a case under this title concerning the debtor may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents, or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property.

(b) A custodian shall—

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

(2) file an accounting of any property of the debtor, or proceeds, product, offspring, rents, or profits of such property, that, at any time, came into the possession, custody, or control of such custodian.[131]

Subsection 543(c)(2) provides that the court, after notice and a hearing, shall -

(2) provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian.[132]

Subsection 543(d)(1) and (2) provides that after notice and hearing, the bankruptcy court -

(1) may excuse compliance with subsection (a), (b), or (c) of this section if the interests of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property.

(2) shall excuse compliance with subsections (a) and (b)(1)

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[130] 11 U.S.C.A. § 101(11).

[131] 11 U.S.C.A. § 543(a) and (b).

[132] 11 U.S.C.A. § 543(c)(2).

> of this section if the custodian is an assignee for the benefit of the debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, unless compliance with such subsections is necessary to prevent fraud or injustice.[133]

Grounds for Turnover

The bank in *In re Hernandez* had obtained possession of Hernandez' residential apartment building during prepetition foreclosure proceedings. Hernandez filed a voluntary chapter 13 petition, and pursuant to Code section 543(b) sought an accounting and turnover of the building.[134] The debtor's evidence showed that, when the bank took possession, the property was in habitable condition and the rental units were occupied, but had become unoccupied at some point prior to hearing on the turnover motion.[135] The debtor also claimed that the bank had collected rents but had not accounted for the amounts received.[136] The debtor made the mortgage payments directly to the bank during the case. Further, the debtor had regained employment, and his chapter 13 plan contemplated payment of all arrearages and principal due to the bank.[137]

As a threshold matter, the court held that a custodian's duty under section 543(b)(2) to account for property in its custody is mandatory. The bank thus would be required to deliver an accounting even if turnover of the property was not granted to the debtor.[138] Further, turnover of the property was appropriate under the circumstances. The rehabilitation and rent-up of the property was required for plan confirmation, and turnover was necessary to enable the debtor to accomplish those goals. Finally, the court found that the bank had not explained why the property had become vacant and "turnover was required to prevent the Bank from continuing

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[133] 11 U.S.C.A. § 543(d)(1).

[134] *In re Hernandez*, 2016 WL 1055061, *1 (Bankr. N.D. Ill. 2016).

[135] *In re Hernandez*, 2016 WL 1055061, *2 (Bankr. N.D. Ill. 2016).

[136] *In re Hernandez*, 2016 WL 1055061, *2 (Bankr. N.D. Ill. 2016).

[137] *In re Hernandez*, 2016 WL 1055061, *2 (Bankr. N.D. Ill. 2016).

[138] *In re Hernandez*, 2016 WL 1055061, *3 (Bankr. N.D. Ill. 2016) (stating that the bank would be required to provide an accounting because it had not previously provided an accounting or sought be excused from compliance in accordance with § 543(d)(1)).

to hold the property unproductive thus constituting fraud and injustice."[139]

The bankruptcy court in *In re Bullitt Utilities, Inc*. noted that once the bankruptcy petition is filed, even if a state court-appointed receiver is in place, the default position under the Bankruptcy Code is that a debtor is entitled to custody of its property. Bankruptcy Code section 543 directs custodians . . . to turnover such property to the Trustee."[140] The court considered whether the debtor's legal title to a sewage treatment plant was severed when it sought authority from the Public Service Commission, or PSC, to abandon the plant prior to the petition date.[141] The court looked to a staff opinion written by the PSC contemporaneously with the receiver's appointment.[142] In relevant part, the staff opinion provided that: "The receiver does not . . . become the owner of the assets or the owner of the utility . . . The foregoing observations support the proposition that a receiver controls the assets on behalf of the utility and does not become the owner of the assets or the owner of the utility by virtue of the receivership."[143] Finding the staff opinion to be persuasive, the bankruptcy court found that the sewage treatment plant was estate property on the petition date and ordered that it and all of the debtor's other assets were under the sole authority and control of the chapter 7 trustee.[144]

In *In re LB Steel, LLC*, also discussed in § II above, Walsh Construction Company entered into a general contract with the City of Chicago to perform work at O'Hare Airport. Walsh entered into a subcontract Carlo Steel Corporation, which entered into a sub-subcontract with the debtor pursuant to which the debtor agreed to furnish steel supports. The debtor

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[139] *In re Hernandez*, 2016 WL 1055061, *4 (Bankr. N.D. Ill. 2016).

[140] *In re Bullitt Utilities, Inc.*, 558 B.R. 173, 175, 178 (Bankr. W.D. Ky. 2016).

[141] In re Bullitt Utilities, Inc., 558 B.R. at 178.

[142] In re Bullitt Utilities, Inc., 558 B.R. at 179.

[143] In re Bullitt Utilities, Inc., 558 B.R. at 179–80.

[144] In re Bullitt Utilities, Inc., 558 B.R. at 180.

engaged Calumet Testing, Inc. to perform weld-testing on the steel supports.[145]

Two years later, "a surge of litigation began."[146] The City sued Walsh, who sued Carlo Steel, who sued the debtor, who sued Calumet Testing, Inc., all in Illinois Circuit Court. Eventually, Calumet Testing and the City — with the approval of the Illinois Circuit Court — deposited about $3.3 million with the clerk of the court in exchange for certain releases and releases of liens.[147] The state court ultimately entered judgment for Walsh against the debtor for $27 million, and for the debtor against Walsh for $8 million — resulting in a net judgment of $19 million for Walsh against the debtor — and ordered that the clerk "shall" pay the $3.3 million to Walsh.

Four days later, and before the clerk disbursed the funds, the debtor filed its chapter 11 bankruptcy petition. Walsh sought stay relief to obtain payment of the $3.3 million on deposit with the clerk. The debtor filed its complaint seeking turnover of the same sum from the clerk under Code section 543(b), alleging that it was estate property.[148] Walsh filed a motion to dismiss for failure to state a claim, arguing that the funds were not property of the estate because the Circuit Court had ordered a prepetition setoff of mutual obligations.[149] The debtor argued that: (i) the funds had not been set off under Bankruptcy Code section 553[150] which requires mutuality, because the obligations were owed in different capacities; and (ii) the funds remained property of the estate because neither Walsh nor the debtor had obtained possession of the

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[145] *In re LB Steel, LLC*, 547 B.R. 790, 792, 76 Collier Bankr. Cas. 2d (MB) 835 (Bankr. N.D. Ill. 2016).

[146] In re LB Steel, LLC, 547 B.R. at 792.

[147] In re LB Steel, LLC, 547 B.R. at 793.

[148] In re LB Steel, LLC, 547 B.R. at 794.

[149] In re LB Steel, LLC, 547 B.R. at 794.

[150] 11 U.S.C.A. § 553. Bankruptcy Code section 553 recognizing setoff when four conditions have been met: (i) the creditor holds a pre-petition claim against the debtor; (ii) the creditor owes a pre-petition debt to the debtor; (iii) the claim and the debtor are mutual; and (iv) both the claim and the debt are valid and enforceable.

funds before the petition date.[151] The bankruptcy court held that the debtor's mutuality argument was a "non-starter" because the Circuit Court had previously determined that the obligations at issue were mutual for purposes of setoff.[152]

The bankruptcy court also held that the setoff occurred prepetition. The court emphasized that the Circuit Court's order provided that the $8 million judgment awarded to the debtor "shall be set-off against [Walsh's] judgment, for a net judgment in favor of Walsh . . . and against [the debtor] in the amount of $19,187,304.00."[153] Accordingly the setoff had effectuated a prepetition transfer and the funds were not property of the debtor's estate.[154]

In *In re Smith*, the final divorce decree between the debtor and his ex-wife required that their marital residence be sold and the net proceeds divided equally between them.[155] Six years after the divorce became final, the debtor's ex-wife moved to enforce the decree and sell the house.[156] The trial court found the husband Smith "guilty" of not complying with the terms of the divorce, yet he did not sell the house.[157] The trial court appointed a receiver to sell the house and divide the proceeds.[158] Before the receiver obtained possession of the house, the husband Smith filed for chapter 13 bankruptcy.[159] The IRS subsequently filed a proof of claim for its federal tax lien on the property and the receiver moved the bankruptcy court for relief from the automatic stay to proceed with the sale of the property.[160]

At the hearing on the lift stay motion, the court held that, upon the filing of a bankruptcy case, the possession of the state court-appointed receiver ends and the bankruptcy

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[151] In re LB Steel, LLC, 547 B.R. at 797.

[152] In re LB Steel, LLC, 547 B.R. at 798.

[153] In re LB Steel, LLC, 547 B.R. at 801.

[154] In re LB Steel, LLC, 547 B.R. at 801.

[155] *In re Smith*, 2016 WL 3582209, *1 (Bankr. S.D. Tex. 2016).

[156] *In re Smith*, 2016 WL 3582209, *1 (Bankr. S.D. Tex. 2016).

[157] *In re Smith*, 2016 WL 3582209, *1 (Bankr. S.D. Tex. 2016).

[158] *In re Smith*, 2016 WL 3582209, *1 (Bankr. S.D. Tex. 2016).

[159] *In re Smith*, 2016 WL 3582209, *1 (Bankr. S.D. Tex. 2016).

[160] *In re Smith*, 2016 WL 3582209, *1 (Bankr. S.D. Tex. 2016).

court's possession immediately attaches.[161] Because the receiver never took possession of the property, it had no duty under Bankruptcy Code section 543(b) to file an accounting or to turn over the property.[162] The bankruptcy court ordered that, though the authority of the receiver over the property had terminated with the commencement of the bankruptcy case, the property must be sold in accordance with the divorce decree.[163] The court provided a strict timeline within which the property must be sold, with the proceeds first being paid to all creditors holding secured liens, including the IRS, and the remaining proceeds, if any, to be split between the debtor and his ex-wife.[164]

In *In re Ute Lake Ranch, Inc*., the bankruptcy court held that the authority of a prepetition state court receiver ended upon the commencement of the bankruptcy case, despite the fact that a receivership order was in place and the state court had entered an order that directed the receiver to initiate the bankruptcy proceedings and authorized the receiver as officer, manager and representative of the debtors to effectuate the bankruptcy filing.[165] The second order purported to grant the receiver the authority to "operate the [Debtors] as debtors-in-possession and to remain in possession, custody and control of the bankruptcy estates."[166] In accordance with the state court's order, the receiver caused the debtors to file a voluntary chapter 11 petition. The United States Trustee argued in the bankruptcy case that the receiver was a "custodian" and, therefore, was prohibited from administering the debtors' property.[167] The receiver countered that it was functioning only as the manager of the debtors, as authorized by the state court's order, and that once it had filed the debtors' bank-

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[161] *In re Smith*, 2016 WL 3582209, *2 (Bankr. S.D. Tex. 2016).

[162] *In re Smith*, 2016 WL 3582209, *2 (Bankr. S.D. Tex. 2016).

[163] *In re Smith*, 2016 WL 3582209,*3 (Bankr. S.D. Tex. 2016).

[164] *In re Smith*, 2016 WL 3582209, *3 (Bankr. S.D. Tex. 2016).

[165] *In re Ute Lake Ranch, Inc.*, 2016 WL 6472043,*1 (Bankr. D. Colo. 2016).

[166] In re Ute Lake Ranch, Inc. 2016 WL 6472043, at *2.

[167] In re Ute Lake Ranch, Inc. 2016 WL 6472043, at *2.

ruptcy petitions, the receivership was stayed and its role as "custodian" was terminated.[168]

The bankruptcy court held that the state court did not have jurisdiction to decide the receiver's status under the Bankruptcy Code.[169] A bankruptcy court is prohibited by Code section 105(b) from appointing a receiver in a bankruptcy case. The court stated that if it were to allow the receiver to remain in control of the debtors' assets, the state court's order would become "a roadmap for court-appointed receivers and custodians to retain control of a debtor's assets in bankruptcy."[170] The court directed the appointment of a chapter 11 trustee.[171]

The state court in *Lynch v. Vaccaro* appointed a receiver and held the debtor in contempt for failure to sell marital property.[172] The state court authorized the receiver to sell the property, and the receiver entered into a contract of sale.

Before the purchaser could close on the deal, the debtor filed for chapter 11 protection.[173] The debtor's ex-husband (later joined by the receiver) filed a motion pursuant to Code section 543(d), requesting that the receiver remain in custody of the property.[174] The bankruptcy court granted the motion, and authorized the receiver to market and sell the property at auction.[175] The debtor appealed the excusal order.[176] A purchaser tendered a winning bid of the property, and the bankruptcy court authorized the sale. The debtor appealed the sale order.[177]

The district court held that reversal of the excusal order would result in delivering possession of the property to the debtor, thereby negating the sale of the property to the

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[168]In re Ute Lake Ranch, Inc. 2016 WL 6472043, at *2.

[169]In re Ute Lake Ranch, Inc. 2016 WL 6472043, at *5.

[170]In re Ute Lake Ranch, Inc. 2016 WL 6472043, at *5.

[171]In re Ute Lake Ranch, Inc. 2016 WL 6472043, at *6–7.

[172]*Lynch v. Vaccaro*, 566 B.R. 290 (E.D. N.Y. 2017).

[173]*Lynch v. Vaccaro*, 566 B.R. 290, 292 (E.D. N.Y. 2017).

[174]*Lynch v. Vaccaro*, 566 B.R. 290, 293 (E.D. N.Y. 2017).

[175]*Lynch v. Vaccaro*, 566 B.R. 290, 293 (E.D. N.Y. 2017)

[176]*Lynch v. Vaccaro*, 566 B.R. 290, 293 (E.D. N.Y. 2017).

[177]*Lynch v. Vaccaro*, 566 B.R. 290, 298 (E.D. N.Y. 2017).

purchaser.[178] The "statutory mootness" provisions of Code section 363(m) bar appellate review of any sale authorized under section 363(b) or (c).[179] The court dismissed the appeals as moot under section 363(m) of the Code.[180]

Custodian's Claim for Fees and Expenses

The court-appointed receiver in *Searcy v. Black* similarly requested payment of prepetition and postpetition fees and expenses.[181] The bankruptcy court granted the receiver's request and awarded the receiver $171,255.

The chapter 11 trustee and the creditors' committee appealed, arguing among other things that the receiver had not filed an accounting.[182] The receiver argued that the appellants did not raise the issue below and therefore could not raise it on appeal.[183] The district court found that the trustee's and committee's arguments before the bankruptcy court regarding the receiver's failure to account were undeveloped assertions, that were insufficient to preserve the issue on appeal, and affirmed.[184]

In *In re Crespo*, the bankruptcy court granted a portion of the receiver's request for fees and reimbursement of expenses in a chapter 13 case.[185] The state court-appointed receiver sought allowance of fees in the amount of 21.9% of the rents collected, and reimbursement of expenses for its prepetition work. The debtor moved for turnover of the rental funds in the receiver's control.[186]

The issues before the court were: (1) whether the receiver,

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[178] *Lynch v. Vaccaro*, 566 B.R. 290, 302 (E.D. N.Y. 2017).

[179] *Lynch v. Vaccaro*, 566 B.R. 290, 301 (E.D. N.Y. 2017).

[180] *Lynch v. Vaccaro*, 566 B.R. 290, 305 (E.D. N.Y. 2017).

[181] In re Bullitt Utilities, Inc., 558 B.R. at 180.

In re LB Steel, LLC, 547 B.R. at 792. *Searcy v. Black*, Bankr. L. Rep. (CCH) P 82936, 2016 WL 866757, *1 (E.D. Tex. 2016).

[182] *Searcy v. Black*, Bankr. L. Rep. (CCH) P 82936, 2016 WL 866757, *5 (E.D. Tex. 2016).

[183] *Searcy v. Black*, Bankr. L. Rep. (CCH) P 82936, 2016 WL 866757, *10 (E.D. Tex. 2016).

[184] *Searcy v. Black*, Bankr. L. Rep. (CCH) P 82936, 2016 WL 866757, *10 (E.D. Tex. 2016).

[185] *In re Crespo*, 561 B.R. 25, 27 (Bankr. D. Conn. 2016).

[186] In re Crespo, 561 B.R. at 27.

as custodian of the funds, was entitled to payment either as an administrative expense pursuant to Bankruptcy Code section 503(b)(3)(E), or as an unsecured, prepetition creditor; and (2) whether the receiver's requested fees were reasonable.[187] The state court had made no determination of the receiver's fees. The bankruptcy court noted that, pursuant to Bankruptcy Code section 503(b)(3)(E), a receiver is entitled to fees as an administrative expense if the receiver's prepetition services provided a benefit to the estate.[188] The debtor did not dispute that the receiver provided a benefit to the estate, but argued that it was not entitled to a priority administrative expense claim because it did not immediately turn over the rents.[189] The court held that the receiver's failure to immediately turn over the funds was not an absolute bar to payment to the trustee of an administrative expense claim, but rather, it was one factor for the court's consideration in determining whether to award fees to the receiver.[190] The court noted that the receiver's records lacked "consistency, transparency, and integrity expected from a court-appointed receiver."[191] Further, part of a receiver's job is to know that when a bankruptcy is filed, and Code section 543 compels immediate turnover.[192] On consideration of these factors, the court awarded the receiver only 5% of the amounts collected, rather than the 21.9% requested by the receiver.[193]

In *In re 29 Brooklyn Ave., LLC*, the bankruptcy court also allowed the requested fees and expenses of the receiver's counsel, but in a reduced amount.[194] The receiver had fully complied with the turnover and accounting requirements of section 543(b).[195] After turning the property over, the receiver filed a proof of claim against the debtor for prepetition expen-

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[187] In re Crespo, 561 B.R. at 28.

[188] In re Crespo, 561 B.R. at 33.

[189] In re Crespo, 561 B.R. at 33.

[190] In re Crespo, 561 B.R. at 33.

[191] In re Crespo, 561 B.R. at 34.

[192] In re Crespo, 561 B.R. at 35.

[193] In re Crespo, 561 B.R. at 35.

[194] *In re 29 Brooklyn Avenue, LLC*, 548 B.R. 642, 654, 62 Bankr. Ct. Dec. (CRR) 140 (Bankr. E.D. N.Y. 2016).

[195] In re 29 Brooklyn Ave, LLC 548 B.R. at 644.

ses, paid and unpaid.[196] The proof of claim was denied in part and allowed in part after an eight day trial.[197] Following the trial, the receiver filed a fee application seeking allowance of its counsel's fees incurred in the bankruptcy case in the amount of $355,953.25, the majority of which was related to the defense of the proof of claim.[198]

The court stated that there was no question that the receiver's attorneys were entitled to fees under Bankruptcy Code sections 543 and 503 for "services directly related to the process of turning over property of the estate in the Receiver's control and providing the required accounting."[199] The issue, however, was whether section 503(b)(4) allowed for fees incurred in defending a receiver's application for compensation under section 503(b)(3)(E)[200] The bankruptcy court distinguished the Supreme Court's recent decision in *Baker Botts L.L.P. v. ASARCO LLC*, reasoning that the work performed by the receiver's counsel was work performed *for the client* in litigating the proof of claim on the receiver's behalf, as opposed to time the law firm in ASARCO spent litigating for its own interests and arguable its own client (*i.e.,* the administrator of the bankruptcy estate).[201] The court also noted that the fee-shifting statute in ASARCO was section 330(a) rather than section 503(b)(4).[202] The services performed by the receiver of 29 Brooklyn Ave. had provided a benefit to the estate and the receiver was entitled to compensation and reimbursement of expenses.[203] The debtor made litigation the "only avenue through which [the Receiver] could receive [his] due compensation." The court approved attorney's fees in a somewhat reduced amount, after analyzing time entries,

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[196]In re 29 Brooklyn Ave, LLC 548 B.R. at 644.

[197]In re 29 Brooklyn Ave, LLC 548 B.R. at 644.

[198]In re 29 Brooklyn Ave, LLC 548 B.R. at 644.

[199]In re 29 Brooklyn Ave, LLC 548 B.R. at 646.

[200]In re 29 Brooklyn Ave, LLC 548 B.R. at 646.

[201]In re 29 Brooklyn Ave, LLC 548 B.R. at 647, citing *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 192 L. Ed. 2d 208, 61 Bankr. Ct. Dec. (CRR) 41, 73 C.B.C. 1017, Bankr. L. Rep. (CCH) P 82811 (2015).

[202]In re 29 Brooklyn Ave, LLC 548 B.R. at 647.

[203]In re 29 Brooklyn Ave, LLC 548 B.R. at 652.

hourly rates, and other factors that it considered to be relevant.[204]

XIV. AUTOMATIC STAY/ADEQUATE PROTECTION

Section 362(a) of the Bankruptcy Code provides in relevant part:

> [A] petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities, of -
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> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
>
> (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
>
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate . . ..[205]

Subsection 362(k)(1) provides that:

> [A]n individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.[206]

In *In re Cowen*, the Tenth Circuit held that a secured creditor did not violate the automatic stay by passively retaining possession of collateral that was repossessed prepetition.[207] The chapter 13 debtor had borrowed money in exchange for liens on two commercial trucks.[208] Following the debtor's default, the secured creditors repossessed the trucks, and the

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[204] In re 29 Brooklyn Ave, LLC 548 B.R. at 652 (citing *In re Wind N' Wave*, 509 F.3d 938, 946, 58 Collier Bankr. Cas. 2d (MB) 1691 (9th Cir. 2007).

[205] 11 U.S.C.A. § 362(A)(1) to (3).

[206] 11 U.S.C.A. § 362(K)(1).

[207] *In re Cowen*, 849 F.3d 943, 951, 63 Bankr. Ct. Dec. (CRR) 211, 77 Collier Bankr. Cas. 2d (MB) 438 (10th Cir. 2017).

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

debtor filed his chapter 13 bankruptcy case.[209] The debtor notified the creditors of the bankruptcy case and requested turn over; however, one of the creditors claimed that he had changed the title to his name and, the other alleged that he had sold the truck.[210] The bankruptcy court ordered immediate turnover of the property and warned that the creditors' continued failure to turn over the trucks could result in the imposition of monetary damages for willful violation of the automatic stay.[211]

Upon the creditors' failure to comply with the turnover order, the debtor filed an adversary proceeding seeking damages for violations of the automatic stay.[212] The bankruptcy court rejected the creditors' arguments that the debtor's rights in the trucks had been terminated prepetition, and "did not find the [creditors'] testimony that they transferred title before the petition date credible."[213] The bankruptcy court even went so far as to say that the creditors manufactured and forged documents and gave perjured testimony after the bankruptcy case commenced.[214] The district court affirmed the bankruptcy court's decision and the creditors appealed to the Tenth Circuit, arguing that the bankruptcy court exceeded its jurisdiction and misinterpreted section 362.[215]

The Tenth Circuit Court held that it was well within the bankruptcy court's jurisdiction to decide a "core issue" such as a section 362(k)(1) proceeding regarding violation of the automatic stay.[216] The Tenth Circuit disagreed with the lower courts and the majority rule that the act of passively holding onto an asset constitutes "exercising control" over it.[217] Rather, it looked to the text of section 362(a)(3) to adopt the minority rule that "only affirmative acts to gain possession of, or to exercise control over, property of the estate violate

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

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

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

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

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

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

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

[216]In re Cowen, 849 F.3d at 947.

[217]In re Cowen, 849 F.3d at 948.

§ 362(a)(3)."[218] Accordingly, it reversed the decision that the creditors' failure to return the trucks postpetition constituted a continuing violation of the automatic stay.[219] The Tenth Circuit did, however, remand a portion of the case and emphasized that the bankruptcy court's damage award might be sustainable under sections 362(a)(3) and 105(a), which allows the bankruptcy court to sanction conduct abusive of the judicial process.[220]

The debtors in *In re Garcia* allegedly had purchased, prepetition, the hereditary shares of their relatives in a probate estate.[221] The purchase price for the shares was paid in notes made by the debtors, which remained unpaid at the time the debtors commenced their bankruptcy case. The heirs sought distributions in the probate proceeding on account of the hereditary shares that they had sold to the debtors. The probate estate included parcels of real property. Eleven days after the debtors' bankruptcy case commenced, the real property was sold in the probate proceeding at public auction, and the proceeds were consigned with the probate court.[222]

Following conversion of the debtors' case to chapter 7, the trustee sought turnover of the proceeds. The bankruptcy court ordered turnover. The district court reversed, holding that the matter of the disposition of the funds fell within the probate exception and thus the bankruptcy court thus lacked jurisdiction over it.[223]

The chapter 7 trustee filed an adversary complaint in the bankruptcy case, alleging that a motion for summary judgment filed by the heirs in the probate court violated the automatic stay.[224] The heirs moved to dismiss in the bankruptcy court, arguing that the automatic stay had not barred their recoupment defense based on the debtors' failure to pay

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

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

[220]In re Cowen, 849 F.3d at 951.

[221]*In re Garcia*, 553 B.R. 1, 2 (Bankr. D. P.R. 2016).

[222]In re Garcia, 553 B.R. at 4.

[223]In re Garcia, 553 B.R. at 6.

[224]In re Garcia, 553 B.R. at 6.

for the hereditary shares, and that the bankruptcy court lacked subject matter jurisdiction.[225]

The bankruptcy court denied the heirs' motion to dismiss. First, it was the not the proper procedural mechanism by which to assert the recoupment doctrine.[226] Further, the bankruptcy court's determination of whether the automatic stay had been violated by the heirs' proceeding postpetition in state court did not infringe on the narrow probate exception, which restricts a bankruptcy court's jurisdiction and authority regarding the disposition of property in the custody of a state probate court.[227]

In *In re Reilly*, a creditor attached and levied on the debtor's checking and brokerage accounts prepetition, pursuant to a state court order. The creditor refused to release the attachments following notice of the bankruptcy case. The chapter 7 trustee moved for an order holding the creditor in contempt for willfully violating the automatic stay.[228] The creditor argued against the motion by claiming that the debtor owed it money from an unpaid judgment that arose from the debtor's breach of a franchise agreement.[229] Additionally, the creditor's "temporary" refusal to release the attachments did not violate the stay because its actions to attach the accounts occurred prepetition and, as a secured creditor, it was entitled to seek adequate protection and because.[230] Moreover, when the debtor requested release of the attachments, the creditor asked that he provide assurances that he would not dispose of the assets, and he had refused to provide such assurances.[231]

The bankruptcy court denied the trustee's motion. The court noted that the creditor had never sought or obtained possession of the debtor's funds and they continued to be held by third-party institutions.[232] Distinguishing the case from *United States v. Whiting Pools, Inc*., the court found that the

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[225]In re Garcia, 553 B.R. at 7.

[226]In re Garcia, 553 B.R. at 11.

[227]In re Garcia, 553 B.R. at 13.

[228]*In re Rielly*, 545 B.R. 435, 447 (Bankr. D. Mass. 2016).

[229]In re Reilly, 545 B.R. at 438.

[230]In re Reilly, 545 B.R. at 438.

[231]In re Reilly, 545 B.R. at 438.

[232]In re Reilly, 545 B.R. at 445.

creditor did not have to relinquish the attachments before seeking adequate protection because it had a reasonable basis—as a result of the debtor's previous refusal—to believe that any request for adequate protection would be moot.[233] Lastly, the court found that the creditor's failure to release its attachments against the funds in the accounts did not amount to an exercise of control over or an action to enforce a lien on property of the estate. In sum, there was no willful violation of the section 362(a)(1) through (6).[234]

The bankruptcy court in *In re Black* granted the chapter 13 debtors' motion for turnover and sanctions for violation of the automatic stay.[235] Pursuant to Code section 362(k)(1), "an individual injured by any willful violation of a stay . . . shall recover actual damages, including costs and attorneys' fees, and in appropriate circumstances, may recover punitive damages."[236] The North Carolina Department of Revenue, with notice of the commencement of the bankruptcy case, issued a bank account garnishment order against the debtors' bank account held at Wells Fargo Bank, N.A.[237] Wells Fargo issued and processed "Legal Order Debits" in the amounts of $289.10 and $301.74 for the benefit of the Department of Revenue, and imposed an additional $125.00 "Legal Order Fee Debit" charge.[238] The debtors' counsel contacted counsel to the Department of Revenue, which stated that a release of the

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[233]In re Reilly, 545 B.R. at 446 (citing *U.S. v. Whiting Pools, Inc.*, 1983-2 C.B. 239, 462 U.S. 198, 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). The Court in *Reilly* also distinguished the case from *Whiting Pools* because that case involved a chapter 11 reorganization and the court in *Whiting Pools* specifically stated that it expresses no view on the issue of whether § 542(a) has the same broad effect in liquidation proceedings.

[234]In re Reilly, 545 B.R. at 447.

[235]*In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674,*4 (Bankr. E.D. N.C. 2016).

[236]11 U.S.C.A. § 362(k)(l).

[237]*In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *1 (Bankr. E.D. N.C. 2016).

[238]*In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *1 (Bankr. E.D. N.C. 2016).

garnishment would be sent to Wells Fargo immediately.[239] The Department then faxed and mailed a letter to Wells Fargo instructing it to return the garnished funds to the debtor.[240] Wells Fargo did not return the garnished funds, despite continued communication between debtors' counsel and Wells Fargo, and the Department of Revenue's efforts to get Wells Fargo to cooperate.[241] As a result, the debtors' counsel incurred legal fees of at least $3,000 in the course of the matter.[242]

The bankruptcy court found that the Department of Revenue had attempted to withdraw the tax garnishment without delay, and Wells Fargo had refused to cooperate.[243] The Department also issued the debtors a check to mitigate their losses and make them whole.[244] Accordingly, the Department did not act in bad faith and was not subject to punitive damages. The court limited the Department's liability to $500, for attorneys' fees incurred by the debtors for the mistakenly issued garnishment.[245] Wells Fargo, by comparison, had repeatedly violated the automatic stay despite ample opportunity to cure the violation.[246] The court ordered actual and punitive damages against Wells Fargo, stating that it had "demonstrated callous disregard towards the operation of the United States Bankruptcy Code and the authority of this court."[247]

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[239] *In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *2 (Bankr. E.D. N.C. 2016).

[240] *In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *2 (Bankr. E.D. N.C. 2016).

[241] *In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *3 (Bankr. E.D. N.C. 2016).

[242] *In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *3 (Bankr. E.D. N.C. 2016).

[243] *In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *3 (Bankr. E.D. N.C. 2016).

[244] *In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *3 (Bankr. E.D. N.C. 2016).

[245] *In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *3 (Bankr. E.D. N.C. 2016).

[246] *In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *4 (Bankr. E.D. N.C. 2016).

[247] *In re Black*, 76 Collier Bankr. Cas. 2d (MB) 572, 2016 WL 1043674, *4 (Bankr. E.D. N.C. 2016).

In *In re Burbano*, the bankruptcy court granted the debtor's motion for sanctions for violation of the automatic stay where a creditor failed to take steps to cause a collection activity to cease by refusing to provide the debtor with a release necessary for the debtor to have his driver's license reinstated.[248] The creditor in *Burbano* was awarded a prepetition judgment against the debtor for an automobile accident.[249] The debtor failed to pay the judgment and, pursuant to Georgia law, the creditor caused the debtor's driver's license to be suspended by notifying the state court of the debtor's default.[250] The debtor, after filing for bankruptcy, requested that the creditor provide a release so that the debtor could have his license reinstated.[251]

The creditor argued that it was under no affirmative obligation to assist the debtor in getting the license suspension lifted. The bankruptcy court disagreed and ordered the creditor to provide the release.[252] The license suspension was lifted, and the debtor filed a motion for sanctions for damages he incurred: (i) for lost wages for not being able to drive to work; and (ii) for attorneys' fees incurred in preparing and prosecuting the motion to compel the creditor to provide the release.[253] The court ordered the creditor to pay the debtor's attorneys' fees. The law that provided for the license suspension was a mechanism for a judgment creditor to collect its debt.[254] Upon a creditor's receiving notification of a pending bankruptcy case, Code section 542 shifts the burden to the creditor to cease any efforts to collect the debt.[255] A creditor engaged in a collection activity—such as by using a statutory

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[248] *In re Burbano*, 2017 WL 1058219, *7 (Bankr. N.D. Ga. 2017).

[249] *In re Burbano*, 2017 WL 1058219, *1 (Bankr. N.D. Ga. 2017).

[250] *In re Burbano*, 2017 WL 1058219, *1 (Bankr. N.D. Ga. 2017) (citing O.C.G.A. § 40-9-60).

[251] *In re Burbano*, 2017 WL 1058219, *1 (Bankr. N.D. Ga. 2017).

[252] *In re Burbano*, 2017 WL 1058219, *1 (Bankr. N.D. Ga. 2017).

[253] *In re Burbano*, 2017 WL 1058219, *2 (Bankr. N.D. Ga. 2017).

[254] *In re Burbano*, 2017 WL 1058219, *4 (Bankr. N.D. Ga. 2017).

[255] *In re Burbano*, 2017 WL 1058219,*5 (Bankr. N.D. Ga. 2017) (citing 11 U.S.C.A. § 542).

license suspension proceeding—has a "clear obligation . . . to take steps to cause that collection activity to cease."[256]

XV. SETOFF

Section 542(b) specifically excepts a matured debt from turnover to the extent that such debt may be offset under § 553 against a claim of the debtor, as follows:

Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.[257]

The bankruptcy court in *In re Ralph Roberts Realty, LLC*, held that defendants in an adversary proceeding did not have valid claims or rights for setoff off or recoupment.[258] The debtor brought an adversary proceeding based on an alleged prepetition oral agreement with the defendants.[259] The debtor asserted that, under the agreement, it was owed profits made on the sale of certain properties, and moved the court for turnover and an accounting of the funds received from the sales.[260] The defendants argued, among other things, that they had a right to setoff losses they suffered on a few properties from the profits that they made on the others.[261] The court held an evidentiary hearing and found that the debtor's testimony regarding the parties' oral agreements on loss-sharing was more credible than the defendants' testimony.[262] Accordingly, the court held that the defendants' setoff and recoupment arguments failed and entered a judgment setting forth the specific amounts owed by each individual defendant.[263]

The bankruptcy court in *In re Corp. Res. Servs., Inc.* held

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[256] *In re Burbano*, 2017 WL 1058219, *7 (Bankr. N.D. Ga. 2017).

[257] 11 U.S.C.A. § 553.

[258] *In re Ralph Roberts Realty, LLC*, 562 B.R. 144, 166 (Bankr. E.D. Mich. 2016).

[259] In re Ralph Roberts Realty, LLC, 562 B.R. at 146.

[260] In re Ralph Roberts Realty, LLC, 562 B.R. at 146 (citing 11 U.S.C.A. § 542).

[261] In re Ralph Roberts Realty, LLC, 562 B.R. at 165.

[262] In re Ralph Roberts Realty, LLC, 562 B.R. at 166.

[263] In re Ralph Roberts Realty, LLC, 562 B.R. at 166–67.

that a claimant's contingent claims could not be used to set off amounts owed because they had not yet accrued and might never accrue.[264] The chapter 11 trustee brought an adversary proceeding against the prepetition purchaser of substantially all of the debtor's assets, alleging breach of contract, and seeking turnover and avoidance of the sale as a constructive fraudulent transfer.[265] The claimant asserted a setoff defense under section 553 for contingent claims.[266] The court faced the issue of whether section 553 creates a right of setoff not available under state law.[267] In answering the question in the negative, the court held that section 553 merely *preserves* the right to setoff.[268] Therefore, the claimant's defense failed because New York law, which applied, does not allow setoff of contingent claims.[269] The court also found that even if the claimant had a right to setoff under New York law, it could not satisfy section 553's requirement that any mutual debts "arose before the commencement of the [bankruptcy case]."[270]

In *In re Buttrill* the court granted the Army and Air Force Exchange Service's motion to retroactively modify the automatic stay so that it could retain the chapter 7 debtors' federal income tax overpayment as an offset pursuant to section 553.[271] The debtors were delinquent, prepetition, on accounts with the Service.[272] The debtors in their bankruptcy case claimed an exemption in an anticipated tax overpayment.[273] Without seeking relief from the automatic stay, the Department of Treasury exercised the Service's right under the Treasury Offset Program to send the overpayment to the Service

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[264]In *In re Corporate Resource Services, Inc.*, 564 B.R. 196, 208, 63 Bankr. Ct. Dec. (CRR) 212 (Bankr. S.D. N.Y. 2017).

[265]In re Corp. Res. Servs., Inc., 564 B.R. at 197.

[266]In re Corp. Res. Servs., Inc., 564 B.R. at 197.

[267]In re Corp. Res. Servs., Inc., 564 B.R. at 197.

[268]In re Corp. Res. Servs., Inc., 564 B.R. at 200.

[269]In re Corp. Res. Servs., Inc., 564 B.R. at 200–01.

[270]In re Corp. Res. Servs., Inc., 564 B.R. at 207 (citing 11 U.S.C.A. § 553).

[271]*In re Buttrill*, 549 B.R. 197, 200, 75 Collier Bankr. Cas. 2d (MB) 502, 117 A.F.T.R.2d 2016-1219 (Bankr. E.D. Tenn. 2016)

[272]In re Butrill, 549 B.R. at 200.

[273]In re Butrill, 549 B.R. at 201.

for satisfaction of prepetition non-tax liabilities.[274] The debtors argued in their objection that the Service had not proven that it was entitled to an offset because there were no "mutual debts" between the Service and the debtors.[275] Specifically, the debtors asserted that the Department of Treasury and the Service are not the same entity.[276]

The court disagreed, finding that the United States owed the debtors for a tax overpayment that matured prepetition and the debtors owed the Service as a result of their prepetition default.[277] Furthermore, the United States and the Service—as an agency of the United States—comprised a unitary creditor holding a mutual debt with the debtors.[278] The court also held that cause existed to modify the automatic stay because the Service had established its right to set off.[279] The court further adopted the minority view, to hold that the debtors' exemption rights under Code section 522 did not supersede the Service's setoff rights under section 553.[280] Instead, "the debtor may only exempt what the applicable law allows the debtor to retain outside of bankruptcy. Even a trustee cannot require a creditor who owes a debt to the estate to make the payment to the estate if the debt is subject to offset."[281]

See also *In re LB Steel, LLC* discussed in § XIII, *supra*.

XVI. FREE EXERCISE CLAUSE OF THE FIRST AMENDMENT; FOURTH AND FIFTH AMENDMENT PRIVILEGE

The authors are not aware of any significant published opinions since last year's Annual Survey addressing the relation between the First, Fourth or Fifth Amendment privilege and turnover actions.

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[274] In re Butrill, 549 B.R. at 200.

[275] In re Butrill, 549 B.R. at 203.

[276] In re Butrill, 549 B.R. at 203.

[277] In re Butrill, 549 B.R. at 203.

[278] In re Butrill, 549 B.R. at 203.

[279] In re Butrill, 549 B.R. at 205.

[280] In re Butrill, 549 B.R. at 207–08.

[281] In re Butrill, 549 B.R. at 208 (citing 11 U.S.C.A. § 543(b)).

XVII. SEVENTH AMENDMENT—RIGHT TO JURY TRIAL

The authors are not aware of any significant published opinions since last year's Annual Survey addressing the relation between the Seventh Amendment right to jury trial and turnover actions.

XVIII. REVOCATION OR DENIAL OF DISCHARGE AND OTHER SANCTIONS FOR FAILURE TO TURNOVER OR COMPLY WITH TURNOVER ORDER

The court may sanction a debtor for violation of a § 542 turnover order by the revocation of a debtor's discharge and, in addition, may sanction the debtor and other parties by other means for such violation.

The bankruptcy "court has few more powerful remedies at its disposal than those provided in § 727(d). That section allows a court to revoke a debtor's discharge when the trustee demonstrates that the debtor has refused to obey a court order and acquired, but failed to account for property of the estate."[282] Bankruptcy Code section 727(d)(2) provides that the court shall revoke a discharge granted under section 727(a) of the Bankruptcy Code if "the debtor acquired property that is property of the estate . . . and knowingly and fraudulently failed to report the acquisition of or entitlement to such property, or to deliver or surrender such property to the trustee . . .."[283] Bankruptcy Code § 727(d)(3) incorporates by reference Bankruptcy Code section 727(a)(6)(A) which provides that a debtor may not be granted a discharge if he has refused to obey a lawful order of the court.[284]

In *In re Johnsson*, the bankruptcy court held that revocation of the debtor's discharge was warranted where the debtor failed to report and surrender a $53,242.06 inheritance to the chapter 7 trustee.[285] The chapter 7 trustee filed an adversary complaint seeking to revoke the debtor's bankruptcy discharge pursuant for knowingly and fraudulently failing to

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[282] *In re Wright*, 371 B.R. 472, 479 (Bankr. D. Kan. 2007).

[283] 11 U.S.C.A. § 727(d)(2).

[284] In re Wright, 371 B.R. at 479.

[285] *In re Johnsson*, 551 B.R. 384, 405–409 (Bankr. N.D. Ill. 2016).

report or to surrender an inheritance to the trustee.[286] Under Illinois law, the debtor became entitled to the inheritance on the date the debtor's uncle passed away and, because that date occurred within 180 days after the debtor commenced its chapter 7 bankruptcy case, the inheritance constituted property of the bankruptcy estate.[287] It was undisputed that the debtor never turned over the inheritance and the court found that the debtor failed to amend her schedules to reflect the asset.[288] The court held that the debtor had acted "knowingly and fraudulently" under section 727(d)(2), because she had "acted with such reckless behavior in failing to report and deliver the [i]heritance to the [t]rustee so as to justify a finding of fraud."[289] Though the debtor repeatedly claimed that she was not entitled to and had wrongfully received the inheritance, she willingly had accepted her portion thereto.[290] The court concluded that the trustee had carried her burden with respect to each of the elements of section 727(d)(2) and revoked the debtor's discharge.[291]

In *In re Reed*, the district court affirmed the bankruptcy court's sanctions against two lawyers and a company for their failure to comply with a turnover order.[292] The bankruptcy court had granted the chapter 7 trustee's turnover motion.[293] The bankruptcy court held that the lawyers and the company had not made a good faith effort to turn over the requested documents, and found that one of the lawyers had made misleading statements at the hearing on the turnover motion.[294] The district court found no abuse of discretion by the bankruptcy court and affirmed.[295]

In contrast, the district court in *In re Fraterfood Serv., Inc.*, also discussed in § VII above, reversed the bankruptcy court's

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[286]In re Johnsson, 551 B.R. at 388, 404.

[287]In re Johnsson, 551 B.R. at 405 (citing 11 U.S.C.A. 541(a)(5)(A).

[288]In re Johnsson, 551 B.R. at 405.

[289]In re Johnsson, 551 B.R. at 409.

[290]In re Johnsson, 551 B.R. at 408.

[291]In re Johnsson, 551 B.R. at 409.

[292]*In re Reed*, 2017 WL 44645, *1 (E.D. Mo. 2017).

[293]*In re Reed*, 2017 WL 44645, *1 (E.D. Mo. 2017).

[294]*In re Reed*, 2017 WL 44645, *2 (E.D. Mo. 2017).

[295]*In re Reed*, 2017 WL 44645, *7 (E.D. Mo. 2017).

order sanctioning the debtor's counsel.[296] The bankruptcy court had dismissed the debtor's turnover complaint because the legal assertions made were not supported by existing law and thus the debtor's factual allegations had failed to establish an estate interest in the disputed property.[297] The court further determined that the complaint was filed for the "improper purpose of forestalling" the appellee-landlord from collecting on its rent claim.[298] The debtor's counsel appealed the bankruptcy court's decision arguing, *inter alia*, that the bankruptcy court had abused its discretion by imposing sanctions because the complaint was supported by existing law.[299] The district court, in reversing the sanctions, held that the bankruptcy court erred in interpreting portions of the lease at issue and, therefore, the complaint was arguably sustained by existing law. Sanctions, thus, were inappropriate.[300]

XIX. TIME LIMITATIONS FOR ACTION; ISSUE PRECLUSION; CLAIM PRECLUSION

The Bankruptcy Code contains no express time limitation for the commencement of a turnover proceeding, however, turnover actions under section 542 are "subject to equitable defenses, such as laches, equitable estoppel, waiver, and acquiescence."[301]

In *In re Brizinova*, also discussed in §§ VII, VIII and IX above, the bankruptcy court ruled that the chapter 7 trustee's turnover action, brought more than three years after the commencement of the case, was not time-barred at the pleadings stage by laches.[302] In holding that the turnover claim was not time-barred, the bankruptcy court stated that the debtors "have not established—at this stage in these proceedings—

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[296] *Fraterfood Service, Inc. v. DDR Del Sol LLC*, 2016 WL 1604702, *10 (D.P.R. 2016).

[297] *Fraterfood Service, Inc. v. DDR Del Sol LLC*, 2016 WL 1604702, *2 (D.P.R. 2016).

[298] *Fraterfood Service, Inc. v. DDR Del Sol LLC*, 2016 WL 1604702, *3 (D.P.R. 2016).

[299] *Fraterfood Service, Inc. v. DDR Del Sol LLC*, 2016 WL 1604702, *3 (D.P.R. 2016).

[300] *Fraterfood Service, Inc. v. DDR Del Sol LLC*, 2016 WL 1604702, *10 (D.P.R. 2016).

[301] *In re Swift*, 496 B.R. 89, 99 (Bankr. E.D. N.Y. 2013).

[302] *In re Brizinova*, 554 B.R. 64, 78–79 (Bankr. E.D. N.Y. 2016).

that the Trustee delayed in asserting this claim despite the opportunity to do so. Nor have [the debtors] shown—at this stage in these proceedings—that they did not know that this claim would be asserted, or that they have been prejudiced by the delay."[303]

XX. APPEALS

The authors are not aware of any published opinions since last year's Annual Survey addressing the standards for review on appeal. The standards for review by the courts of appeals of the decisions of the district courts, and by the district courts of the decisions of the bankruptcy courts, continue to adhere to established principles.

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[303] In re Brizinova, 554 B.R. at 78–79 (internal quotation marks omitted).