No. 11-16019

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re BARBARA MELINDA HENSON,
Debtor.

BRIAN DAVID SHAPIRO,
Trustee-Appellant

— v. —

BARBARA MELINDA HENSON
Debtor-Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEVADA No. 10-00726-ECR-GWF

BRIEF OF *AMICUS CURIAE* NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS IN SUPPORT OF DEBTOR AND SEEKING AFFIRMANCE OF THE DISTRICT COURT'S DECISION

/s/ Tara Twomey
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December 11, 2012

CERTIFICATE OF INTEREST AND CORPORATE DISCLOSURE STATEMENT

Brian David Shapiro v. Barbara Melinda Henson – No. 11-16019

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure *Amicus Curiae* the National Association of Consumer Bankruptcy Attorneys makes the following disclosure:

1) For non-governmental corporate parties please list all parent corporations.
NONE.

2) For non-governmental corporate parties please list all publicly held companies that hold 10% or more of the party's stock. **NONE.**

3) If there is a publicly held corporation which is not a party to the proceeding before this Court but which has a financial interest in the outcome of the proceeding, please identify all such parties and specify the nature of the financial interest or interests. **NONE.**

4) In all bankruptcy appeals counsel for the debtor or trustee of the bankruptcy estate must list: 1) the debtor, if not identified in the case caption; 2) the members of the creditors' committee or the top 20 unsecured creditors; and, 3) any entity not named in the caption which is an active participant in the bankruptcy proceedings. If the debtor or trustee is not participating in the appeal, this information must be provided by appellant.
NOT APPLICABLE.

/s/ Tara Twomey
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Dated: December 11, 2012

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STATEMENT OF INTEREST

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 4,000 consumer bankruptcy attorneys nationwide. NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

NACBA interest in this case is to protect debtor's acting in good faith from overreaching trustees. In the course of payment ordinary household expenses it is common for debtors to write checks before filing bankruptcy that are not cashed until after the bankruptcy petition has been filed. Allowing the trustee to recover the amount of these checks from the debtor would work an injustice with respect to debtors, because they have to pay twice, while providing a windfall for the payee of the checks. The Trustee has a legal and appropriate mechanism to recapture amount that the payees have received in section 549 of the Bankruptcy Code, which allows the trustee to undo post-petition transfers of estate assets. Congress never intended such results when enacting the Bankruptcy Code and the plain

language of the Code does not support such an interpretation. Consistent with the language and intent of the Code, the district court properly concluded that, at a minimum, possession is a prerequisite to a turnover order under section 542.

CERTIFICATION OF AUTHORSHIP

Pursuant to FRAP 29(c)(5), the undersigned counsel of record certifies that this brief was not authored by a party's counsel, nor did party or party's counsel contribute money intended to fund this brief and no person other than NACBA contributed money to fund this brief.

I. STATUTORY FRAMEWORK

Bankruptcy is a balancing act. It has two main purposes: to provide a fresh start for the debtor and to facilitate the fair and orderly repayment of creditors to the extent possible. *Kokoszka v. Belford*, 417 U.S. 642, 645 (1974); In re *Sanchez*, 372 B.R. 289, 296-98 (Bankr. S.D. Tex. 2007). To achieve these twin objectives, Chapter 7 of the Bankruptcy Code employs a mechanism by which all the debtor's non-exempt assets may be liquidated by a trustee. *See* 11 U.S.C. § 704(a)(1). In turn, the trustee distributes the liquidation proceeds to creditors in accordance with an elaborate system that dictates the order in which claims are paid and in what amount. *See, e.g.,* 11 U.S.C. §§ 506, 507, 726.

A. The Bankruptcy Estate.

To achieve the dual goals of bankruptcy, the Code first creates the bankruptcy estate upon commencement of a case. 11 U.S.C. § 541. Section 541(a) defines the bankruptcy estate and contains an expansive definition of property that includes all legal or equitable interests in property whether tangible or intangible, real or personal. 5 COLLIER ON BANKRUPTCY ¶ 541.01 (A. Resnick and H. Sommer, eds., 16th ed). Some property, such as that described in section 541(b), is specifically excluded from becoming property of the estate. *See, e.g.*, 11 U.S.C. § 541(b)(5) (excluding certain funds placed in an education savings accounts). Other property initially considered part of the bankruptcy estate may be removed from the estate through the exemption process. 11 U.S.C. § 522(b)(l). Certain property may also be added to the bankruptcy estate after the commencement of the case. 11 U.S.C. § 541(a)(5) (property acquired by inheritance within 180 days of the filing of the petition). The Bankruptcy Code authorizes the trustee to collect and reduce to cash any property of the estate for distribution to creditors. *See* 11 U.S.C. § 704(a)(1).

B. Exempt Property

The purpose of exemption law has always been to allow debtors to keep those items of property deemed essential to daily life. In the bankruptcy context, exemptions serve the overriding purpose of helping the debtor to obtain a fresh start by maintaining property necessary to build a new life. *See* H.R. Rep. No. 95-

595, at 117 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6078 (purpose of this scheme is to provide "adequate exemptions and other protections to ensure that bankruptcy will provide a fresh start."); *Rousey v. Jacoway*, 544 U.S. 320, 322, 325 (2005). Section 522 of the Bankruptcy Code permits debtors to exempt certain property from the bankruptcy estate pursuant to the federal exemptions, listed in 11 U.S.C. § 522(d), or the applicable state exemptions.[1] Exempt property is removed from the bankruptcy estate and shielded from administration by the trustee.

C. Collection of Property of the Estate

The primary duty of the chapter 7 trustee is to collect and reduce to money property of the estate and expeditiously close the estate. 11 U.S.C. § 704(a)(1). The Bankruptcy Code provides the trustee with various powers to enable him to collect assets of the estate. The powers contained in sections 544 to 553 are tools the trustee may use to prevent the unequal treatment of creditors. For example, the trustee may undo certain transfers of property to creditors made before the filing of the bankruptcy, 11 U.S.C. § 547, may reverse fraudulent transfers, 11 U.S.C. § 548, and may unwind transfers of property made after the commencement of the case, 11 U.S.C. § 549. The trustee may also obtain control of estate property

[1] The Bankruptcy Code allows states to "opt out" of the federal exemption scheme. 11 U.S.C. § 522(b)(1). Debtors domiciled in "opt-out states" are limited to using state law exemptions and any federal non-bankruptcy exemptions. 11 U.S.C. § 522(b)(3). The State of Nevada has "opted out" of the federal exemption scheme.

through an order requiring a third party to turnover that property to the trustee. 11 U.S.C. § 542. Section 521(a)(4) imposes a duty on the debtor to surrender to the trustee all property of the estate.

II. The Trustee May Not Compel Turnover From an Entity Unless the Entity is in Present Possession of the Property or Its Proceeds.

When interpreting provisions of the Bankruptcy Code, the Supreme Court has long stated that past bankruptcy practice must not be eroded absent a clear indication in the legislative history that Congress intended such a departure. *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998); *see also, e.g., Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection,* 474 U.S. 494, 501 (1986) ("The normal rule of construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific . . . The Court has followed this rule with particular care in construing the scope of bankruptcy codifications."). Prior to the enactment of the Bankruptcy Code, courts regularly issued turnover orders against third parties who possessed a debtor's property or identifiable proceeds from the sale of debtor's property. In codifying the turnover procedure, there is no indication that Congress sought to vastly expand the reach of turnover orders to entities that are not in possession of the debtor's property or of identifiable proceeds of the debtor's property.

A. Pre-Code Practice

The Bankruptcy Act, the predecessor to the Bankruptcy Code, specifically provided that if a receiver or trustee was in control of the debtor's property by virtue of a receivership proceeding, the bankruptcy trustee or the debtor could obtain possession of such property. Bankruptcy Act of 1898, § 257, *added by* Act of June 22, 1938, ch. 575, § 1 (1938), Addendum B. However, the Bankruptcy Act did not expressly authorize turnover procedures against non-fiduciary third parties, such as creditors or debtors. Nevertheless, courts upheld the use of such turnover orders based on the general equity powers of the bankruptcy courts and the jurisdiction of the bankruptcy court over all the debtor's property. *See, e.g., Reconstruction Fin. Corp. v. Kaplan*, 185 F.2d 791, 795 (1st Cir. 1950) (upholding bankruptcy court's order requiring landlord to turnover security deposit); In re *Manning*, 104 F. Supp. 506, 510-11 (N.D. W.Va. 1952) (affirming order requiring oversecured warehouseman to return debtor's personal property to the bankruptcy trustee). In *Maggio v. Zeitz*, 333 U.S. 56 (1948), the Supreme Court approved of turnover orders as "an appropriate and necessary step in enforcing the Bankruptcy Act." *Id*. at 63.

In *Maggio*, the leading pre-Code case, Joseph Maggio, the president and manager of the debtor company, was ordered to turnover photographic supplies and equipment or the proceeds from their sale. In re *Luma Camera Serv*., 84 Supp.

839 (D.N.Y. 1949). He was later jailed for failing to comply with the turnover order even though he claimed that he was no longer in possession of the property or proceeds of the property. Noting that a turnover proceeding "is one primarily to get at property rather than to get at a debtor," the Supreme Court stated that:

> The nature and derivation of the remedy make clear that it is appropriate only when the evidence satisfactorily establishes the existence of the property or its proceeds, and possession thereof by the defendants at the time of the proceeding.

Maggio, 333 U.S. at 63-64. That is, a party's possession of the property in question or of proceeds from the sale of that property was a necessary pre-condition of the issuance of a turnover order. Following *Maggio*, circuit courts consistently held that "a turnover order cannot be made unless the party proceeded against at that time has possession of the specific property sought to be recovered as part of the bankrupt's estate." In re *Welded Const., Inc.,* 339 F.2d 593 (6th Cir. 1964); *see also* In re *Penco Corp*., 465 F.2d 693, 696 (4th Cir. 1972) ("object of turnover proceeding is to obtain possession of *specific* property or its proceeds"); *Shilder v. Rochelle*, 207 F.2d 95 (5th Cir. 1953) ("The primary condition upon which a turnover order may be issued is the possession of existing property or its proceeds capable of being surrendered by the person ordered to do so.")

B. Codification of Turnover Procedures Did Not Eliminate the Requirement of Possession

Prior to the enactment of the Bankruptcy Code, turnover procedures against non-fiduciary third parties were not expressly authorized by statute, but rather were considered "judicial innovation[s]" necessary for the administration of the bankruptcy estate. *Maggio*, 333 U.S. at 63. However, not everyone agreed that turnover orders absent statutory authorization were permissible. In *Maggio*, Justice Black concurred with the majority that Joseph Maggio could not be held in contempt for violating a turnover order when he did not have possession of the property sought, but he disagreed with the majority's reasoning. Justice Black wrote that the majority's reasoning rested upon the false assumption that the turnover procedure was legal when, in fact, the statute did not authorize such procedures. *Id*. at 80 (Black, J., concurring). According to Justice Black, Joseph Maggio could not be held in contempt because there was no legal basis for the turnover order in the first instance. *Id.*

Codification of turnover procedures with the enactment of the Bankruptcy Code sought to remedy this statutory defect and expand turnover powers. In place of the limited statutory and judge-made powers related to turnover, the Bankruptcy Code contains three specific provisions—section 521(a)(4), 542 and 543. 11 U.S.C. §§ 521(a)(4), 542, 543. Section 543, applicable to custodians in possession of property of the debtor, has its roots in several sections of the Bankruptcy Act.

See In re *WPAS, Inc.,* 6 B.R. 40, 43 (Bankr. M.D. Fla. 1980). As in the Bankruptcy Act, the Code's definition of custodian does not extend to creditors or debtors, but rather is limited to trustees, receivers and agents. 11 U.S.C. § 101(11). Section 542 applies to non-custodians and fills the statutory gap identified by Justice Black in *Maggio*. It gives an explicit statutory basis for the traditional turnover order against persons other than the debtor. Section 521(a)(4), originally codified as 521(4), represented a "new express requirement that the debtor surrender property." *See* Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong., 1st Sess. (1973), *available at* B-4c COLLIER ON BANKRUPTCY § 4-502, cmt 2, Addendum C. This provision requires the debtor to "surrender to the trustee all property of the estate."

The legislative history of section 542 shows that Congress intended to expand the turnover power in two ways: 1) to reach property in the hands of secured creditors; and 2) to apply in liquidation cases, not just reorganization cases. *See U.S. v. Whiting Pools, Inc*., 674 F.2d 144, 153-155 (2d Cir. 1982) (describing concerns that the statutory language in the Bankruptcy Act was insufficient to require turnover of collateral from secured creditors in possession and the extension of turnover powers to straight bankruptcy cases), *aff'd* 462 U.S. 198 (1983).

As codified, section 542 provides that:

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

The language of section 542, which states that the "property or value of such property" shall be delivered to the trustee, does not differ remarkably from the language of *Maggio*, which applied turnover procedures to "property or its proceeds." For thirty years after *Maggio*, courts consistently limited turnover procedures to instances in which the party from whom turnover was sought had possession of the property or its proceeds. *See* 2 J. Moore, COLLIER ON BANKRUPTCY ¶ 23.10(2), pp 568-69 (14th ed. 1972) ("it must be proved that the person proceeded against has either possession or control of the property or proceeds demanded."), Addendum D.

Despite this deeply rooted pre-Code practice, the Trustee argues that in enacting the Bankruptcy Code, Congress sought to radically alter turnover procedures and completely do away with the possession requirement. Tr. Brief at 16. In essence, under the Trustee's argument, the codification of turnover procedures in section 542 transformed a mechanism for gathering estate property into a means for recovering a monetary judgment against any entity that at one

time possessed estate property regardless of whether it maintains possession of that property. The Trustee and the cases he cites identify no legislative history, no congressional report, and no witness testimony that even hint at such extreme deviation from pre-Code practice.

Congress held extensive hearings on the draft bankruptcy legislation throughout 1975 and 1976. These hearings spanned thirty-five days and produced over 2,700 pages of testimony from more than 100 witnesses. Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DePaul L. Rev. 941, 944 (1979). Some of that testimony included recommendations related to the codification of the turnover power. *See* Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary, 94th Cong. (1975-76), at 1838 (prepared statement of Leon S. Foreman) (recommending that turnover power be continued for reorganizations and be extended to liquidation cases), Addendum E. None of the testimony suggested that the possession prerequisite established by *Maggio* be eliminated. Absent any indication that Congress intended to dispense with thirty years of jurisprudence and eliminate the possession requirement in turnover proceedings, possession of property or its proceeds by the entity from whom turnover is sought remains a necessary precondition. *See* In re *Pyatt*, 486 F.3d 423 (8th Cir. 2007); *see also, e.g., Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection,* 474 U.S. 494,

501 (1986) ("The normal rule of construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific . . . The Court has followed this rule with particular care in construing the scope of bankruptcy codifications.").

C. Viewing the Words of Section 542 in Isolation, Without Reference to Their History or Context, Is An Insufficient Basis for Eliminating the Possession Requirement.

The Trustee and cases he cites rely on two phrases—"value of property" and "during the case"—without reference to their history or context to conclude that Congress fundamentally altered the pre-Code turnover practice and eliminated the possession requirement. The Trustee argues that he is no longer limited to recovery of specific property or its proceeds because section 542 permits him to demand money in lieu of the property from any entity that possessed the property during the case. Tr. Brief at 16; *see In re USA Diversified Products, Inc*., 100 F.3d 53, 56 (7th Cir. 1996) (summarily concluding that statutory language requiring the delivery of the "value" of property abrogated *Maggio* and its progeny); In re *Shearin*, 224 F.3d 353, 356 (4th Cir. 2000) (summarily relying on the meaning of the word "value" given in *Diversified Products*). This argument was flatly rejected by the Eighth Circuit Court of Appeals in *Pyatt*. 486 F.3d at 429; *see also* 5 COLLIER ON BANKRUPTCY ¶ 542.02 (agreeing with the court in *Pyatt* and stating

that possession, custody, or control of the property sought, or its identifiable proceeds, is a necessary prerequisite for turnover). The *Pyatt* court correctly noted that pre-Code practice allowed the estate to recover the liquidated value of property. *Id*. "Thus under both precode practice and current law, if a debtor transfers property of the estate and receives value for it, a trustee may compel him to turn over the value of the property because he still has control over the proceeds of the property." *Id*. The word "value" is easily interpreted in a manner consistent with pre-Code practice. *See* In re *Henson*, 449 B.R. 109, 113 (D. Nev. 2011) (the language requiring turnover of the value may simply correspond to the pre-Code practice of allowing turnover of proceeds of property). It does not abolish possession as a prerequisite to a turnover order.

The phrase "during the case" similarly is insufficient to abrogate the possession requirement established in *Maggio*. Section 542 focuses on the obligations of a third party to turn over property to the trustee; it does not specify whether that obligation continues after the party no longer has custody or control of the property. The Trustee and cases he cites ascribe more weight to these words than they can reasonably bear. When viewing the statutory language as a whole, nothing in the text demonstrates a clear intent to eliminate possession as a necessary prerequisite to a turnover order.

III. Turnover Provisions of Section 542 Are Directed to Third Parties Not Debtors

The Bankruptcy Code contains three specific provisions addressing the gathering of estate property. Section 543 deals with turnover by custodians, section 521(a)(4), originally enacted as 521(4), imposes surrender obligations upon the debtor, and section 542 imposes turnover obligations on third parties. All three sections were enacted together and each applies to a separate group of parties that may have possession of estate property. Because section 521(a)(4) applies specifically to debtors, that provision, not section 542 controls surrender of property in the hands of the debtor. Where both a specific and a general statute address the same subject matter, the specific one takes precedence. *See* In re *Padilla*, 22 F.3d 1184, 1192 (9th Cir. 2000) (applying this canon of statutory construction to sections 523(a)(2)(A), 727(a)(2), 707(b), and 707(a) of the Bankruptcy Code). Any interpretation that applies section 542 to debtors renders section 521(a)(4) largely meaningless. *See FCC v. NextWave Personal Communications, Inc*., 537 U.S. 293, 302 (2003) (rejecting an interpretation of the Code that would render provisions inoperative); *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd*, 484 U.S. 365, 369-71 (1988) (same).

Here section 542 applies broadly to an entity, and section 521(a)(4) applies specifically to debtors. Interpreting section 542 as applicable to debtors makes section 521(a)(4) surplusage, denying the more specific section any independent

effect. *See* In re *Cervantes*, 219 F.3d 955, 960 (9th Cir. 2000) ("statutes should not be construed in a manner which robs specific provisions of independent effect.), quoting *Davis v. City and County of San Francisco*, 976 F.2d 1536, 1551 (9th Cir. 1992). Moreover, section 542 requires an entity to turn over property that the debtor may exempt (i.e., protect from creditors). 11 U.S.C. § 542(a) ("…an entity…in possession, custody or control, during the case, of property that…the debtor may exempt under section 522 of this title…"). Given this directive to turn over property the debtor may exempt, it makes no sense to construe section 542 to apply to the debtor. If read to apply to the debtor, section 542 would literally require the debtor to turn over all household goods, clothing, and other personal property to the trustee. There is no reason to adopt such a nonsensical reading. The language of section 521(a)(4), requiring "surrender" of such property as the trustee chooses to take, is much more apt because surrender does not require the debtor to deliver property to the trustee. *See* 4 COLLIER ON BANKRUPTCY ¶ 521.16.

The legislative history surrounding the codification of the turnover provisions expressly acknowledges that a "new" section 521(4) was intended to apply specifically to debtors. *See* Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong., 1st Sess. (1973), *available at* B-4c COLLIER ON BANKRUPTCY § 4-502, cmt 2., Addendum C (referring to the "new express requirement that the debtor surrender property").

Additionally, the Table of Derivation in a congressional report describes section 542(a) as "Turnover by Creditor." *See* Staff of Subcomm. On Civil & Const. Rights of House Comm. on Judiciary, Table of Derivation, 95th Cong., 1st Sess., Table of Derivation of H.R. 8200 at 12 (Comm. Print 1977), Addendum F.

Though the judicially created turnover provision pre-Code applied equally to debtors and other non-custodians, in enacting the Code, Congress consciously created distinct sections to apply to different parties that may have possession of estate property. Section 542 applies to non-custodian third parties, not the debtor. For this alternative reason, the District Court was correct in affirming the denial of the Trustee's Motion to Compel Turnover under section 542.

IV. The Interplay of Several Code Sections and Rules Demonstrate a Coherent Scheme for Dealing with Bank Accounts and Other Debts Owed to the Debtor.

A. Bank accounts are merely debts owed by a bank to a depositor.

The filing of a chapter 7 bankruptcy petition creates an estate comprised of "all legal or equitable interests of the debtor in property at the commencement of the case." 11 U.S.C. § 541(a)(1). This provision is very broad and includes all kinds of property both tangible and intangible. Accordingly, debtor's interest in a bank account becomes property of the estate upon commencement of a case.

The debtor's interest in a bank account is an intangible asset in the nature of a debt. A bank account does not consist of money belonging to a depositor and

held by a bank, rather it consists of nothing more, or less, than a promise to pay, from bank to depositor. *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 21, 116 S. Ct. 286 (1995); *see also Bank of Marin v. England*, 385 U.S. 99. 101 (1966); *Barnhill v. Johnson*, 503 U.S. 393, 112 S. Ct. 1386, 1389 (1992)("[a] person with an account at a bank enjoys a claim against the bank for funds in an amount equal to the account balance."); *State v. Carson City Sav. Bank*, 30 P. 703 (Nev. 1882)(once deposited funds become property of the bank and depositor only has a debt owing him from the bank). This is because the deposits made into the account are property of the bank, not the depositor. As stated by the Supreme Court:

> [i]t cannot be doubted that, except under special circumstances, or where there is a statute to the contrary, a deposit of money upon general account with a bank creates the relation of debtor and creditor. The money deposited becomes a part of the general fund of the bank, to be dealt with by it as other moneys, to be lent to customers, and parted with at the will of the bank, and the right of the depositor is to have this debt repaid in whole or in part by honoring checks drawn against the deposits. It creates an ordinary debt, not a privilege or right of fiduciary character.

New York County Nat'l Bank v. Massey, 192 U.S. 138, 145 (1904).

Thus, the debtor's interest and that of the estate at the time of filing was an interest in the debt owed to the debtor by the bank. The courts below and the Trustee seemingly take the common layman's perspective that the "money" in the Debtor's account was tangible property of the Debtor, merely held by bank for her

use. Cases cited by the Trustee that hold debtors responsible for turning over "the funds" in their bank account at the inception of the case suffer from the same flaw. Tr. Brief at 14. *See, e.g., Yoon v. Minter-Higgins,* 399B.R. 34 (N.D. Ind. 2008); In re *Sawyer*, 324 B.R. 115, 121 (Bankr. D. Ariz. 2005); In re *Maurer*, 140 B.R 744 (D. Minn. 1992). However, a check in the hands of a payee is nothing more than an order given by a party having a claim to the funds in the hands of the bank. *See* Nev. Rev. Stat. § 104.3409 & cmt 4. The debtor's claim against the bank is not reduced until the bank agrees to honor the check.

B. The Code Provides A Comprehensive Scheme For Dealing With Bank Accounts.

Bank accounts and other debts owed to the debtor at the commencement of the case are governed by section 521(a)(1) and Fed. R. Bank. P. 1007(b)(1) and 4002(3). In re *Pyatt*, 348 B.R. 783, 785 (B.A.P. 8th Cir. 2006); *see also* In re *Taylor*, 332 B.R. 609, 612 (Bankr. W.D. Mo. 2005); In re *Figueria*, 163 B.R. 192, 194 (Bankr. D. Kan. 1993). In addition, sections 521(a)(4) and 542(b) and Fed. R. Bankr. P. 2015(a)(4) are also an integral part of the system for dealing with debts owed to the debtors.

Section 521 describes the duties of the debtor in a bankruptcy case. Section 521(a)(4) requires a debtor to surrender to the trustee all property of the estate. Debts owed to the debtor, as intangible assets, are not capable of being physically surrendered. However, such debts may be constructively surrendered by informing

the trustee of their existence. Notice of debtor's bank accounts, i.e., the debt owed by the bank to the debtor, may be provided to the trustee at the commencement of the case in one of two ways. First, section 521(a)(1)(B) and Rule 1007(b)(1) require a debtor to file a list of assets and liabilities. Assets include "debts" owed to a debtor. Schedule B specifically requires the debtor to list assets such as "checking, savings, and other financial accounts..." Thus, the filing of Schedule B with the specified information detailing the debt serves as constructive surrender of the debt to the trustee, at least to the extent the asset has not been claimed as exempt property under section 522. If the debtor, however, does not file this schedule with the petition, Rule 4002(3) requires the debtor to inform the trustee immediately in writing of the name and address of every person holding money or property subject to the debtor's withdrawal or order. Written notice in compliance with Rule 4002(3) would also constitute constructive surrender a bank account.

While the debtor has a duty to notify the trustee of the existence of the debt owed, the obligor of a "debt that is property of the estate and that is matured, payable on demand, or payable on order" is instructed to pay such debt to the trustee, except if it may be claimed as exempt or to the extent such debt may be subject to offset. 11 U.S.C. § 542(b); *see* In re *Franklin*, 254 B.R. 718, 721 (Bankr. W.D. Tenn. 2000)("Citizens' checking account become 'property of the estate' and the **bank became obliged** to turn over the account balance to the

trustee)(emphasis added); In re *Mills*, 167 B.R. 663, 664 (Bankr. D. Kan. 1994)("When the debtor filed his bankruptcy petition, his credit union deposit account became property of the estate pursuant to § 541(a), and the **credit union became obliged** to turn the account balance over to the trustee pursuant to § 542)(emphasis added). To facilitate the collection of such debts, Rule 2015(a)(4) directs the trustee to give notice as soon as possible to every entity known to be holding money or property subject to withdrawal or order of the debtor, including every bank, savings, or building and loan association…"

In this case, the record is silent as to whether the debtor, the bank, or the trustee followed these procedures for handling bank accounts and other debts owed to the debtor. However, even if they did not, the fact is that the property of the estate was dissipated. The question is who is responsible for reimbursing the estate.

V. The Payees, Having Received Preferential Treatment at the Expense of the Estate, Should Be Responsible for Reimbursing the Property, or Its Proceeds.

The three potential parties that could be liable for reimbursing the estate for the amount of the checks cashed post-petition are the bank, the payees, or the debtor.

The Bank: Apparently, the bank in this case had no knowledge of the bankruptcy when it honored the debtor's checks post-petition. As a result, it is

absolved from liability for honoring those checks. 11 U.S.C. § 542(c). The fact the section 542(c) allows a financial institution without notice of the bankruptcy filing to honor checks post-petition with impunity is a recognition of the commercial realities and competing statutory requirements imposed on financial institutions. In re *Mills*, 167 B.R. at 664.

The Payee: Section 549 affords the trustee broad authority to avoid unauthorized transfers of a debtor's property that occur after filing of the bankruptcy petition. *See* In re *Pyatt*, 486 F.3d 423, 429-30 (8th Cir. 2007); In re *Kingsley*, 208 B.R. 918 (B.A.P. 8th Cir. 1997); In re *Thomas*, 311 B.R. 75, 78 (Bankr. W.D. Mo. 2004). A principal purpose of these provisions is to promote equity among creditors. The payees were creditors of the debtors at the commencement of the case, and to make them reimburse the trustee only deprives the payees of preferential treatment. *See Bank of Marin v. England*, 385 U.S. 99, 102, 87 S. Ct. 274 (1966). If the post-petition transfers are not recovered from the payees, then they receive a windfall because they get the full amount of the unauthorized transfer while depriving other creditors of a share in those funds. *In addition,* a payee who was not paid in full could still file and be paid on its claim in the bankruptcy case, resulting in a total recovery that is more than the payees pro rata share. Such a result would violate the Bankruptcy Code's equitable distribution scheme. *See Howard Delivery Service, Inc. v. Zurich American Ins.*

Co., 126 S.Ct. 2105, 2114, 165 L.Ed.2d 110 (2006)(holding that claims for workers' compensation insurance premiums do not qualify for § 507(a)(5) priority and noting that preferential treatment of a class of creditors is in order only when clearly authorized by Congress) (citations omitted). Here Payees who are permitted to keep full amount of the checks cashed post-petition when other unsecured creditors may only receive a pro rata portion of their debt, or nothing at all violates the policy of equality of distribution. *See id.* Both the plain language of the Code and the equities of this case point to the payees as the appropriate parties to reimburse the estate.

The district court properly concluded that the Trustee is not left without a remedy for recovering the dissipated funds. Section 549, which relates to post-petition transfers of estate property, provides the appropriate mechanism for the return of the funds from the payees. In fact, the Trustee in this case used section 549 to recover the portion of disputed funds from the Debtor's attorney. *See* In re *Hensen*, No. 09-24347, Docket #34, Complaint for Avoidance of Pre-Petition and Post-Petition Transfers (Bankr. D. Nev. Jan. 19, 2010). To allow a trustee to utilize both section 542 and section 549 in these circumstances would, as the district court pointed out, permit the trustee to obtain a double satisfaction, a result certainly not intended by the Code. Since there is no doubt the trustee has a remedy under section 549, there is simply no reason to twist the language of section 542

beyond its plain meaning and historical purpose in order to provide an additional remedy to the Trustee.

It is unclear why the Trustee did not proceed against other payees as he proceeded against the Debtor's attorney. To the extent that the Trustee suggests that going after the payees is too much trouble for such nominal assets, the question is raised whether the Trustee should be pursuing nominal assets in the first place. *See* 5 COLLIER ON BANKRUPTCY ¶ 554.02[7][a] ("Congress has encouraged the abandonment of nominal assets"); 6 COLLIER ON BANKRUPTCY ¶ 704.02[1] (trustees are strongly discouraged from liquidating assets in nominal asset cases); United States Trustee Chapter 7 Handbook § 4A (October 1, 2012)("A trustee shall not administer an estate or an asset in an estate where the proceeds of liquidation will primarily benefit the trustee or the professionals, or unduly delay the resolution of the case…the trustee must consider whether sufficient funds will be generated to make a meaningful distribution to unsecured creditors…"). This directive to abandon minimal amounts of property deals with the practical problem that debtors have no way of controlling when checks, often written well before the petition date to pay ordinary living expenses, are cashed. In practice, most trustees have followed the directives to abandon nominal assets and have not attempted to obtain small amounts of outstanding checks that have not been cashed as of the petition date. If the asset of the estate is sufficient to result in

a meaningful distribution to creditors, the trustee can file a proceeding under section 549. If not, the trustee should not be seeking to administer it.

The Debtor: In this case, the Trustee has presented no evidence that the debtor engaged in fraudulent behavior or acted in bad faith. *Henson*, 449 B.R. at 113 ("There is no allegation of fraudulent intent on her part when she wrote the checks pre-petition."). The debtor simply wrote checks prepetition that had not yet been cashed by the payees. The trustee has not shown that the debtor did anything wrong that has caused prejudice to the estate. Nevertheless, the Trustee argues that the debtor should be required to essentially pay the same bills twice—once to the payees of the check and once to the Trustee. The Trustee further suggests that making the debtor pay twice is "a quick and just result to recover property of the estate that was utilized by the debtor." Tr. Brief at 15. Contrary to the Trustee's suggestion, it is not equitable to require a debtor in bankruptcy to pay creditors twice because the Trustee has the power to recover funds in the hands of payees, but refuses to do so.

CONCLUSION

For the reasons stated herein, the decision of the district court should be affirmed.

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STATEMENT OF RELATED CASES

Pursuant to Ninth Circuit Local Rule 28-2.6, Amicus states that it is aware of not other cases in this Court that may be deemed related.

CERTIFICATE OF COMPLIANCE

This brief, exclusive of the certifications, tables of contents and authorities and the identity of counsel at the end of the brief, is 5904 words in text and footnotes as counted by Microsoft Word, the word processing system used to prepare this brief. This brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman 14-point font.

I certify under penalty of perjury that the foregoing is true and correct.

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on 12/12/12.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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ADDENDUM A
Selected Sections of the Bankruptcy Code

11 U.S.C. § 521
(a) The debtor shall—
(4) if a trustee is serving in the case or an auditor is serving under section 586 (f) of title 28, surrender to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate, whether or not immunity is granted under section 344 of this title;

11 U.S.C. § 542
(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.
(b) 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.
(c) Except as provided in section 362 (a)(7) of this title, an entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith and other than in the manner specified in subsection (d) of this section, to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case under this title concerning the debtor had not been commenced.
(d) A life insurance company may transfer property of the estate or property of the debtor to such company in good faith, with the same effect with respect to such company as if the case under this title concerning the debtor had not been commenced, if such transfer is to pay a premium or to carry out a nonforfeiture insurance option, and is required to be made automatically, under a life insurance contract with such company that was entered into before the date of the filing of the petition and that is property of the estate.
(e) Subject 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.

11 U.S.C. § 543

(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.

(c) The court, after notice and a hearing, shall—

(1) protect all entities to which a custodian has become obligated with respect to such property or proceeds, product, offspring, rents, or profits of such property;

(2) provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian; and

(3) surcharge such custodian, other than 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, for any improper or excessive disbursement, other than a disbursement that has been made in accordance with applicable law or that has been approved, after notice and a hearing, by a court of competent jurisdiction before the commencement of the case under this title.

(d) 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, and

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

11U.S.C. § 549

(a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate—
(1) that occurs after the commencement of the case; and
(2)
(A) that is authorized only under section 303 (f) or 542 (c) of this title; or
(B) that is not authorized under this title or by the court.
(b) In an involuntary case, the trustee may not avoid under subsection (a) of this section a transfer made after the commencement of such case but before the order for relief to the extent any value, including services, but not including satisfaction or securing of a debt that arose before the commencement of the case, is given after the commencement of the case in exchange for such transfer, notwithstanding any notice or knowledge of the case that the transferee has.
(c) The trustee may not avoid under subsection (a) of this section a transfer of an interest in real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of an interest in such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such real property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to such interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.
(d) An action or proceeding under this section may not be commenced after the earlier of—
(1) two years after the date of the transfer sought to be avoided; or
(2) the time the case is closed or dismissed.

ADDENDUM B
Bankruptcy Act of 1898, § 257, *added by* Act of June 22, 1938, ch. 575, § 1 (1938).

1 of 1 DOCUMENT

Collier on Bankruptcy, Sixteenth Edition

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App. Pt. 3 Bankruptcy Act of 1898
App. Pt. 3(a) The Bankruptcy Act of 1898
CHAPTER X Corporate Reorganizations
(United States Code, Title 11, Chap. 10, Secs. 501-676.)
Article XIV Prior Proceedings.
(11 U.S.C. ßß 656-659.)

A-3a Collier on Bankruptcy Sec. 257

Sec. 257.

The trustee appointed under this chapter, upon his qualification, or if a debtor is continued in possession, the debtor, shall become vested with the rights, if any, of such prior receiver or trustee in such property and with the right to the immediate possession thereof. The trustee or debtor in possession shall also have the right to immediate possession of all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage.

ADDENDUM C
Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong., 1st Sess. (1973), *available at* B-4c COLLIER ON BANKRUPTCY § 4-502

1 of 1 DOCUMENT

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App. Pt. 4 Bankruptcy Reform Act of 1978
App. Pt. 4(c) Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong., 1st Sess. (1973)
CHAPTER IV. PROVISIONS APPLICABLE TO CASES UNDER MORE THAN ONE CHAPTER
Part 5. Debtor's Duties and Benefits

B-4c Collier on Bankruptcy Section 4-502

ß **4-502 Duties of Disclosure and Turnover of Property.**

(a) Duties of Debtor. In addition to performing other duties prescribed by the Act and by rules promulgated by the administrator thereunder, the debtor shall (1) attend and submit to examination as directed by the administrator pursuant to section 4-310; (2) attend at the hearing, if any, on a complaint objecting to discharge, seeking revocation of a discharge, or seeking the setting aside of an order of confirmation, and testify if called as a witness; (3) promptly after the direction of relief under section 4-203 or 4-210, inform the administrator in writing as to the location of real property he owns and the name and address of every person holding money or property subject to his withdrawal or order; (4) if requested by the trustee, file a statement

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of executory contracts and unexpired leases to which he is a party; (5) cooperate with the receiver or trustee in the preparation of any inventory and the examination of claims; and (6) surrender to the receiver, if one is appointed, or to the trustee all property of the estate, including any documents and records relating thereto.

(b) Duties of Officers, Directors, Controlling Equity Security Holders, Partners, and Other Persons in Control. If the debtor is a corporation, the administrator or the court may designate any or all of its officers, members of its board of directors or similar controlling body, a controlling equity security holder or member, or any other person in control to perform the duties specified in subdivision (a) of this section. If the debtor is a partnership, the administrator or the court may similarly designate any or all of its general partners or any other person in control to perform such duties.

NOTE

1. This section is derived from ß 7a of the present Act and Proposed Rules 402 and 13-402. The obligation imposed by present ß 7a(8) and (9) to file schedules of property and debts and a statement of affairs is omitted because it is contemplated that the administrator will by rule prescribe the form and content of such information to be submitted by the debtor.

2. *Subdivision (a).* Clause (1) implements ß 4-310, providing for examinations. Clause (2) preserves the policy of present ß 7a(1) by requiring the debtor to attend and testify at any hearing on a complaint objecting to discharge and adds a similar obligation to attend and testify at hearings on a complaint seeking revocation of discharge or setting aside of an order of confirmation. Clause (3) implements the provisions of ß 4-605(c) on constructive notice and the obligations imposed on the trustee and receiver by ß 4-306(1) to file and give notice. Clause (4) obligates the debtor to assist the trustee in acquiring information about executory contracts on request. Clause (5) imposes a similar obligation to assist the trustee or receiver in preparing an inventory, if one is required by the administrator pursuant to ß 4-306(2), and in the examination of claims. Clause (6) adds a new express requirement that the debtor promptly surrender to the trustee or receiver all property of the estate.

3. *Subdivision (b)* is derived from ß 7b of the present Act, but limits the obligations imposed to those designated by the administrator or the court. The categories of persons who may be so designated are in one respect more limited than under present ß 7b, being confined to stockholders or members of corporations who are in control. In other respects the categories are more broadly defined, extending to general partners of a partnership and to any person in control of a corporation or a partnership.

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ADDENDUM D

2 J. Moore, COLLIER ON BANKRUPTCY ¶ 23.10(2), pp 568-69 (14th ed. 1972)

[2]—Proof Required.

It should be borne in mind at the outset that the burden of proof in a turnover proceeding is at all times on the receiver or trustee; he must at least establish a *prima facie* case.[16] After that, the burden of explaining or going forward shifts to the other party, but the ultimate burden or risk of persuasion is upon the receiver or trustee.[17] It

covery of the property or its proceeds, the decision appears to be in error. The bankruptcy court, however, may properly deny offsets claimed by the defendant against the property or proceeds turned over. Bank of California, Nat. Ass'n v. McBride, *supra*.

See also Shideler v. Rochelle (C.A. 5th, 1953) 207 F.(2d) 95, cert. den. (1954) 347 U.S. 918, 74 S.Ct. 517, 98 L.Ed. 1073.

[16] Maggio v. Zeitz (1948) 333 U.S. 56, 68 S.Ct. 401, 92 L.Ed. 476; Sheinman v. Chalmers (C.C.A., 3d Cir.), 14 Am.B.R.(N.S.) 374, 33 F.(2d) 902, aff'g 14 Am.B.R.(N.S.) 370, 33 F.(2d) 901.

Judicial notice.—See by analogy Matter of Aughenbaugh [Appeal of Kunkel] (C.C.A. 3d, 1942) 48 Am.B.R. (N.S.) 640, 125 F.(2d) 887 (In a proceeding before the referee to determine the validity of a mortgage the crucial issue was the mortgagor's solvency at the time the mortgage was executed. Judge Maris stated: "In passing upon this question we may consider only the evidence which was presented to the referee at the hearing upon the trustee's exceptions to the mortgagee's priority claim. We may not consider other evidence which may have been in the files of the referee in the bankruptcy administration proceeding. To hold otherwise would be to violate the fundamental concept of procedural due process that a party to litigation is entitled to have the evidence relied on by his opponent presented at the hearing of his case so that he may have the opportunity to cross-examine his opponent's witnesses and to offer evidence in rebuttal. . . . Our examination of the record indicates that the referee reached his decision from a consideration not only of the evidence offered at the hearing upon the trustee's exceptions but also of the bankruptcy schedules, the official appraisal, the proofs of claim, the return of sale and perhaps other papers on file in the bankruptcy administration proceeding, none of which was offered in evidence. It is true that the papers in this file so far as relevant would have been admissible as court records without other proof and would if offered in evidence have constituted some evidence of the facts to which they related. But the facts to which they related, being disputed in the very controversy under consideration were not the sort of facts of which the referee was entitled to take judicial notice."); also see ¶ 21.03, *supra*.

Where the respondent in a turnover proceeding concedes that a savings account standing in her name "in trust for" the bankrupt is not hers and that none of her own funds constitute any part of such account, the trustee has sustained the burden of proof; and if a third person asserts in the turnover proceeding that the account belongs to him, the burden of persuasion rests with such third person to demonstrate a title superior to the bankrupt's. In re Skodnick (E.D.N.Y. 1950) 91 F. Supp. 529.

[17] In the Matter of Harnick (W.D.

is not for the referee, in a turnover proceedings, to decide the merits of really controverted issues.[17a]

In order to secure a turnover order, the receiver or trustee must first of all establish the summary jurisdiction of the court, except where the defendant consents.[18] The burden is also on the receiver

Ark. 1957) 151 F.Supp. 504, citing **Treatise.**

See Fox Jewelry Company v. Lee (C.A. 5th, 1959) 264 F.(2d) 720, app'l pending; Feldser v. Lee (C.A. 5th, 1959) 264 F.(2d) 721.

In Sheinman v. Chalmers, *supra*, n. 16, the court said: "Turning to the referee's report (which the bankrupt is here using as evidence) it appears that the referee in finding the initial difference between merchandise on hand and that which should have been on hand said:

" 'We therefore have relevant proofs, which are uncontradicted, that are sufficient to warrant a finding that the bankrupt failed to account for the sum of $51,727.25; the burden therefore shifts to the bankrupt to explain the apparent discrepancy.'

"Thereupon the bankrupt, on this appeal, entered the familiar mist which arise from and surrounds the expression 'the burden of proof never shifts.' We shall not try to dispel it beyond saying that it is true the burden of proof never shifts from the party having the affirmative of an issue. There it rests, at least until he has made out a *prima facie* case. Then the burden, not of proving the proponent's case but of explaining or rebutting it, shifts to the other party. This burden he may assume or ignore as he may wish, but he will suffer the consequences of not taking it up and carrying it. *Moffat v. United States,* 112 U.S. 24, 5 S.Ct. 10, 28 L.Ed. 623; *In re Locust Bldg. Co.* (C.C.A., 2d Cir.), 3 Am.B.R.(N.S.) 144, 299 Fed. 756; *In re Chavkin* (C.C.A., 2d Cir.), 41 Am.B.R. 36, 249 Fed. 342; *In re Edelman* (D.C., Md.), 42 Am.B.R. 229, 251 Fed. 429; *In re Bass* (D.C., Pa.), 43 Am.B.R. 280, 257 Fed. 137; *In re Magen Co.* (C.C.A., 2d Cir.), 7 Am. B.R.(N.S.) 283, 10 F.(2d) 91; *Suravitz v. Insurance Co.*, 261 Pa. 390, 104 A. 754.

"What the referee plainly meant by the words 'the burden shifts' was that the trustee had proved his case against the bankrupt and that it would stand unless the bankrupt should assume the burden of explaining or contradicting it. Failing in that, the trustee's proofs would stand uncontradicted."

To the same effect, see also In re Schimmel (D.C., Pa.), 29 Am.B.R. 361, 203 Fed. 181; Matter of Fisher (D.Md. 1940) 43 Am.B.R.(N.S.) 30, 32 F.Supp. 69; Matter of Victor's Ladies Shop, Inc. (E.D.Pa. 1940) 50 Am.B.R.(N.S.) 122, 45 F.Supp. 417; Oglebay, Some Developments in Bankruptcy Law (1948) 22 J. of Nat'l Ass'n of Ref. 82.

[17a] In re Murray Packing Co. (S.D. N.Y. 1961) 200 F.Supp. 16; *Murray* was reversed *sub nom.* Sahn v. Pagano, 302 F2d 629 (2d Cir 1962) citing **Treatise,** the court agreeing with the preceding statement but deciding that this case did not present a "really controverted issue."

[18] If the receiver's or trustee's allegations are denied, the burden of proof is on the receiver or trustee to establish grounds for summary jurisdiction.

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or trustee to show that the property or proceeds involved are a part of the bankrupt estate, and thus support the summary jurisdiction he seeks to invoke.[19] In addition, it must be proved that the person

City of Long Beach v. Metcalf (C.C.A., 9th Cir.), 40 Am.B.R.(N.S.) 91, 103 F.(2d) 483, cert. den. 60 S.Ct. 139, 84 L.Ed. 504; Kelso v. Maclaren (C.C.A. 8th, 1941) 47 Am.B.R.(N.S.) 69, 122 F.(2d) 867 (and the referee should make findings of fact and conclusions of law on the essential jurisdictional facts); In re Cantelo Mfg. Co. (D.C., Me.), 29 Am.B.R. 704, 201 Fed. 158. See ¶ 23.08, *supra*, as to consent conferring summary jurisdiction.

In Bradley v. St. Louis Terminal Warehouse Co. (C.A. 8th, 1951) 189 F.(2d) 818 it was held that the bankruptcy court acquires no jurisdiction over property wrongfully seized from an adverse claimant in ex parte proceedings, and that such proceedings are a denial of due process.

See Fox Jewelry Company v. Lee (C.A. 5th, 1959) 264 F.(2d) 720, app'l pending; Feldser v. Lee (C.A. 5th, 1959) 264 F.(2d) 721; In re Wire Corporation of America (D.N.J. 1955) 131 F.Supp. 586.

[19] Matter of Scranton Knitting Mills, Inc. (D.C., Pa.), 37 Am.B.R.(N.S.) 532, 23 F.Supp. 803, citing Matter of Retail Stores Delivery Corp. (D.C., N.Y.), 24 Am.B.R.(N.S.) 15, 5 F.Supp. 892; Bradley v. St. Louis Terminal Warehouse Co., *supra*, n. 18; Fox Jewelry Company v. Lee, *supra*, n. 18; In re Wire Corporation of America, *supra*, n. 18. Buss v. Long Island Storage Warehouse Co. (C.C.A., 2d Cir.), 23 Am.B.R.(N.S.) 66, 64 F.(2d) 338. The court said: "Concluding, as I do, that the burden is on the trustee to show that the moneys involved were the property or the proceeds of property belonging to the bankrupt estate, and that he has not sustained that burden, the order of the referee cannot now be sustained." See also Matter of Italian Importing Co. (C.C.A., 7th Cir.), 7 Am.B.R.(N.S.) 472, 98 F.(2d) 908; Matter of Gordon & Gelberg (C.C.A., 2d Cir.), 25 Am. B.R.(N.S.) 22, 69 F.(2d) 81; Wuchner v. Goggin (C.A. 9th, 1949) 175 F.(2d) 261.

But see Central States Corp. v. Luther (C.A. 10th, 1954) 215 F.(2d) 38, cert. den. (1955) 348 U.S. 951, 75 S.Ct. 438, 99 L.Ed. 743, where a turnover order was affirmed although it was not even alleged that the property was part of the bankrupt estate. On the contrary, the court recognized that compliance with the order would revest the property in third parties, its rightful owners. Nevertheless, summary jurisdiction and the turnover order were held sufficiently supported by the fact that proper administration of the estate was facilitated by their use, because all the parties involved were creditors of the estate, and the determination of the amounts of their various claims depended upon the determination of the ownership of the property. The result seems questionable, for, as pointed out by the dissenting judge, the amount of the estate's total liabilities was not changed by the determination of who owned the property. Only allocation of those liabilities among the various creditors was affected, and this was of no benefit to the bankrupt estate.

See Simon v. Schaetzel; In re Simon (C.A. 10th, 1951) 189 F.(2d) 597 where bankrupt resisted the trustee's petition for a turnover order directing bankrupt to surrender certain government bonds. The Court of Appeals affirmed the findings of the referee as confirmed by the district court, that the bankrupt was co-

proceeded against has either possession or control of the property or proceeds demanded. It is not enough, however, for the receiver or trustee to prove that at the time of bankruptcy the property or proceeds sought to be recovered were within the possession or control of the person proceeded against; it must also be proved that possession or control exists "at the time of the proceeding."[20] In many instances

owner and in constructive possession of the bonds at the time of his petition in bankruptcy, notwithstanding testimony to the contrary by the bankrupt and his wife.

[20] Maggio v. Zeitz (1948) 333 U.S. 56, 68 S.Ct. 401, 92 L.Ed. 476; also Brune v. Fraidin (C.C.A. 4th, 1945) 149 F.(2d) 325, aff'g (D.Md. 1944) 56 Am.B.R.(N.S.) 277, 55 F.Supp. 129, citing **Treatise**; In re Wire Corporation of America, *supra*, n. 18. Sheehan v. Hunter (C.C.A. 8th, 1943) 52 Am.B.R. (N.S.) 607, 133 F.(2d) 303, citing **Treatise** (Collector of Internal Revenue who seized money belonging to bankrupt estate three days after bankruptcy, in collection of unpaid taxes, and has covered this money into the United States Treasury is not subject to a turnover order since he would be unable to comply with such order and could not be held in contempt for failure to do so). In re Standard Coal Mining & Converters Corp. (C.A. 7th, 1949) 178 F.(2d) 819, cert. den. (1950) 70 S.Ct. 673; In re Milgrom (S.D.N.Y. 1950) 94 F.Supp. 762 (salable merchandise and cash were in possession of the bankrupt at the date of bankruptcy, but nine months had elapsed before the turnover proceeding; order denied); See also Simon v. Schaetzel; In re Simon (C.A. 10th, 1951) 189 F.(2d) 597; In re Vitemb (S.D.Tex. 1954) 120 F.Supp. 830; In the Matter of Harnik (W.D. Ark. 1957) 151 F.Supp. 504, citing **Treatise** (trustee failed to prove that money received by bankrupt just before filing of petition was still in his possession at the time of turnover proceedings more than 8 months later, where bankrupt was a heavy gambler and testified that he had spent the money on gambling, but refused to further explain on grounds of possible self-incrimination).

In Maggio v. Zeitz, *supra*, the Supreme Court further declared: "While some courts have taken the date of bankruptcy as the time to which the inquiry is directed, we do not consider resort to this particular proceeding appropriate if, at the time it is instituted, the property and its proceeds have already been dissipated, no matter when that dissipation occurred. Conduct which has put property beyond the limited reach of the turnover proceeding may be a crime, or, if it violates an order of the referee, a criminal contempt, but no such acts, however reprehensible, warrant issuance of an order which creates a duty impossible of performance, so that punishment can follow." The Court, therefore, specifically overruled the doctrine previously adopted in the Third Circuit, and criticized in Oglebay, Some Developments in Bankruptcy Law Regarding Summary Jurisdiction and the Determination of the Effect of Discharges (1946) 21 J. of Nat'l Ass'n of Ref. 18, 20–21, that a turnover order would issue on proof of possession or control at the time bankruptcy began. See, *e.g.*, Price v. Kosmin (C.C.A. 3d, 1945) 149 F.(2d) 102.

Referee's power.—The referee, of course, may make the determination from the evidence. See Matter of Kramer & Muchnick (D.C., Pa.), 33 Am.B.R. 223, 218 Fed. 138; In re Schimmel (D.C., Pa.), 29 Am.B.R. 361,

summary jurisdiction may be established, but the turnover order will be denied because of failure to prove the requisite possession or control.[21] A person cannot turn over what he does not have; it must be determined whether or not the property is in his possession or control so that he has the personal, physical ability to comply with the order demanded.[22] The court will not undertake to compel the futile or impossible.[23] Nor is the fact that the defendant should have possession or control sufficient, if it is shown that he does not have it.[24] In such

203 Fed. 181; May v. Henderson, 268 U.S. 111, 5 Am.B.R.(N.S.) 739, 45 S.Ct. 456, 69 L.Ed. 870. See also ¶ 23.07 [1], *supra*, and ¶ 38.09, *infra*.

21 See In re Vitemb (S.D.Tex. 1954) 120 F.Supp. 830; Matter of Schoenberg (C.C.A., 2d Cir.), 25 Am.B.R.(N.S.) 262, 70 F.(2d) 321; Sheehan v. Hunter, *supra*, n. 20; Matter of World Cigar Co., Inc. (E.D.N.Y. 1943) 53 Am.B.R. (N.S.) 125, 49 F.Supp. 134 (turnover order against controlilng officers and stockholders of bankrupt is not justified where it is impossible to point to any specific property or money which come into their hands).

22 Maggio v. Zeitz, *supra*, n. 20; In re Standard Coal Mining & Converters Corp. (C.A. 7th, 1949) 178 F.(2d) 819, cert. den. (1950) 70 S.Ct. 673.

Control sufficient.—Control of the property or proceeds is sufficient basis for the turnover order [Matter of Panamer Realty Corp. (D.C., N.Y.), 19 Am. B.R.(N.S.) 472, 54 F.(2d) 656; In re Cole (C.C.A., 1st Cir.), 16 Am.B.R. 302, 144 Fed. 392], unless the party can show an inability to obtain actual possession of what he ought to surrender [In re Cole, *supra*]. See also Matter of Vyse (D.C., N.Y.), 34 Am.B.R. 378, 220 Fed. 727.

23 Maggio v. Zeitz *supra*, n. 20; American Trust Co. v. Wallis (C.C.A., 3d Cir.), 11 Am.B.R. 360, 126 Fed. 464; In re Baum (C.C.A., 8th Cir.), 22 Am.B.R. 295, 169 Fed. 410, cert. den. 216 U.S. 622, 30 S.Ct. 577, 54 L.Ed. 642; Matter of Tabak (D.C., Pa.), 14 Am.B.R.(N.S.) 515, 34 F.(2d) 209.

24 In re Laplume Condensed Milk Co. (D.C., Pa.), 16 Am.B.R. 729, 145 Fed. 1013. See also Shidler v. Rochelle, *supra*, n. 15; Boyd v. Glucklich (C.C.A., 8th Cir.), 8 Am.B.R. 393, 116 Fed. 131, where the court quotes the district court with approval: "The computation made by the referee shows that the bankrupt ought to have so much on hand but I do not find that he has it on hand. And that is the test."

Exception in the case of fiduciaries.—Where the person proceeded against occupies a position which places him in a fiduciary relationship, or as holding the assets of the estate in a position of trust, lack of present possession or control will be no answer to the turnover order. May v. Henderson, 268 U.S. 111, 5 Am.B.R.(N.S.) 739, 45 S.Ct. 456, 69 L.Ed. 870; Reifsynder v. Levy & Son (C.C.A., 3d Cir.), 33 Am. B.R.(N.S.) 590, 88 F.(2d) 287, cert. den. 301 U.S. 696, 57 S.Ct. 926, 81 L.Ed. 1351.

In Rabinovitz v. Oughton (C.C.A., 3d Cir.), 35 Am.B.R.(N.S.) 29, 92 F.(2d) 297, the court said: "In the second place, the appellant contends that he did not have possession of the property which he was ordered to turn over, but that he had paid it to other persons.

'The referee and the District Court, however, found that he was in posses-

cases his responsibilities may be determined in a plenary suit;[25] or he may, perhaps, be proceeded against for contempt, if he has violated any previous orders or has taken assets from the custody of the

sion of the money when the petition in bankruptcy was filed, but, even if he had paid the money to his individual creditors as he asserts, the turnover order could be sustained.

"Since the appellant occupied a fiduciary position, he is not relieved of the duty to account for the property merely by placing it beyond his control. 'If he has sold it or mingled it with his own, he may be compelled by summary order to restore the value of the property thus wrongfully diverted.' *May v. Henderson, supra,* 268 U.S. 111, at page 119, 5 Am.B.R.(N.S.), at page 747, 45 S.Ct. 456, 69 L.Ed. 870.

"The reason a turnover order is not usually granted where the bankrupt is not shown to possess or control the specific property is because the order might be futile. But the appellant has not shown that he is insolvent or in other respects unable to comply with the order of the District Court. Therefore, under the facts of this case the order should be affirmed regardless of appellant's allegation, even if true, that he had paid the money to others. *May v. Henderson, supra,* 268 U.S. 111, at pages 120, 121, 5 Am.B.R.(N.S.) at page 748, 45 S.Ct. 456, 460, 69 L.Ed. 870."

[25] Matter of Korin (D.C., N.Y.), 39 Am.B.R.(N.S.) 490, 25 F.Supp. 323.

In Matter of American Dry Corporation (D.C., N.Y.), 18 Am.B.R.(N.S.) 309, 50 F.(2d) 625, the court said: "It now becomes necessary to determine whether all of the respondents have been shown to have been in possession of the foregoing property and upon this subject it is necessary to differ with the referee.

"Having in mind that the object of this turnover proceeding is to recover property withheld from the trustee by the respondents, it will be seen that unless they came into such possession they cannot be directed to surrender it; while it is entirely probable that the respondents Gordon, Keller and Weinberg contrived to bring about the diversion in question and thereby may have rendered themselves answerable to the trustee in an appropriate action at law, it does not seem that the evidence under examination justifies the making of a turnover order against them for the disobedience of which they could be punished for contempt; the drivers who took the goods from the place of business of the bankrupt were just as culpable as the principals who directed their operations but it is not shown that the diverted merchandise came into the ultimate possession of the drivers any more than that it came into the ultimate possession of the individuals above named.

"The reasoning employed in *In re Gilroy & Bloomfield* (D.C., N.Y.), 14 Am.B.R. 627, 140 Fed. 733, while the result of different circumstances, reflects the attitude of this court, upon this aspect of the record.

"It was the Manhattan Food Co. that received the merchandise and probably profited thereby and it is that company which should be the subject of the order herein."

In In re Glostex Products Co. (C.A. 7th, 1961) 295 F.(2d) 324 citing **Treatise,** a Chapter XI debtor in possession was ordered to turn over funds to the referee which he should have, under a previous order, been segregating as a withholding tax fund. The

court;[26] or he may be liable to criminal prosecution.[27] The entire matter has been well stated in the case of *In re Rosser*,[28] where Circuit Judge Sanborn said:

"There can be no doubt that under the general rules of law and under these specific provisions of the Bankrupt Act, the court and the referee were vested with the right and subjected to the duty of making the necessary orders to require the bankrupt and all other persons who had the possession and control of the property of the bankrupt estate to surrender and deliver it to the trustee. Such orders constitute one of the essential means by which the court and the referee are empowered to collect the estate of the bankrupt. It is a broad and comprehensive power, and great caution should be exercised to observe its limits and to issue under it only lawful orders. But, without its lawful exercise, the administration of the estates of bankrupts would in many cases be so complicated and tedious that all the assets would be wasted in litigation, and the beneficent purpose of the bankrupt law would fail of accomplishment. Two essential facts limit this power and condition its lawful exercise. They are that the money or property directed to be delivered to the trustee or other officer of the court is a part of the bankrupt estate, and that the bankrupt or person ordered to deliver it has it in his possession or under his control at the time that the order of delivery is made. If the property is not a part of the estate, obviously no lawful order for its delivery to the trustee can be made. If the money or property in controversy was a part of the estate of the bankrupt, but before the order for its delivery is made he has squandered, disposed of, or lost it, so that it is not in his control or possession, and he cannot obtain and deliver it at the time of the order of delivery is made, or within a reasonable time thereafter, it cannot be a lawful order, because the court may not order one to do an impossibility, and then punish him for refusal to perform it. The punishment of the bankrupt for such acts must be sought under the provisions of the bankrupt law relative to the fraudulent concealment of the property of the estate and the making of false oaths relative thereto. But, if it appears to the satisfaction of the referee or the court that property of the bankrupt estate is in control or possession of the bankrupt, a lawful order for its delivery to the trustee may be made, and a refusal to obey this order may be punished as a contempt of court, both under the general law relative to contempts and under the specific provisions of the Bankrupt Act."[29]

These principles were substantially reiterated by the Supreme Court in *Maggio* v. *Zeitz*.[30]

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trustee contended that the debtor as a fiduciary was personally liable for the fund. The court held, however, that the order to the debtor was a turnover order and that possession had to be proved, and that under the circumstances of the case, the debtor was not personally liable.

26 As to contempts, see ¶ 2.58, *supra*; ¶ 41.02, *infra*.

27 See 18 U.S.C. §§ 151–155, 3057, 3248, and ¶¶ 29.05-29.06, 29.10-29.12, *infra*. See also In re Sax (D.C., Pa.), 15 Am.B.R. 455, 141 Fed. 223.

28 (C.C.A., 8th Cir.), 4 Am.B.R. 153, 101 Fed. 562.

29 In re Rosser (C.C.A., 8th Cir.), 4 Am.B.R. 153, 101 Fed. 562. See also In re Standard Coal Mining & Converters Corp. (C.A. 7th, 1949) 178 F.(2d) 819, cert. den. (1950) 70 S.Ct. 673.

30 (1948) 333 U.S. 56, 68 S.Ct. 401, 92 L.Ed. 476, citing Treatise.

As we have already seen, the burden of proving possession or control at the time of the turnover proceeding is place on the receiver or trustee.[31] A summary proceeding to compel a person to turn over assets is civil; but since it is predicated upon a charge which is equivalent to fraud and since the proceeding is one in which coercive methods by imprisonment are probable, the allegation of the defendant's present ability to comply with the order by virtue of his possession or control must be supported by clear and convincing evidence.[32] A mere preponderance of evidence is not enough, but on the other hand it is not necessary that the evidence be beyond reasonable doubt, as this would render the bankruptcy system less effective.[33] Circumstantial evidence, moreover, may be sufficient to sustain the burden of proof.[34] The bankrupt's acquittal in a criminal proceeding on a

[31] In re Milgrom (S.D.N.Y. 1950) 94 F.Supp. 762 (salable merchandise and cash were in possession of the bankrupt at the date of bankruptcy, but nine months had elapsed before the turnover proceeding; order denied). See nn. 16, 17 *supra*, and text accompanying.

[32] Maggio v. Zeitz, *supra*, n. 30; Oriel v. Russell, 278 U.S. 358, 18 Am. B.R.(N.S.) 121, 49 S.Ct. 173, 73 L.Ed. 419.

Compare In re Livingston (N.D.Cal. 1950) 93 F.Supp. 173, where a turnover order against one who had taken certain property from the possession of the bankrupt after the filing of his petition, and had sold it, was set aside and remitted to the referee for lack of adequate proof as to the value of the property taken.

[33] *Ibid.* As stated in Matter of Ginsberg (D.C., N.Y.), 17 Am.B.R. (N.S.) 498, 50 F.(2d) 240, the requirement is 'proof of a clear and convincing character, a mean between the extremes of mere preponderance and proof beyond reasonable doubt." Accordingly, some older cases requiring only a preponderance, as for example Matter of Hoffman (C.C.A., 7th Cir.), 9 Am.B.R.(N.S.) 455, 17 F.(2d) 925, are no longer authoritative.

[34] Matter of Cohan (C.C.A. 3d Cir.), 16 Am.B.R.(N.S.) 388, 41 F.(2d) 632; Matter of Silverman (D.C., N.Y.), 30 Am.B.R. 798, 206 Fed. 960; Matter of Ginsburg (D.CC., N.Y.), 17 Am.B.R.(N. S.) 498, 50 F.(2d) 240; Matter of Glassberg (D.C., N.Y.) 21 Am.B.R. (N.S.) 408, 59 F.(2d) 209; Matter of Lafer (D.C., Minn.) 8 Am.B.R.(N.S.) 480; Matter of Fisher (D.Md. 1940) 43 Am.B.R.(N.S.) 30, 32 F.Supp. 69.

Thus the bankrupt's schedules, admissions, financial statements, tax returns, accountants' reports, cancelled checks, testimony on general examination, and other similar species of evidence, may be considered, if properly introduced. See Matter of Cohan, *supra;* Matter of Glassberg, *supra;* Matter of Panamer Realty Corp. (D.C., N.Y.), 19 Am.B.R.(N.S.) 472, 54 F. (2d) 56 (evidence on § 21a examination rejected); Matter of Admur (M.D. Pa. 1942) 51 Am.B.R.(N.S.) 282, 47 F.Supp. 8, aff'd (C.C.A. 3d, 1943) 54 Am.B.R.(N.S.) 394, 137 F.(2d) 708 (accounting records); Matter of Goldberg (C.C.A., 2d Cir.), 34 Am.B.R. (N.S.) 630, 91 F.(2d) 996; Matter of Chavkin (C.C.A., 2d Cir.), 41 Am.B.R. 36, 249 Fed. 342; Sheinman v. Chalmers (C.C.A., 3d Cir.), 14 Am.B.R.(N.S.) 374, 33 F.(2d) 902; Matter of Gins-

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charge of concealing property is no bar to a subsequent proceeding to compel him to surrender the property, although the acquittal is a factor entitled to due weight.[35]

In making his case, the receiver or trustee initially may be aided by a presumption or inference of present possession arising from proof of actual possession at some earlier time.[36] But this is not irrebuttable or conclusive; it is only to be considered in view of the other circumstances presented.[37] In other words, "Presumptions are but generalizations for experience and must give way to evidence . . ."[38]

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burg (D.C., N.Y.), 17 Am.B.R.(N.S.) 498, 50 F.(2d) 240; Matter of J. H. Small Shoe Co. (D.C., N.Y.), 2 Am. B.R.(N.S.) 678, 1 F.(2d) 416 (accountant's report rejected as based on evidence not before court and *ex parte* statements). *Cf.*, however, Matter of Gerson (D.C., Pa.), 14 Am.B.R.(N.S.) 332, 35 F.(2d) 539, where the court refused, without substantial reason, to consider an accountant's analysis and report; Matter of Zappala (E.D.Pa. 1942) 52 Am.B.R. (N.S.) 325, 44 F. Supp. 353 (ditto; see discussion in Matter of Admur, *supra*).

35 In re Jacobs & Adelberg (D.C., Mich.), 10 Am.B.R.(N.S.) 466, 21 F. (2d) 1006.

36 Maggio v. Zeitz (1948) 333 U.S. 56, 68 S.Ct. 401, 92 L.Ed. 476; Brune V. Fraidin (C.C.A., 4th, 1945) 149 F. (2d) 325, aff'g (D.Md. 1944) 56 Am. B.R.(N.S.) 277, 55 F.Supp. 129. See also Oglebay, Some Developments in Bankruptcy Law (1948) 22 J. of Nat'l Ass'n of Ref. 82.

37 *Ibid.* See also In re Sussman (S.D. N.Y. 1949) 85 F.Supp. 570.

Thus a presumption or inference that property traced into the possession of a bankrupt continued to remain in his possession is not a sufficient basis for a turnover order when rebutted by the testimony of the bankrupt and the corroborative testimony of another witness. Matter of Paul (D.C., Pa.), 8 Am.B.R.(N.S.) 269, 14 F.(2d) 703, See also Matter of Gordon & Gelberg (C.C.A., 2d Cir.), 25 Am.B.R. (N.S.) 22, 69 F.(2d) 81. And where the evidence relied on by the trustee depends largely upon estimates of the value of the stock made at different times, and the bankrupt explains the discrepancy to the satisfaction of the court, the trustee's petition for a turnover order will be dismissed. In re Reese (D.C., Pa.), 22 Am.B.R. 521, 170 Fed. 986.

Reopening the proceeding.—There is no abuse of discretion on the part of the referee in refusing to reopen turnover proceedings and admit further testimony of the bankrupt as to the disposition of assets, where it appears that the bankrupt was represented by counsel at the hearing and had every opportunity to give an explanation and there was nothing in his testimony to show that he did not understand the nature of the proceedings. Matter of Walt (D.C., Minn.), 9 Am.B.R.(N.S.) 256, 17 F.(2d) 588; see also Bramow v. Robbin (Ct.App., D.C.), 18 Am.B.R. (N.S.) 479, 50 F.(2d) 499. As to the right of the referee to reopen the proceedings, see Matter of Free & Klinck, Inc. (D.C., N.Y.), 33 Am.B.R. (N.S.) 183, 18 F.Supp. 802. See also ¶ 38.09, *infra*, under subhead "Referee's Power to Reconsider Orders."

38 Consumers Power Co. v. Nash (C.C.A. 6th, 1947) 164 F.(2d) 657.

ADDENDUM E

Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary, 94th Cong. (1975-76) (prepared statement of Leon S. Foreman)

cause they usually side with the debtor on this question, as to how long he is going to be given to try to rehabilitate, reorganize and how quickly are you going to allow the secured creditor to realize on its collateral.

It is a continuous struggle. It requires a very delicate balancing of interests and the public is involved as well because the public wants to see a business unit continue, if possible, and not be liquidated.

I don't think any statute is going to answer that question. I think that is a question that is going to exist forever because it is something you are going to have to deal with under our system.

There is nothing in this statute that tells the court how to decide that issue. That issue is going to come up under this statute, no matter how many times it is modified or changed.

All you can do is perhaps suggest some guidelines and some standards. I am inclined to think that they ought not to be too detailed. The secured creditors would like to see as much detail as possible in the statute.

Mr. EDWARDS. Mr. Forman, we have not given you the opportunity to make a statement. Do you wish to?

[The prepared statement of Leon S. Forman follows:]

STATEMENT OF LEON S. FORMAN ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

I am Leon S. Forman, a member of the Bar of Philadelphia, Pennsylvania, where I have practiced law for approximately 35 years, specializing in the field of creditors rights, including bankruptcy and corporate reorganizations. I graduated from the University of Pennsylvania Law School in 1939. I have written a number of articles in the area of creditors' rights, and I am the author of the practice handbook published by the Committee on Continuing Legal Education of the American Bar Association and the American Law Institute entitled, "Compositions, Bankruptcy and Arrangements." I have also lectured extensively and conducted educational programs on behalf of the Committee on Continuing Legal Education throughout the United States. I was until recently a member of the faculty of the Temple University School of Law, teaching a course in creditors' rights. I am Vice Chairman of the Editorial Board of the "Commercial Law Journal." I have been Chairman of the Section of Corporation, Banking, and Business Law of the Philadelphia Bar Association. I am Chairman of the Bankruptcy Committee of the Pennsylvania Bar Association. I am a member of the National Bankruptcy Conference, and Chairman of its Committee on Preferences, Liens and Title. I am also a member of the American Law Institute.

I am here today on behalf of the National Bankruptcy Conference to testify in support of HR-31 with the changes suggested by the National Bankruptcy Conference ("NBC").

The NBC is a nonprofit, unincorporated organization composed of representatives of different groups who are interested in the administration of bankruptcy law, including bankruptcy judges, full time professors of law, and practicing attorneys who specialize in this area. There are about 55 full members of the Conference and 15 associate members, and all sections of the country are represented among the membership.

My testimony will be confined principally to business bankruptcies as distinguished from personal or consumer bankruptcies, and reorganizations, and in particular will cover the subjects of preferences, liens and title. My subject matter is covered in Section 4-601 to 4-611 of Chapter IV, and Chapter V of the Commission's Bill. Chapter V of HR-31 is by definition applicable only to liquidation proceedings. Chapter IV on the other hand applies to all kinds of cases intended both for liquidation and reorganization. The other sections of Chapter IV will be covered by other witnesses on behalf of the NBC.

The sections in Chapter IV which I will discuss have to do with the collection and liquidation of the estate. The principles enacted by these sections are sometimes referred to as the substantive law of bankruptcy. For the most part,

the basic concepts of the Bankruptcy Act presently in effect in this area are retained in the Commission's bill, although substantial changes are introduced. The NBC supports these provisions with a number of modifications.

I will discuss only the more important parts of this aspect of the Bills, leaving the details and more technical changes to an Appendix attached hereto and to the redrafts which will be submitted to the staff of the Committee by our Drafting Committee.

PROPERTY OF THE ESTATE (SECTION 4–601)

This section replaces Section 70a of the present Act. It presents a new approach to the concept of property includible in the estate. A full explanation of the change in concept is set forth in the Notes to the Commission's Bill. Existing law vests in the trustee title by operation of law to the property of the bankrupt as specifically defined in eight separate categories. The most comprehensive subdivision is 70a(5), which establishes the tests of transferability, or capability of execution by a creditor.

The various categories and definitions of Section 70a are replaced by the simple notion of "property of the estate," which in turn is defined as "property of the debtor" at the date of the petition.

NBC approves as a general principle the simplified approach to the concept of property of the estate as embodied in the above section. However, NBC recommends that the words "wherever located" be inserted in an appropriate place in this section to make certain that all property of the debtor will be includible, especially that which may be located outside of the United States. It is also recommended that there be added to Section 4–601 a new subsection providing that where matters concerning "title" are material, the trustee shall be deemed to be vested with title.

It is also suggested that the Commission's Bill is deficient in omitting a provision similar to Section 70i of the present law. Accordingly, it is recommended that a similar provision should be added to Section 4–601.

The books and records of the debtor are an important part of the administration of a bankruptcy estate, and the right of the trustee to their possession must be clearly established. Some question has been raised as to the sufficiency of the language of Section 4–601 to extend to books and records inasmuch as they do not constitute the kind of property having a realizable value. In order to remove any confusion on the subject, NBC recommends that Section 4–502(a)(6) be amended to include any books, documents, papers, and records relating to the property of the debtor. It is suggested that this section which imposes various duties upon the bankrupt, is the proper place to deal with the matter rather than Section 4–601.

Community property, a subject of great importance in a number of our Western States, is dealt with separately in Section 4–601. NBC found the community property subdivision inadequate and has adopted a number of substantial proposals for modification of this subdivision. This area will be covered by another witness representing NBC, who will submit the specific resolutions adopted by NBC on community property.

Subdivision (b) is an attempt to invalidate certain restrictions and forfeitures. It represents an effort to codify some of the court decisions which authorize a trustee to ignore restrictions on transfers in the liquidation of the assets of the estate. These cases have dealt with state and federal licenses, patent and copyright restrictions, franchises, stock agreements, etc. Although not all the decisions involving such restrictions were favorable to the trustee, the trend has been to enable the trustee to realize as much value from the assets as possible without being hampered by statutory or contractual limitations. Despite the fact that the courts have been able to cope with these problems in most situations, codification is probably helpful in setting up some guidelines. Accordingly, NBC approves of this concept in principle.

The principal difficulty which we found with this provision is its lack of clarity and some confusion as to its scope. Accordingly, NBC adopted a resolution recommending a change in this subdivision along the following lines:

"The following prohibitions and restrictions on transfer of the property of the estate are not enforceable against the trustee:

"(1) Any prohibition or restriction on transfer of property by the debtor conditioned on the insolvency of the debtor or on the filing of a petition:

"(2) Any restriction or condition on the transfer of property by the debtor compliance with which will alter the order of distribution under this Act;

"(3) Any provision for forfeiture or termination conditioned on the insolvency of the debtor or on the filing of a petition."

Subdivision (b) also contains a limitation on the enforceability of a spendthrift trust. NBC considered the spendthrift trust to be related to the question of exemptions which is dealt with in Section 4–503. NBC will present its position on exemptions at another session of this Committee, at which time a recommendation will be made that Section 4–503 shall establish a federal exemption scheme as a floor only, enabling the debtor or bankrupt to take advantage of higher exemptions in his own state. In view of that recommendation, NBC believes that the limitation in Section 4–601(b) on spendthrift trusts should be eliminated and a provision should be added to Section 4–503 to the effect that a spendthrift trust is enforceable against a trustee according to its terms and applicable nonbankruptcy law.

SALE OF PROPERTY OF THE ESTATE (5–203)

NBC had no difficulty with subparagraph (a) dealing with the sale of property but devoted considerable discussion to subparagraph (b). The latter covers a sale subject to a lien as well as one free and clear of a lien. The recommended changes will appear in the Appendix.

Subdivision (c) is of special interest. This provision enables the trustee to sell both the debtor's interest and his spouse's interest in property held as tenants by the entireties, and the portion of the net proceeds attributable to the spouse's interest is to be disbursed to such spouse and the balance to the estate. Partition of a tenancy by the entireties in bankruptcy will represent a radical departure from existing law in a number of states. Bankruptcies may be encouraged in such states by the enactment of the Commission Bill. However, it is suggested that this change in bankruptcy policy should be assessed in conjunction with the expanded provision for federal exemptions. In this view, the doctrine of tenancy by the entireties is looked upon as in the nature of an exemption no longer required in bankruptcy in the context of a uniform federal exemption for bankruptcy cases. The Commission's approach should promote uniformity and eliminate another device which heretofore has been used to frustrate the efforts of creditors to reach property of an individual debtor.

NBC approves the proposal in subdivision (b) but believes that it should be expanded. NBC has adopted a resolution to extend subdivision (c) to all joint ownership situations. However, it is pointed out that some protection must be provided for the case in which the bankrupt's interest in the property is minor and a partition might have serious consequences for the owners of the major interest in the property. We recommend that subdivision (c) should be amended to provide that the trustee may sell both the debtor's interest and the interest of a co-owner, including his spouse, in nonexempt property which the debtor and his co-owner own as tenants in common, tenants by the entirety, or joint tenants, if the benefits of such a sale to the estate outweigh the detriment to the co-owner. The portion of the net proceeds of the sale attributable to the co-owner's interest shall be disbursed to him, and the balance shall constitute property of the estate. The co-owner will be given notice of the sale of his interest, but no order of the court is required unless the co-owner files a complaint to prevent the sale.

Subdivision (d) sets up a provision for protection of a purchaser for value from a bankruptcy estate. NBC was of the opinion that such provision is unnecessary from a legal standpoint, but agreed that a clear statutory statement of the rights of purchasers might improve bids offered to trustees. HR–32 contains an expanded statement of the rights of purchasers, but NBC found the language unacceptable and in lieu thereof recommends that subdivision (d) be amended to provide that a purchaser for value of property from the trustee sold pursuant to this section, free of any lien or free of any other interest encumbering the property, or of any interest of a co-owner, takes free of such lien and interest.

The Judges' Bill has added a new provision to this section for the purpose of prohibiting collusive bidding. NBC considered this provision and found it unnecessary and recommends that it not be included. Collusive bidding is better left to the courts, as they have dealt with the subject adequately heretofore. The language of the proposed provision in the Judges' Bill appears to be too broad

and might well cover legitimate instances in which more than one person interested in property offered by the trustee for sale enter into an agreement to purchase the same jointly.

EXECUTORY CONTRACTS AND UNEXPIRED LEASES (SECTION 4–602)

Executory contracts and leases represent one of the more complicated areas of bankruptcy law. This subject has been troublesome for lawyers and courts throughout the history of bankruptcy and Section 4–602 makes an effort to clarify some of the difficulties. NBC approves of the section in principle but recommends a number of changes.

It is to be noted that leases of personal property are included whereas the existing law on the subject of assumption and rejection applies only to leases of real property. We consider this to be a desirable change. The Commission's Bill continues the concept that the trustee may reject or assume any executory contract including leases, and NBC endorses this principle except that both rejection and assumption of such contracts and leases should require an official authorization, such as by the administrator. The Commission's Bill requires authorization only in the case of rejection, but assumption of a contract is just as important, bearing in mind that the breach of an assumed contract will create a claim in favor of the other party as a cost of administration.

Under subdivision (c) in the case of the rejection of a lease in which the debtor is the lessor, the Commission Bill provides that the rejection constitutes the abandonment of the leased property to the lessee and not a breach of the lease. NBC considers this to be an undesirable solution to a very troublesome situation. One illustration will suffice. If the owner of an office building should become bankrupt, it is not feasible to permit the rejection of a lease of one floor to be an abandonment of the leased property. NBC recommends that where the debtor is the lessor, and a rejection occurs, the lessee should have the option to treat the lease as terminated or to remain in possession and offset against the rent the cost to the lessee of the rejection.

Subdivision (b) changes existing law by making unenforceable contractual provisions which terminate or modify the contract or lease by reason of the insolvency of the debtor or the commencement of a bankruptcy. However, this provision is limited to the reorganization chapters. NBC regards this change as salutary but recommends that it extend to liquidation cases as well.

Where a contract or lease is assumed or assigned by the trustee, despite the existence of an anti-assignment or assumption provision in the contract, subdivision (b) requires that defaults in prior performance of the debtor be cured and that adequate assurance of future performance be provided. However, the Commission's Bill restricts this safeguard to executory contracts and omits leases. The NBC found no sound basis for the distinction and recommends that this provision apply to leases as well as contracts.

EFFECT OF FILING PETITION ON PRIOR CUSTODIAN OF DEBTOR'S PROPERTY (SECTION 4–603)

This section deals solely with the impact of a bankruptcy proceeding upon the property of the debtor in the possession of a nonbankruptcy receiver, trustee, assignee for the benefit of creditors or other custodian or officer. The changes are for the most part matters of reorganization of existing law, correcting defects and improving the language. With respect to such custodians, no controversial questions appeared to the NBC in the Commission's proposal. However, the NBC noted that there is no provision either in the reorganization chapter or elsewhere comparable to existing Section 257 of Chapter X. This section authorizes the Court to require a mortgagee or other secured creditor to turn over to a trustee property in his possession. In view of the expanded jurisdiction of the Bankruptcy Court under the proposed bills, it is also clear that this power should continue in the Court and the NBC concluded that it should be extended to liquidation cases.

The following principles are therefore recommended: (1) The right to gain possession from a secured creditor should exist in both liquidation and reorganization cases. (2) Some standard or guidelines, even if only of a general nature, should be established as to the occasions when such rights should be exercised. (3) The standards or guidelines in liquidation cases should be those contained in Section 5–203 and in reorganization cases those in Section 7–203.

It was also agreed that the proper place to include this matter is Section 4–603, and accordingly a resolution was adopted by the NBC recommending appropriate

changes in this section, and such resolution will be found in the Appendix to this Statement.

RIGHTS OF TRUSTEE AS LIEN CREDITOR AND AS SUCCESSOR TO CREDITORS (SECTION 4–604)

Subsection (a) is intended to replace Section 70c of the present Act. The latter is popularly known as the "strong arm clause." It grants to the trustee the status of a hypothetical or ideal lien creditor and thereby enables him to set aside any transfer or transaction which would be invalid under state law against a lien creditor whose lien was obtained through legal proceedings. This is an important power granted to the trustee and is continued in the new bill. Subsection (a) is endorsed by the NBC with some clarifying amendments.

The most important suggestion is the inclusion at the end of the first sentence of subparagraph (a) language such as, "whether or not a creditor exists." The Judges' Bill also found a need for additional explanation on this point but did so by adding a much more elaborate clause. The NBC is of the opinion that the Judges' modification is too wordy and tends to be confusing.

Subsection (b) is the successor to Section 70e of the present Act. Here we are concerned with substantial changes. Section 70e of the present law gives to the trustee the right to set aside transfers which are fraudulent or voidable against a creditor under state or federal law. The Commission Bill continues the basic concept of Section 70e but with one very important modification. The interpretation of existing Section 70e by the Supreme Court in the famous case of *Moore* v. *Bay*, 284 U.S. 4 (1931) is overruled. The doctrine of *Moore* v. *Bay* is one of the most controversial in the entire field of bankruptcy law. This doctrine under present law allows the trustee to avoid a transfer of obligation entirely without regard to the size of the claim of the creditor whose rights and powers the trustee is asserting with the recovery to be retained for the benefit of the entire estate. Accordingly, if the trustee can derive a cause of action from even one creditor who is in a position to avoid a transfer of substantial property of the debtor, the right of the trustee to recover is not dependent upon the size of the creditor's claim. The entire transfer can be set aside even though the creditor's claim may be nominal and the recovery will be for the benefit of all creditors.

The Judges' Bill retains the doctrine of *Moore* v. *Bay*. The NBC has divided the problem into two questions. First, a determination must be made with respect to the measure of the trustee's recovery, that is, whether it is to be limited to the amount which the particular creditor whose rights are being asserted could have recovered under state law or whether it should be unlimited and thus permit recovery of the entire amount of the transfer of the debtor's property. This issue was very controversial in the debates of the NBC, but a majority has recommended the abolition of this aspect of the doctrine of *Moore* v. *Bay*. We endorse the proposal of the Commission that the recovery by the trustee should be limited to the amount which the particular creditor whose rights are asserted could have recovered. This conclusion is based on the proposition that it is unfair and unreasonable to permit a trustee to set aside a large transaction involving substantial sums when under state law the creditor whose claim is being asserted by the trustee could have recovered from the transferee no more than the amount of his claim.

As to the question of whether the recovery should be for the benefit of the estate rather than as proposed by the Commission for the benefit solely of the particular creditor or creditors whose rights are being asserted, the NBC disapproves of the Commission proposal and recommends that the recovery should be for the benefit of all creditors.

The remaining subparagraph of Section 4–604 was designed to overrule the well-known case of *Caplan* v. *Marine Midland Grace Trust Company of New York*, 92 S. Ct. 1678 (1972) interpreting the present Act to mean that a trustee in a Chapter X reorganization case had no standing to enforce a claim on behalf of debenture holders against an indenture trustee for misconduct. The benefit to the estate contemplated by this paragraph is that which results from the reduction or elimination of the claims against the estate held by the creditors on whose benefit the trustee brings the action.

POST-SECTION TRANSFERS (SECTION 4–605)

This section should be considered in conjunction with Section 4–208(c). These two sections together represent a substantial improvement over existing law,

ADDENDUM F

Staff of Subcomm. On Civil & Const. Rights of House Comm. on Judiciary, 95th Cong., 1st Sess., Table of Derivation of H.R. 8200 at 12 (Comm. Print 1977)

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Table of derivation of H.R. 8200—Continued

Present law	H.R. 8200	H.R. 31	Section title or content
See §§ 2a(21), 69d, 70a(8); rule 604	542(a)	NCP: NBC 4–603(b); 4–603(a)(4)	Turnover by Creditor.
See generally, Bank of Marin v. *England;* §§ 70d(2) & (3) *compare with* § 68b.	542(b)	*See generally* 4–605(b); 5–201	Payment on Order of Trustee.
See generally, Bank of Marin; §§ 70d(2) & (3).	542(c)	4–605(b)	*Bank of Marin.*
New	542(d)	NCP	Automatic Premium Loans.
Compare with § 7a and Rule 402	542(e)	4–502(a)(6); NBC 4–502(c)	Turnover of Books and Records.
NCP. *See generally and compare with* §§ 11a, 17c(4), *Cf.* Rules 401, 601, 10–601, 11–44, 12–43, 13–401.	543(a)	NCP: *See generally* 4–501(a)(1)(A).	Prohibition of Action by Custodian.
See § 2a(21), 69d and 70a(8)	543(b)(1)	4–603(b) preamble	Duty to Turnover Property.
See § 2a(21), 69d and 70a(8)	543(b)(2)	4–603(b) preamble	Duty to Account.
See § 2a(21), 69d, 70a(8); Rule 604	543(c)(1)	4–603(c) 3d sentence	Protection of Custodial Obligations.
See § 2a(21), 69d, 70a(8); Rule 604	543(c)(2)	4–603(c) 3d sentence	Payment of Custodian.
See § 2a(21), 69d, 70a(8); Rule 604	543(c)(3)	4–603(c) 4th sentence	Surcharge of Custodian.
See § 2a(21), 69d, 70a(8); Rule 604	543(d)	4–603(b)(2)	Abstention.
See § 70c	544(a)(1)	4–604(a)	Trustee as Judicial Lien Creditor.
See § 70c	544(a)(2)	4–604(a)	Execution Returned Unsatisfied.
NCP; *See generally* § 60a(2)	544(a)(3)	NCP: *See generally* § 60a(2) 2d sentence.	B.F.P. of Debtor's Realty.
Compare with § 70c	544(b)	H.R. 32 4–604(b)(1)	Status as Unsecured Creditor.
See § 70c	544(c)(1)	4–604(b)(2)	*Caplin* Rights of Trustee.
See § 70c	544(c)(2)	4–604(b)(2) 1st two sentences	Stay and Notice.
See § 70c	544(c)(3)	4–604(b)(2) 3d sentence	Res Judicata.
§ 67c(1)(A); *compare with* § 67	455(1)	§ 67c(1)(A) of B.A., *see generally* 4–606.	Statutory Lien that arises on insolvency.
§ 67c(1)	545(2)	§ 67c(1)(B) of B.A	Statutory Lien not perfected against a bona fide purchaser.
§ 67c(1)(C)	545(3)	§ 67c(1)(C)	Statutory lien for rent.
§ 67c(1)(C)	545(4)	§ 67c(1)(C)	Statutory lien of distress for rent.
§ 67c(1)(B)	546(a)	§ 67c(1)(B) proviso: *See* NBC 4–606(b).	Retroactive Perfection Permitted.
U.C.C. § 2–702	546(b)(1)	U.C.C. 2–702; cf. NBC 4–407	Right of Reclamation (U.C.C. 2–702).
Cf. § 9–109 of U.C.C.	546(b)(2)	N.C.P.	Administrative Expense Alternative.