SECTIONS 542 AND 543—TURNOVER OF PROPERTY OF THE ESTATE

By Bruce Grohsgal[*]

I. Introduction

Section 542 of the Bankruptcy Code generally requires a noncustodial entity who has possession, custody, or control of property of the estate that the trustee may use, sell, or lease under section 363 or may exempt under section 522 to deliver to the trustee and account for the property or the value of such property.[1] Section 543 generally requires a custodian with knowledge of the commencement of the case to deliver to the trustee and account for such property of the estate and the proceeds of such property.[2] This paper reports on opinions regarding turnover published since the 2011 update.[3]

II. Jurisdiction and Sovereign Immunity

Bankruptcy jurisdiction is essentially in rem, based on the court's jurisdiction over the property of the bankruptcy estate.[4] The bankruptcy court, by the standing order of reference from its district court, has exclusive jurisdiction over property of the debtor's estate wherever located.[5] It follows that a turnover action with respect to such property is a core proceeding, and the jurisdictional statute that governs bankruptcy proceedings expressly so provides.[6]

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[*]Bruce Grohsgal is a Partner in the Delaware Office of Pachulski Stang Ziehl & Jones LLP. His Practice is Focused in the Areas of Business Reorganization and Bankruptcy, Representing Debtors, Creditors' Committees, and Chapter 11 Trustees.

[1]11 U.S.C.A. § 542.

[2]11 U.S.C.A. § 543.

[3]The opinions considered in this update are mostly from early 2010 through early 2011. The author welcomes additional opinions, published and unpublished, on the subject.

[4]*Central Virginia Community College v. Katz*, 546 U.S. 356, 126 S. Ct. 990, 163 L. Ed. 2s 945 (2006).

[5]28 U.S.C.A. § 1334(c).

[6]28 U.S.C.A. § 157(b)(2)(E).

Jurisdiction—Generally

A turnover action under section 542 or 543 generally cannot be used, however, to demand assets whose title is in dispute. And the courts have struggled with whether the prosecution of a disputed claim against a third party is a core proceeding—even though, clearly, such a claim is property of the estate, and even though such claim, once successfully prosecuted to judgment, will give rise to a turnover action which will be subject to the bankruptcy court's core jurisdiction. Moreover, the Supreme Court's 2011 decision in *Stern v. Marshall* has called into questions the bankruptcy courts' authority and, arguably, jurisdiction to hear even those matters that are designated as "core" in 28 U.S.C.A. § 157(b).[7] Several recent decisions were made regarding this gray area of turnover jurisdiction.

In *In re Point Blank Solutions, Inc.* the debtor entered into a prepetition settlement agreement, conditioned on entry of a final order approving the settlement, and deposited the $32 million settlement payment in escrow. Prior to the settlement order's becoming final, the debtor filed for bankruptcy and rejected the settlement agreement as an executory contract. The debtor then commenced an adversary proceeding for declaratory relief that the debtor had a right to the escrowed funds, and seeking turnover of the escrowed funds under section 542.[8]

The court held that the proceedings were core. The claim for declaratory relief asked the court to determine debtor's rights to the escrowed funds. The bankruptcy court noted that it "is well established that proceedings to determine what constitutes property of the bankruptcy estate under section 541(a) of the Bankruptcy Code are core proceedings." That the dispute may involve the application of New York state law did not undermine the core finding.[9]

"Properly understood in this way," the court continued, the debtor's claims for declaratory relief and for turnover of estate assets were core proceedings because they were "matters concerning the administration of the estate" and "orders to turn over property of the estate," under 28 U.S.C. § 157(b)(2)(A) and (E)." These claims arose directly from the substantive bankruptcy law right to reject executory contracts, a fundamental issue of bankruptcy law unique to the Bankruptcy Code. Additionally, the

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[7] *Stern v. Marshall*, __ U.S. __, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011).

[8] *In re Point Blank Solutions, Inc.*, 449 B.R. 446, 448 (Bankr.D.Del. 2011).

[9] *In re Point Blank Solutions, Inc.*, 449 B.R. at 449–450 (citing cases).

court held that the claims qualified as core because they required the court to interpret and enforce its own rejection order.[10]

In *In re Republic Windows & Doors, LLC*, the trustee sought turnover of an unpaid obligation in the "possession, custody and control" of the defendant. The defendant posited that dismissal of the claim was "warranted in light of the jurisdictional limitations on bankruptcy courts imposed by *Stern v. Marshall*. The bankruptcy court found that, if the trustee prevailed on the claim, he would "bring money into the bankruptcy estate for distribution, affecting the allocation of property among creditors. Accordingly, "the Court ha[d] related-to jurisdiction" over the turnover count, and did not dismiss that count.[11]

In *In re Heller Ehrman LLP*, the liquidating debtor and former law firm commenced an action against two defendants to recover an account receivable, for breach of contract and quantum meruit, and for turnover. The court held that the adversary proceeding was not a core proceeding, notwithstanding Heller's designation of one claim for relief as a turnover action under section 542. "Turnover actions involve the 'return of undisputed funds.' " Here, the defendants disputed their liability to Heller, and the estate's property was "the claim for damages itself, which is not subject to turnover." There was "no specific, identifiable fund belonging to Heller in Defendants' possession. A suit by a debtor against a non-creditor arising out of breach of contract, absent more . . . is not a turnover action under § 542."[12]

In *In re Salem Baptist Church of Jenkintown*, the debtor had commenced a malpractice action in federal district court prepetition against its law firm in connection with a construction project.[13] In the bankruptcy case, the debtor initiated an adversary proceeding (1) for declaratory judgment as to whether the defendants' malpractice insurance policy provided coverage in connection with the district court litigation and whether the proceeds of the policy were property of the estate, (2) for turnover of the proceeds of the policy, (3) for injunctive relief barring the defendants from expending any of the proceeds of the policy in

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[10] *In re Point Blank Solutions, Inc.*., 449 B.R. at 450 (citing cases).

[11] *In re Republic Windows & Doors, LLC*, 460 B.R. 511, 514, 516 (Bankr.N. D.Ill. 2011), citing *Stern v. Marshall*, __ U.S. __, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011).

[12] *In re Heller Ehrman LLP*, 2011 WL 3878347 *1 (Bankr.N.D.Cal.), quoting *In re Gurga*, 176 B.R. 196, 199–200 (9th Cir.BAP1994).

[13] *In re Salem Baptist Church of Jenkintown*, 455 B.R. 857, 860 (Bankr.E.D. Pa. 2011).

connection with their defense of the district court litigation, and (4) for an accounting of all proceeds of the policy. At the hearing, the debtor's counsel informed the bankruptcy court that the essence of its complaint sought to enjoin the defendants from expending the proceeds of the policy. "With this acknowledgement in mind," the court found that the debtor was essentially seeking prejudgment attachment of the proceeds of the policy.[14]

The defendants sought to dismiss, including on the ground that the bankruptcy court lacked jurisdiction. The court stated that, although the debtor styled the complaint as an action pursuant to section 542 and 543 for turnover of specific assets, its claim against the policy arose "from state tort law and not in the context of a bankruptcy." The court drew the distinction between core turnover proceedings and related-to state-law contract actions that have been styled as turnover proceedings, and determined that the proceeding before it was subject to the court's core jurisdiction only if the debtor's estate had an interest in the policy.[15] The court analyzed the terms of the policy and found that the debtor lacked any interest in the policy or its proceeds. As a result the bankruptcy court lacked subject matter jurisdiction to adjudicate the matters raised by the complaint.[16]

Similarly, in *In re Kotyuk*, the Chapter 7 trustee filed a complaint "styled as one for turnover or to recover property of the estate," alleging that the defendant owed the debtor $8,000.00 on account of a "receivable" that the defendant allegedly had owed to the debtor on the petition date. The defendant failed to answer or otherwise respond to the complaint, the Clerk of the United States Bankruptcy Court entered and gave notice of default to the defendant, and the trustee filed a motion for default judgment. The bankruptcy court determined that the complaint, "although styled effectively as one for turnover under 11 U.S.C. § 542," actually sought "to liquidate a contract claim based on State-created rights formerly held by the Debtor but now included within the property of the estate under 11 U.S.C. § 541. The "adjudication of such claims, in the absence of consent of the parties, falls within 'the judicial power' that may be exercised only

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[14] *In re Salem Baptist Church of Jenkintown*, 455 B.R. at 861.

[15] *In re Salem Baptist Church of Jenkintown*, 455 B.R. at 863, citing *Beard v. Braunstein*, 914 F.2d 434, 444 (3rd Cir.1990) (distinguishing between core turnover proceeding and related-to state-law contract actions that have been styled as turnover proceedings) and 28 U.S.C. § 157(b)(2)(a) (establishing "matter concerning the administration of the estate" as being within a bankruptcy court's core jurisdiction).

[16] *In re Salem Baptist Church of Jenkintown*, 455 B.R. at 869.

by a court with the 'essential attributes' of federal judicial power prescribed in Article III of the United States Constitution." The bankruptcy court determined that it lacked such attributes,[17] and thus "lacked jurisdiction to enter final judgment in such a situation, and that it must proceed by recommending that the District Court grant the motion for default judgment, rather than by granting the motion and entering judgment itself." Accordingly, the court did not enter the judgment but recommended to the District Court that it do so.[18]

A disputed contract claim is not a turnover claim under section 542(b). See § X below. However, the bankruptcy court in *In re Legal Xtranet* noted that a defendant "cannot resist section 542(b) by *manufacturing* a dispute where there in fact is none. And simply resisting recovery is not enough to create a legitimate dispute."[19] The court further observed that the "real point of the Plaintiff's couching this action as one arising under section 542(b) is clear: if the matter is truly one arising under section 542(b), then it may be a core proceeding, on which this court can rule with finality. If, on the other hand, this is not a matter arising under section 542(b), then it may well be an action the basis for which in no way derives from or is dependent on bankruptcy law. In the latter event, this court could not adjudicate the dispute to final judgment." The court determined that it "need not decide that question on this motion, which seeks only dismissal under Rule 12(b)(6). The fact that the court denie[d] relief on this motion in no way decide[d] the questions raised by the *Stern v. Marshall* decision, which questions" the court "reserved for another day."[20]

Turnover is available to a trustee or debtor in possession under section 542(b) to recover a matured debt owed to the estate. The trustee in *In re Smith* alleged that a note under which the defendants were obligors was in default and constituted property of the bankruptcy estate, contended that the full remaining balance was due and owing, and sought an order pursuant to section 542 requiring the defendants to turn over and deliver to the trustee the sum of $92,000.00, plus interest from the trustee's

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[17]*In re Kotyuk*, 2011 WL 1596228 *1 (Bankr.W.D.Mich.), citing *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 485 U.S. 50, 102 S.Ct. 2858 (1982).

[18]*In re Kotyuk*, 2011 WL 1596228 *1–2.

[19]*In re Legal Xtranet*, 2011 WL 3236053 *1, N. 1 (Bankr.W.D.Tex.).

[20]*In re Legal Xtranet*, 2011 WL 3236053 *1, citing See *Stern v. Marshall*, __ U.S. __, 180L.Ed.2d 475, 489–95 (2011).

written notice of default. The bankruptcy court held, simply, that this was a core proceeding under 28 U.S.C. § 157(b)(2) as it concerned a request for turnover of property of the estate pursuant to 11 U.S.C. § 542(b).[21]

The decision of the bankruptcy court in *In re AFY, Inc.* regarding turnover of a matured debt may be the nadir of bankruptcy court jurisdiction. The express requirement that "an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order" must "pay such debt to, or on the order of, the trustee" is four-square within the turnover provisions of section 542(b).[22]

The court determined that the trustee in *AFY* was attempting to collect a debt that was "undisputed and presumably is matured and payable on demand." The court noted that while the trustee's action fell within the scope of section 542(b), it nevertheless was "simply a collection action." It was "a claim that would not be before the bankruptcy court but for the fact that the debtor filed a bankruptcy petition. As a collection action, it could, and normally would, be adjudicated outside of bankruptcy." Because the action did not arise under Title 11 or arise in the bankruptcy case itself, nor would it be resolved in the claims allowance process, it was "not a core proceeding within the constitutional authority of the bankruptcy court to enter judgment." Instead, the bankruptcy court ruled, "the case should be transferred to the United States District Court for the District of Nebraska for entry of final judgment."[23]

The same court held that held in another adversary proceeding in the *AFY* bankruptcy case that it was not deprived of subject matter jurisdiction simply because the resolution of the suit before it might require the application of state law.[24]

In *In re Kindernecht* the bankruptcy court held that a claim for an accounting under section 542(e) is also a core proceeding.[25]

In *In re Miller*, the bankruptcy court held that as a result of the dismissal of the debtor's Chapter 13 case, there was "no longer any 'estate property' " in the case, "nor a debtor or trustee" to

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[21] *In re Smith*, 2011 WL 2518890 *1, 3 (Bankr.D.Colo.).

[22] 11 U.S.C. § 542(b).

[23] *In re AFY, Inc.*, 2011 WL 3800041 *2 (Bankr.D.Neb.); *In re AFY, Inc.*, 2011 WL 3800120 *2 (Bankr.D.Neb.).

[24] *In re AFY, Inc.*, 2011 WL 3812598, *1 (Bankr. D. Neb. 2011), citing *In re Salander O'Reilly Galleries*, __ B.R. __, 2011 WL 2837494, at *10–13 (Bankr.S. D.N.Y. July 18, 2011).

[25] *In re Kinderknecht*, 2011 WL 841141 *2 (Bankr.D.Kan.).

whom the court could order the funds turned over. Accordingly, the court "was divested of jurisdiction of Plaintiff's claim for turnover when the underlying case, from which the claim arose, was dismissed."[26]

Sections 542 and 543 do not apply in Chapter 9 cases, for the adjustment of the debts of a municipality.[27] In *In re Jefferson County, Ala.*, a receiver was appointed prepetition by the Alabama state court the county's sewer system assets, following which the county filed its Chapter 9 petition. The indenture trustee for certain warrant holders, the receiver and other parties in interest asked the bankruptcy court "(1) to abstain 'from taking any action to interfere with' the Alabama state court receivership case for Jefferson County's sewer system, (2) to determine that the automatic stays of 11 U.S.C. §§ 362(a), 922(a), [did] not apply to the Alabama receivership case" or to the receiver; (3) to hold that the receiver was "entitled to continue as receiver of Jefferson County's sewer system properties, and (4) to modify the automatic stays of §§ 362(a) or § 922(a) should they apply to the Alabama receivership case" or the receiver, so the receivership proceedings might "continue unabated by Jefferson County's chapter 9 bankruptcy."[28]

Many of the arguments made by the movants were "premised on the assumption that the jurisdictional grants of a bankruptcy court are actions of the court and not those self effectuating on the filing of a bankruptcy case. A few misapprehend[ed] the 'first in time' concurrent court rules regarding *in rem* jurisdiction."[29] The court found and held that, "[i]mmediately on the filing of the County's chapter 9 case, the Alabama receivership court lost its possession and control over the County's property interests in its sewer system. Under Alabama's receivership law and comparable federal and state laws on receiverships, a court appointed receiver of the kind appointed in the Alabama receivership case holds all properties for the appointing court and has no interest in the properties held. Neither does the receivership court, other than for holding the properties in *custodia legis.*" This applied to the receiver in the *Jefferson County* case. Under the Supreme Court precedent, "filing of the County's bankruptcy case automatically and immediately transferred the properties held by the Receiver for the Alabama receivership court to" the bankruptcy court's

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[26] *In re Miller*, 2011 WL 6217342 *2 (Bankr.D.Colo.).

[27] 11 U.S.C. § 901(a).

[28] *In re Jefferson County, Ala.*, 465 B.R. 243, 248 (Bankr.N.D.Ala. 2012).

[29] *In re Jefferson County, Ala.*, 465 B.R. at 249.

"exclusive jurisdiction under the grant of 28 U.S.C. § 1334(e)(1) and the Receiver, at best," held the County's sewer system for the bankruptcy court, "not another court."[30]

In reaching this conclusion, the court held that "[t]he absence of § 543 turnover authority" in Chapter 9 cases did "not alter the *in rem* jurisdiction of a bankruptcy court or the application of the automatic stays with respect to property subject to this Court's *in rem* jurisdiction." A "turnover provision is not necessary under federal case law for the County to obtain possession of its property interests."[31] As a practical matter, the court considered that the "absence of 11 U.S.C. 543 in chapter 9 cases does not necessarily leave a chapter 9 debtor without the ability to obtain its property from others. Before enactment of the Chandler Act of 1938, June 22, 1938, ch. 575, 52 Stat. 883, amending former title 11, a trustee would frequently seek property of the bankruptcy estate by suit in a court of competent jurisdiction, be it a state or federal one. Some of what happened under the Chandler Act amendments to the prior bankruptcy statute is the plenary jurisdiction prerequisite for a turnover action was eliminated by basing such proceedings on summary jurisdiction over the *res*."[32] In sum, the *Jefferson County* court held that a bankruptcy court has jurisdiction over a Chapter 9 debtor's property upon the filing of the case, even if a receiver was previously appointed, and that a Chapter 9 debtor can obtain turnover of its property from a receiver and other any parties, notwithstanding that the turnover provisions of sections 542 and 543 do not apply in a Chapter 9 case.

Jurisdiction after Chapter 11 Plan Confirmation

Jurisdiction over turnover actions must be preserved—and can be lost—by the provisions of a confirmed Chapter 11 plan. The debtor in *In re Crescent Resources, LLC* obtained confirmation of its plan, and the litigation trust commenced an adversary proceeding against Duke Energy Corporation, alleging that the transaction that had created the debtor in 2006 had rendered it

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[30] *In re Jefferson County, Ala.*, 465 B.R. at 249, citing *Taylor v. Sternberg*, 293 U.S. 470, 55 S.Ct. 260, 79 L.Ed. 599 (1935).

[31] *In re Jefferson County, Ala.*, 465 B.R. at 268.

[32] *In re Jefferson County, Ala.*, 465 B.R. at 268, n. 10, citing *Emil v. Hanley (In re John M. Russell, Inc.)*, 318 U.S. 515, 517–19, 63 S.Ct. 687, 87 L.Ed. 954 (1943); and *In re Seven Springs Apartments, Phase II*, 33 B.R. 458, 468–69 (Bankr. N.D. Ga. 1983).

insolvent.[33] The defendant moved to dismiss on the ground that the bankruptcy court lacked jurisdiction because the action had not been preserved to the estate in the plan.[34]

The court considered the plan's provisions and case law, and agreed with the "specific and unequivocal" test established in *Texas Wyoming Drillling*. Under that test, the court must determine " 'whether the language in the [p]lan was sufficient to put creditors on notice that [the debtor] anticipated pursuing the [c]laims after confirmation.' " If so, the language meets the "specific and unequivocal" requirement and the action survives confirmation.[35]

The language in the plan stated that:

> "The Litigation Trust Assets shall include, but are not limited to, those Causes of Action arising under Chapter 5 of the Bankruptcy Code including those actions which could be brought by the Debtors under §§ 544, 547, 548, 549, 550, and 551 against any Person or Entity other than the Litigation Trust Excluded Parties."

The court noted that this language fell "somewhere between 'any and all claims' and listing turnover claims by statute number . . . Chapter 5 is referenced as well as six specific code sections. So the question before the Court [was] whether a reference to Chapter 5 of the Bankruptcy Code, in conjunction with Sections 544, 547, 548, 549, 550, and 551," was sufficiently " 'specific and unequivocal' to retain a turnover cause of action under Section 542." The court found "that a cause of action for turnover was specifically and unequivocally retained by this language in the Plan."[36] Further, "[u]sing the test from *Texas Wyoming* it seem[ed] far-fetched to believe that a creditor would not be on notice that the Trust anticipated pursuing turnover claims after confirmation."[37] The court held that the plan "preserved turnover claims with language which was specific and unequivocal." Therefore the trust had standing to pursue the turnover claims and the court had subject matter jurisdiction.[38]

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[33]*In re Crescent Resources, LLC*, 455 B.R. 115, 116 (Bankr.W.D.Tex. 2011).

[34]*In re Crescent Resources, LLC*, 455 B.R. at 117.

[35]*In re Crescent Resources, LLC*, 455 B.R. at 129, citing *Spicer v. Laguna Madre Oil & Gas, LLC (In re Texas Wyoming Drilling, Inc.)*, 422 B.R. 612, 627–628 (Bankr.N.D.Tex.2010).

[36]*In re Crescent Resources, LLC*, 455 B.R. at 129.

[37]*In re Crescent Resources, LLC*, 455 B.R. at 129–130.

[38]*In re Crescent Resources, LLC*, 455 B.R. at 130.

Sovereign Immunity

The Sixth Circuit in *U.S. v. Carroll* considered the sovereign immunity of the IRS in a case that, strangely, was brought by the IRS, and involved standing orders requiring the IRS to turn over Chapter 13 debtors' tax refunds directly to the Chapter 13 standing trustees. In the court's words, this was "not an everyday case . . . Governments do not usually invoke the jurisdiction of the federal courts in order to contest it; they normally raise sovereign immunity as a defense to an action already filed against them."[39]

The case arose out of procedures established in the bankruptcy courts of the Eastern District of Michigan with respect to federal tax refunds paid to Chapter 13 debtors. The Sixth Circuit observed that "[o]ne asset of Chapter 13 individual debtors that sometimes makes a difference in the completion of a reorganization plan is a tax refund. That might come as a surprise. Is it really the case that individuals seeking bankruptcy protection have a proclivity for *overpaying* their taxes? The explanation is that the overpayment is not voluntary; the taxes are withheld by law, and the absence of a high income leads to a low to non-existent taxable income, resulting in meaningful tax refunds. Perhaps less surprising is the reality that people who seek bankruptcy protection do not always pay their creditors first when they come across unanticipated disposable income. When the IRS paid these tax refunds directly to the affected taxpayers, a significant number of them put the money to their own uses, not to pay off creditors as required by the terms of their reorganization plans."[40]

To address this problem, beginning in 2008 the bankruptcy judges of the Eastern District of Michigan began entering orders in Chapter 13 plans that required the IRS to send individual tax refunds directly to the Chapter 13 trustees, and not to the individual taxpayers as contemplated by the Internal Revenue Code. The IRS did not initially oppose entry of these orders, and redirected the affected tax refunds directly to the trustees who redistributed them in accordance with the Chapter 13 plans.[41]

In 2009, the IRS had a "change of heart" spurred by the need to process each return by hand and the dramatic, more than tenfold increase in the number of affected returns. Thus, "[a]t the request of the Chief Counsel to the Internal Revenue Service, the

[39]*U.S. v. Carroll*, 667 F.3d 742, 743 (6th Cir. 2012).

[40]*U.S. v. Carroll*, 667 F.3d at 744.

[41]*U.S. v. Carroll*, 667 F.3d at 744.

United States filed this lawsuit against the standing Chapter 13 bankruptcy trustees of the Eastern District of Michigan in their official capacities, complaining that the refund-redirection orders violated the United States' sovereign immunity."[42]

The court described the merits of the IRS' sovereign-immunity claim as proceeding "in three steps. Step one: the bankruptcy code abrogates any governmental unit's sovereign immunity 'to the extent set forth' in 11 U.S.C. § 106. Step two: one provision set forth in § 106 says that '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.' 11 U.S.C. § 542(b). Step three: this language, according to the government, does not clearly waive its immunity from the bankruptcy courts' refund-redirection orders."[43]

"Consistent with this theory, the United States sought two forms of relief: a declaratory judgment preventing the trustees from enforcing the existing refund-redirection provisions and a writ of mandamus prohibiting the bankruptcy court from including these provisions in future Chapter 13 plans. The district court granted both forms of relief. The trustees appeal[ed]."[44]

The Sixth Circuit reversed, but not on substantive grounds. Though both sets of parties preferred that the court resolve the suit on the merits, the court held that it lacked the jurisdiction to do so. "The government sued the wrong parties, depriving it of standing to bring this lawsuit." The court reasoned that of "the three 'irreducible constitutional minimum[s]' of standing—injury in fact, causation and redressability,—the government satisfie[d] just one of them"—the requisite injury.[45] Causation and redressability were another matter. Causation was not satisfied because the government had sued a group of bankruptcy trustees, "but the harm it suffered—administrative costs associated with processing tax refunds—flow[ed] not from the trustees' actions but from the bankruptcy court's orders."[46] The government also came up short on redressability. A judgment against the trustees would not eliminate the problem. In particular, nothing would

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[42]*U.S. v. Carroll*, 667 F.3d at 744.

[43]*U.S. v. Carroll*, 667 F.3d at 744–745, citing *United States v. Nordic Village, Inc.*, 503 U.S. 30, 38, 112 S.Ct. 1011, 117 L.Ed.2d 181 (1992).742, 743 (6th Cir. 2012).

[44]*U.S. v. Carroll*, 667 F.3d at 745.

[45]*U.S. v. Carroll*, 667 F.3d at 745, citing *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992).

[46]*U.S. v. Carroll*, 667 F.3d at 745.

prevent debtors, creditors, or other parties from asking the bankruptcy court to issue the same order, or the bankruptcy court from "doing the same on its own, exercising its equitable powers over the bankruptcy process to fashion an equivalent order."[47]

The court held that the government lacked standing to seek declaratory or injunctive relief against the trustees, vacated the district court's judgment, and remanded the case for an order dismissing the action for lack of jurisdiction. The court observed, however, that the "lawsuit was apparently born of three good intentions: (1) a need to resolve the government's sovereign-immunity defense to the redirection orders; (2) a timing exigency in view of the growing administrative burden of the orders; and (3) a desire not to sue federal judges—thank you—unless absolutely necessary." The court suggested the government's "unusual vehicle for handling these concerns was not the only one available. The government could have filed a direct appeal from the entry of a redirection order in one (or more) of the cases in which the IRS is a party," which course the government had followed in other cases involving similar redirection provisions. Nothing prevented government from taking this conventional path to protecting its sovereign immunity."[48]

III. Preemption of State Law by the Bankruptcy Code; Preemption of the Bankruptcy Code by Other Federal Law

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

IV. Form of Action/Service

Federal Rule of Bankruptcy Procedure 7001(1)[49] includes in the list of adversary proceedings "a proceeding to recover money or property, other than a proceeding to compel the debtor to deliver property to the trustee." Thus a turnover of estate property from a debtor[50] and a turnover action for recorded information under

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[47] *U.S. v. Carroll*, 667 F.3d at 746.

[48] *U.S. v. Carroll*l, 667 F.3d at 746.

[49] Fed. R. Bankr. P. 7004(m). 7001(1).

[50] *See e.g., In re McCrory*, 2011 WL 4005455 *3 (Bankr.N.D.Ohio); *In re Rogove*, 2010 WL 3748151 (Bkrtcy.S.D.Fla. 2010).

section 542(e)[51] may be brought by motion, while Rule 7001(1) requires all other actions for turnover of estate property under section 542(a) and (b) (i.e., an action against a nondebtor) and section 543(a) to be commenced by an adversary proceeding.[52]

The Rule is not slavishly applied. In *In re Olson* the Chapter 7 trustee sought turnover from a non-debtor by motion and the bankruptcy court scheduled the matter for trial.[53] The court also observed that the trustee had not specified whether he was seeking turnover under section 542 or section 543, and that since further proceedings were necessary with respect to the motion, "the trustee may clarify in such future proceedings" whether his motion was filed pursuant to section 542 or section 543. The court noted that "[i]t seems apparent that such sections are mutually exclusive."[54]

Moreover, the court in *In re Stasz* held that "a bankruptcy court's decision not to require an adversary proceeding is subject to a harmless error analysis, and under that standard, if the failure to commence an adversary proceeding did not cause prejudice, form should not be elevated over substance."[55]

Further, notwithstanding this Rule, the provisions of section 542(a)of the Bankruptcy Code, governing the turnover of tangible property, are intended to be self-executing. The bankruptcy court in *In re Century City Doctors Hosp., LLC* noted that the duty to turn over property of the estate is not contingent on any order or demand, and arises on the filing of the petition. The court emphasized, though, that these obligations apply only to *undisputed* funds or other estate property. Because the trustee had "made no allegations in the complaint or submitted any evidence in opposition to the summary judgment motion to suggest that the transferred funds" were "*indisputably* estate property subject to the turnover requirements under § 542," and the defendant had disputed the trustee's right to recovery under any theory of

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[51]*See e.g.*, *In re MV Pipeline CO.*, 2007 WL 1452591 at *8 (Bankr.E.D.Okla. 2007). A turnover action against a debtor may also be brought by adversary proceeding. *In re McKenzie*, 2011 WL 4600407 *6 (Bankr.E.D.Tenn.).

[52]*See e.g., In re Spence*, 2009 WL 3756621 (Bankr.W.D.Tex. 2009), *In re Hodge*, 2009 WL 3645172 (Bkrtcy.W.D.Tex. 2009), and *In re Clark*, 2009 WL 2849785 (Bankr.D.Dist.Col. 2009).

[53]*In re Olson*, 2011 WL 6010226 *1-2 (Bankr.D.Neb.).

[54]*In re Olson*, 2011 WL 6010226 *1.

[55]*In re Stasz*, 2011 WL 3299162 *4 (9th Cir.BAP), citing *Korneff v. Downey Reg'l Med. Ctr.-Hosp., Inc. (In re Downey Reg'l Med. Ctr.-Hosp, Inc.)*, 441 B.R. 120, 127–28 (9th Cir.BAP2010), citing *Austein v. Schwartz (In re Gerwer)*, 898 F.2d 730, 734 (9th Cir.1990).

recovery, the defendant was entitled to summary judgment on the turnover count "because there simply [was] no legal basis for a stand-alone 'turnover' claim" in the case.[56]

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

By contrast, in *In re Randolph Towers Cooperative, Inc.*, turnover under section 542(b)—of a debt that is property of the estate and that is matured, payable on demand, or payable on order—was held to be not self-executing, and to require the filing of an adversary proceeding.[57]

V. Standing

A trustee clearly has standing to bring an action under Code section 542.[58] The bankruptcy court in *In re Young* held that in a Chapter 7 case the trustee, not the debtor, is entitled to turnover.[59]

Standing to pursue turnover claims can be conferred on a litigation trust or liquidating trust or similar entity form pursuant to a plan, provided the plan preserves turnover claims and transferred or vested those claims in the trust.[60] *See In re Crescent Resources, LLC* discussed in § II above.

A Chapter 13 trustee would appear to lack standing and authority to seek turnover. The bankruptcy court in *In re Adams* reasoned that "[o]ne of the elements of a turnover action is that the property being sought is 'property that the trustee may use, sell, or lease under section 363 of this title.' 11 U.S.C. § 542(a). This poses a potential problem when a chapter 13 trustee seeks an action for turnover because a chapter 13 trustee is prohibited from using, selling, or leasing property of the estate: Section 1303 provides that the debtor, exclusive of the trustee, has the rights and powers of a trustee under section 363(b), the subsection

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[56]*In re Century City Doctors Hosp., LLC*, 466 B.R. 1, 19 (Bankr.C.D.Cal. 2012).

[57]*In re Randolph Towers Cooperative, Inc.*, 2011 WL 2940664 *4 (Bankr.D. Dist.Col.).

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

[59]*In re Young*, 439 B.R. at 217–218.

[60]*In re Crescent Resources, LLC*, 455 B.R. at 130 (plan preserved claims and litigation trust formed pursuant to the plan had standing to pursue those claims).

which gives a trustee authority to use, sell, or lease property of the estate."[61] In the court's view, "the beg[ged] the question: If a § 542 turnover action must seek turnover of property that the trustee may use, sell, or lease, and a chapter 13 trustee is prohibited from using, selling, or leasing property, how can such chapter 13 trustee seek turnover pursuant to § 542?" But because the parties had not addressed this question in their briefs or at the hearing, and because the Chapter 13 trustee had not had an opportunity to make his case before the court, the court was "not comfortable" finding that the trustee had shown that he was entitled to judgment as a matter of law on this issue, and denied the trustee's motion for partial summary judgment on this and other grounds.[62]

The court in *In re Diaz Esteras* was clear, however, stating that "the trustee's use of Section 542 in a chapter 13 case is thwarted by Section 1303. " 'Literal application of the turnover power in § 542 produces nonsense in a Chapter 13 case: delivery of property to the trustee will never be required because the Chapter 13 trustee is prohibited from using or possessing estate property, at least until entry of a contrary confirmation order.' "[63]

The bankruptcy court in *In re Miller* held that, upon a dismissal of a debtor's bankruptcy case, "there is no longer any 'estate property' in [the] case, nor a debtor or trustee to whom the Court can order the funds turned over." Accordingly, the court is divested of jurisdiction of a claim for turnover "when the underlying case, from which the claim arose, was dismissed." Accordingly, the turnover claim also was dismissed."[64]

See also *U.S. v. Carroll* discussed in § II above.

VI. Burden of Proof

The party seeking turnover has the burden of proof,[65] and "must prove that the subject property constitutes property of the estate

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[61] *In re Adams*, 453 B.R. 774, 777 (Bankr.N.D.Ala. 2011), citing 11 U.S.C. § 1303 and 11 U.S.C. § 363(b).

[62] *In re Adams*, 453 B.R. at 777.

[63] *In re Diaz Esteras*, 2011 WL 5953483 *3 (Bankr.D.Puerto Rico), quoting Keith M. Lundin & William H. Brown, Chapter 13 Bankruptcy, 4th Edition, § 52.1, Rev. Aug. 16, 2004, www.Ch13online.com.

[64] *In re Miller*, 2011 WL 6217342 *2 (Bankr.D.Colo.).

[65] *In re Miller*, 2011 WL 3741846 *2 (Bankr.N.D.Ohio); *In re Asif*, 455 B.R. 768, 797 (Bankr.D.Kan.); *In re McCrory*, 2011 WL 4005455 *3 (Bankr.N.D. Ohio); *In re Crump*, 2010 WL 4501629 *2 (Bankr.M.D.Ga. 2010); *In re Brubaker*, 426 B.R. 902, 905 (Bankr.M.D.Fla. 2010); *In re Schneider*, 417 B.R. 907, 919 (Bankr.N.D.Ill. 2009).

and that the defendant is in possession of that property."[66] The courts continue to split on whether the preponderance of the evidence or the clear and convincing evidence standard applies.

In *In re Indian Capitol Distributing, Inc.* the bankruptcy court stated the general rule that section 542 "is self-operative and mandatory" and "requires any entity with control of property of a bankruptcy estate to deliver that property to the trustee." Nonetheless, "[i]n any action to compel compliance with this section, the burden of proof is on the trustee. The trustee must prove: 1) during the case; 2) an entity (other than a custodian); 3) was in possession, custody or control; 4) of property that the trustee could use, sell or lease; and 5) that such property is not of inconsequential value or benefit to the estate."[67]

In *In re DBSI, Inc.* the bankruptcy court stated, similarly, that in a turnover action it is the trustee's burden "to establish every element of the cause of action, that is: '(1) the property is in the possession, custody or control of another entity;(2) the property can be used in accordance with the provisions of section 363; and (3) the property has more than inconsequential value to the debtor's estate.' "[68]

In *In re Jokiel* the trustee moved for turnover of a severance payment received by the debtor. The bankruptcy court stated that the trustee bore "the burden of establishing a *prima facie* case for turnover." Once a prima facie case has been established, the debtor has to "provide a reason for going forward with the case, but the ultimate burden of persuasion remains with the trustee at all times."[69]

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[66] *In re McCrory*, 2011 WL 4005455 *3 (Bankr.N.D.Ohio); *In re Rogove*, 2010 WL 3748151 *2 (Bankr.S.D.Fla. 2010). See also, In re Brubaker, 426 B.R. at 905 and *In re Green*, 423 B.R. 867, 869 (Bankr.W.D.Ark. 2010).

[67] *In re Indian Capitol Distributing, Inc.*, 2011 WL 4543954 *1 (Bankr.D.N.M.), citing *Boyer v. Davis (In re USA Diversified Products, Inc.),* 193 B.R. 868, 872 (Bankr.N.D.Ind.1995), aff'd., 196 B.R. 801 (N.D.Ind.1996), aff'd. 100 F.3d 53 (7th Cir.1996); and *Evans v. Robbins (In re Robbins)*, 897 F.2d 966, 968 (8th Cir.1990).

[68] *In re DBSI, Inc.*, 2011 WL 6934544 *4 (Bankr.D.Del.), quoting *In re Steel Wheels Transport, L.L.C.*, 2011 WL 5900958, at *5 (Bankr.D.N.J.).

[69] *In re Jokiel*, 447 B.R. 868, 872 (Bankr.N.D.Ill. 2011), citing *In re Meyers*, 616 F.3d 626, 629 (7th Cir.2010).

In *In re Rood*, by contrast, the court stated that the trustee, as movant, must "demonstrate by clear and convincing evidence that the assets in question are part of the bankrupt's estate."[70]

Similarly, in *In re Kana* the bankruptcy court held 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. 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.' As part of a *prima facie* case, the trustee must demonstrate by clear and convincing evidence that the assets in question are part of the bankrupt's estate."[71]

The turnover of documents involves as somewhat different standard, though the burden remains on the movant. In *In re Crescent Resources, LLC* the bankruptcy court determined that, for the purposes of turnover of attorney-client files under section 542(a), the movant bears the burden of proving that the files re property of the estate "by a preponderance of the evidence." The same files in addition may be sought pursuant to section 542(e). For turnover under that provision, the movant "must first show that the documents relate" to the debtor's "property or financial affairs." If the movant meets this initial burden, then the objecting party must show the existence of an attorney-client relationship between it and the counsel from whom turnover is sought.[72]

The court in *In re Asif* held simply that, in an action seeking the turnover of documents, the trustee "has the burden of proving what property belongs to the estate, and thus has to be turned over to the estate."[73] The court found that the trustee had not established that the itemized information sought existed, was in debtor's possession, and had not been turned over. After reviewing the evidence presented at trial, the court found that none of the property sought by the trustee was in the debtor's possession, and denied the trustee's turnover motion.[74]

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[70] *In re Rood*, 2011 WL 4459094 *17 (Bankr.D.Md.), quoting *In re Himes*, 179 B.R. 279, 282 (Bankr.E.D. Okla.1995).

[71] *In re Kana*, 2011 WL 1753208 *2 (Bankr.D.N.D.), quoting *Evans v. Robbins*, 897 F.2d 966, 968 (8th Cir.1990).

[72] *In re Crescent Resources, LLC*, 2011 WL 3022554 *7 (Bankr.W.D.Tex.).

[73] *In re Asif*, 455 B.R. at 797.

[74] *In re Asif*, 455 B.R. at 797–798.

VII. Section 542(a)—Property of the Estate That the Debtor May Use, Lease, Sell, or Exempt

Generally—Property of the Estate

"It is crucial to the trustee's claim that the asset to be turned over is property of the estate."[75]

This rule does not apply to records, which need only be related to the debtor's property or interests,[76] as discussed in § VI above and in § XII below.

A "creditor has an affirmative duty to return estate property, regardless of whether the creditor obtained the property pre- or post-petition."[77]

The bankruptcy court in *In re Atwood* held that claims that arise postpetition are not property of the estate, and thus are not subject to turnover.[78]

In *In re Seminole Walls & Ceilings Corp.*, the bankruptcy court held that property that is revested in a reorganized debtor on the effective date of a confirmed plan, and then sold by the reorganized debtor, is no longer property of the estate. Converting the case to Chapter 7 does not bring the property back into the estate, and accordingly the Chapter 7 trustee's cannot obtain turnover of such property.[79]

State and federal law applies to such determination. In *In re Waiehu Aina, LLC* the trustee sought turnover of property that the defendants argued was not part of the bankruptcy estate because it was included in the "crown lands" or the "government lands" that still belonged to the Kingdom of Hawaii and were owned by its monarch. The bankruptcy court held that it was bound by the laws of the United States of America and the State of Hawaii, that "American law does not recognize the continued existence of the former Kingdom of Hawaii," and that "[u]nder

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[75] *In re Hoerr*, 2004 WL 2926156 at *2 (Bankr. C.D. Ill. 2004). "Federal law determines what property is included in the estate, while state law controls whether the debtor has a legal or equitable interest in the property at the time the bankruptcy case is filed." *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. 139, 157 (Bankr.W.D.Ark. 2011); *In re Miller*, 2011 WL 6217342 *2 (Bankr.D.Colo.), citing *Butner v. United States*, 440 U.S. 48, 55 (1979).

[76] *In re McKenzie*, 2011 WL 4600407 *6. (Bankr.E.D.Tenn.).

[77] *In re Forkner*, 2010 WL 5462543 *4 (Bankr.N.D.Iowa 2010), citing *In re Knaus*, 889 F.2d 773, 775 (8th Cir.1989).

[78] *In re Atwood*, 452 B.R. 249, 256–257 (Bankr.D.N.M. 2011).

[79] *In re Seminole Walls & Ceilings Corp.*, 446 B.R. 572, 598 (Bankr.M.D. 2011).

American law, all of the former 'crown lands' and 'government lands' are controlled by the State of Hawaii or the United States government." The court found that the property at issue was property of the estate and granted the trustee's motion for summary judgment on the turnover count.[80]

The question of who holds title is not dispositive. In *In re Henry*, the bankruptcy court held that the debtor's right to purchase a car under a retail installment purchase agreement gave the debtor the right to turnover of the car, notwithstanding that title had not yet been transferred to the debtor.[81]

In *In re Miller*, though the debtor's right to receive a bonus from his employer "was conditioned on his continued employment" and on his employer's decision to declare a bonus, the debtor "had an interest in the bonus at the time he filed his case based on his prepetition employment, and that interest [was] an asset of his bankruptcy estate." Since, however, based on the debtor's initial and amended exemption claims, the money which the trustee was seeking to have turned over had been "exempted by the debtor without objection," the debtor was not required to turn over the funds."[82]

In *In re Harajli*, while the defendant and the debtor were still married, they jointly obtained a line of credit from the bank with a limit of $238,000.00, which was secured by a mortgage on the marital home. In 2004 the defendant and the debtor were divorced, and the defendant was awarded the marital home "as her sole property" required to " 'hold [Debtor] harmless for same.' " The divorce judgment "said nothing" about the line of credit. In 2009, the defendant made draws totaling $238,000.00 on the line of credit, which encumbered the defendant's home. The debtor never made any draws on the line of credit, and did not receive any of the $238,000.00 in proceeds that the defendant borrowed. In 2010, the debtor filed a voluntary petition for relief under Chapter 7, and listed on Schedule F an unsecured claim of the bank in the amount of $238,138.00, based on the debtor's joint liability with the defendant on the line of credit. On the date on which the debtor filed his Chapter 7 petition, the defendant still had at least $225,127.55 of the $238,000.00 in cash

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[80] *In re Waiehu Aina, LLC*, 2011 WL 862657 *1–2 (Bankr.D.Hawai'i).

[81] *In re Henry*, 2011 WL 1402767 *2–3, 5 (Bankr.D.Mont.).

[82] *In re Miller*, 2011 WL 6217342 *4.

advance proceeds. The Chapter 7 trustee sought turnover from the defendant of $119,000, one-half of the amount drawn.[83]

The court denied the motion. The court reasoned that, "[b]ecause the parties were divorced, Debtor no longer had any interest in any of Defendant's property, including the $238,000.00 in cash advance proceeds Defendant obtained on the line of credit. Assuming that after the divorce, Debtor still retained the right to make draws on the line of credit, on the date of filing the petition, the only interest Debtor had in the line of credit was *an unexercised right to make a draw on the line of credit up to the contractual limit.* Because the contractual limit had already been reached, however, Debtor's property interest in the line of credit, if any, was effectively worthless on the petition date. Any contractual right(s) of the Debtor under the . . . line of credit that the Trustee succeeded to, upon the filing of the bankruptcy petition, was worth $0.00. So there [was] nothing for the Trustee to recover from anyone, based on the line of credit.[84]

In re Adams demonstrates the interplay between Chapter 13 and Chapter 7 with respect to a turnover proceeding. The facts were not disputed. The debtor filed a voluntary Chapter 13 bankruptcy petition and the bankruptcy court confirmed the debtor's plan. The confirmation order prohibited the debtor from disposing of any property without the consent of the court. While the Chapter 13 case was pending, the debtor received unreported income in excess of $55,000.00. The debtor conceded that this unreported income became property of the Chapter 13 case estate, yet spent all of it. The debtor and his ex-wife subsequently filed a joint federal tax return and received a refund of $10,350.00. The debtor did not disclose the receipt of the tax refund to the Chapter 13 Trustee. The debtor also conceded that the tax refund became property of the Chapter 13 estate, yet allowed his ex-wife to keep the entire tax refund and did not receive anything in return.

The Chapter 7 trustee commenced an adversary proceeding seeking a money judgment for $60,175.00: $55,000.00 for the undisclosed income received and spent by the debtor while the Chapter 13 case was pending, and $5,175.00 for one-half of the undisclosed tax refund received and given away by the debtor

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[83]*In re Harajli*, 2012 WL 255326 *2–3 (Bankr.E.D.Mich.).

[84]*In re Harajli*, 2012 WL 255326 *6.

while the Chapter 13 case was pending.[85] The Chapter 7 trustee sought summary judgment.[86]

The court denied the Chapter 7 trustee's motion. The court reasoned that a "finding that a trustee has cause to bring a § 542 cause of action does not necessitate a finding that the trustee has an interest in the cause of action itself; rather, the power to seek turnover pursuant to § 542 is a 'statutorily created power to recover property,' not an interest in property itself." Therefore, the court found that the alleged section 542 cause of action was not an interest in property and did not become property of the Chapter 13 estate pursuant to section 541(a)(7). As a result, the court also found that the Chapter 7 trustee failed to show that he was entitled to judgment as a matter of law, and thus had failed to show that he was entitled to summary judgment.[87]

A similar requirement that the property sought to be turned over must be "property of the debtor" or "property of the estate" is found in Code section 543 regarding a custodian's turnover obligations.[88] Recent cases under section 543 are discussed in § XIII of this article, below.

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

Property that the Debtor May Use, Lease of Sell

In *In re DBSI, Inc.*, the trustee of the litigation trust sought turnover from certain former employees of the debtors of computer equipment and confidential financial information that the debtors gave to those employees postpetition. The transfers were not approved by the court. The trustee further alleged that the property was of substantial value, benefit and use to the debtors' estates. The court determined that the complaint "simply failed to allege" that the computer equipment and financial records held by the defendants could be "be used, leased, or sold pursuant to § 363. Further, the trustee made "no factual allegations" showing that the property was "of substantial value, benefit and use" to the estates. Having found that the pleading of the turn-

[85] *In re Adams*, 453 B.R. 774, 775 (Bankr.N.D.Ala. 2011).

[86] *In re Adams*, 453 B.R. at 780.

[87] *In re Adams*, 453 B.R. at 781.

[88] 11 U.S.C.A. § 543(a), (b).

over claim was deficient, the court dismissed the count with leave to amend.[89]

Property that the Debtor May Exempt

The application of the turnover provisions to a trustee's motion for turnover of property asserted by the debtor to be subject to an exemption is somewhat peculiar, since the debtor's exemption would appear to put the exempt property beyond a trustee's reach.

The bankruptcy court in *In re Moore* held that the debtor's assertion of an exemption, which the trustee had indicated he intended to dispute, was not a defense to a turnover action by the trustee.[90]

Similarly, in *In re Jokiel*, the bankruptcy court held that "[e]ven if property is subject to a valid exemption, it is not automatically removed from the estate. Rather, the debtor must claim the exemption." Since the court had "found that at least a portion of the severance payment was property of the estate, and the Debtor ha[d] not yet properly asserted an exemption under Illinois law, whether valid or not," the property was still subject to turnover under section 542(a).[91]

In *In re Stewart*, the court allowed the Chapter 7 trustee's objection to the debtors' claim of exemption, and ordered the debtors to promptly turn over to the trustee an escrow refund check and a homestead proceeds check.[92]

By contrast, in *In re Ellis*, the bankruptcy court held that the debtor's annuity was exempt and thus denied the trustee's motion for turnover.[93]

The court in *In re Tennihill* took the same approach, holding that certain checks constituted domestic support and child support payments under Florida law and the statutory definition of section 101(14A) of the Bankruptcy Code, and thus were exempt pursuant to section 522(d)(10)(D) and not subject to turnover pursuant to section 542(a).[94]

In *In re Randall*, the court held that the trustee's time to challenge the claimed exemption in certain of the debtor's property

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[89] *In re DBSI, Inc.*, 2011 WL 6934544 *4 (Bankr.D.Del.).

[90] *In re Moore*, 2011 WL 2182884 *3 (Bankr.D.Dist.Col.).

[91] *In re Jokiel*, 447 B.R. 875.

[92] *In re Stewart*, 452 B.R. at 745.

[93] *In re Ellis*, 454 B.R. 404, 414 (Bankr.S.D.Tex.,2011).

[94] *In re Tennihill*, 2012 WL 293633 *5 (Bankr.M.D.Fla.).

had passed, and ordered turnover of the property directly to the debtor.[95]

And in *In re Biondo*, the Chapter 13 debtor sought turnover from his credit union of retirement and pension fund totaling approximately $135,000 that the debtor alleged the credit union had unlawfully attached and seized because it had been pledged as collateral for a loan.[96] The debtor claimed that the funds were exempt. The court held that the "fact that a debtor may claim an exemption in property does not preclude the property from being used as collateral for a loan, or debtors would be filing bankruptcy in droves to avoid all deeds of trust on their homesteads and liens on their cars." The court found "the Debtor's argument to be untenable as Debtor previously reaffirmed and acceded to payoff" of another loan "based on its being secured by his retirement funds." The court rejected the debtor's argument "that this type of property, *per se,*" could not "be used to secure one debt when Debtor reaffirmed it as security for another." Further, "in view of the court's inability to find that Debtor ha[d] scheduled" certain termination benefits turnover of which the debtor also sought, the turnover motion was denied "in part as it does not go to property 'that Debtor may exempt under section 522 of this title.' "[97]

Nonetheless, rather than deny the debtor's motion for turnover, the court in *In re Biondo* issued an order on the lender's lift stay motion and the debtor's turnover motion "granting the parties relief to pursue their rights and remedies according to applicable nonbankruptcy law, without prejudice to Debtor's assertion of claims or defenses against the Credit Union." The credit union's objection to exemptions was sustained based on the court's finding that the debtor had not scheduled or claimed an exemption in the termination benefits.[98]

See also *In re Miller*, discussed in the § VII, "Generally—Property of the Estate," above.

Types of Property Interests Subject to Turnover

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

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[95] *In re Randall*, 2011 WL 5417092 *2 (Bankr.N.D.Iowa).

[96] *In re Biondo*, 2012 WL 162285 *4 (Bankr.D.Md.).

[97] *In re Biondo*, 2012 WL 162285 *5.

[98] *In re Biondo*, 2012 WL 162285 *8.

Bank and Checking Account Balances

The courts continue to consider the obligation of a debtor to turn over checking account balances as of the petition date, notwithstanding that uncashed checks might be presented against those accounts postpetition. As a general rule, "[f]unds in the debtors' checking account, upon which no checks have been written as of the date of the petition, are property of the estate."[99]

In *In re Henson* the trustee sought turnover from the debtor of funds held in her checking account on the petition date, which had been diminished by the bank's honoring postpetition checks that the debtor had written prepetition. The bankruptcy court held that checks "written pre-petition by Debtor became property of the estate because they had not been honored when Debtor filed for bankruptcy," but despite this conclusion, "because Debtor no longer had possession of the funds when the motion for turnover was filed, Trustee could not compel turnover of the value of those funds pursuant to 11 U.S.C. § 542(a)." The trustee appealed.[100]

The district court considered the split in the Courts of Appeals, and affirmed. The court reasoned that, "[u]nder 11 U.S.C. § 542(a), a trustee may not compel turnover of property of the estate unless the entity against whom the trustee seeks turnover is in possession of the property sought, or its proceeds, *at the time the motion for turnover is filed*. In this case, Debtor was not in possession of the funds Trustee seeks, nor its proceeds, *when the motion for turnover was filed*."[101]

By contrast, the Tenth Circuit BAP reversed the bankruptcy court's decision in *In re Ruiz*, discussed in last year's Annual Survey. The BAP reasoned that, "[a]t any time prior to the filing of the petition, and up to the time the funds were withdrawn by the third parties to whom Debtors had written pre-petition checks, Debtors had the ability to withdraw all funds in their account, to close the account, to stop payment on any outstanding checks, and to transfer the funds from the account to another account. There [could] really be no question that these Debtors had nearly total control over these funds on the date they filed the petition, and this control extended through the following Monday for one check, Tuesday for two checks, and Wednesday for the last of those checks." That left "the final question of

[99] *In re Anderson*, 410 B.R. 289, 294 (Bankr.W.D.Mo. 2009).

[100] *In re Henson*, 449 B.R. 109, 111–112 (Bankr.D.Nev. 2011).

[101] *In re Henson*, 449 B.R. at 112–114 (emphasis supplied).

whether that control, which lasted for at least two days after the case was filed, constitute[d] control 'during the case,' which is required by § 542(a)." The BAP held that it did, and reversed.[102]

Simpler cases are those involving transfers of a debtor's funds to accounts controlled by the defendants to the turnover action, which are subject to turnover, as in the case of *In re Rood*.[103]

Tax Payments and Refunds

The courts also continued to be concerned with tax payments and refunds.

In *In re McCrory* the primary issue presented was whether the debtor had an interest "in the entire $8,000 first-time homebuyer credit refunded to him and his non-debtor spouse after filing their joint 2010 federal income tax return." The second issue was "whether Debtor's non-debtor spouse ha[d] any interest in the total income tax refund received by them since no taxes were withheld from her income."[104] Generally, under Ohio law, which applied, neither spouse has any interest in the property of the other.[105] The court determined that the $8,000 first-time homebuyer credit was allowed only because the debtor and his wife filed a joint tax return. Had they each individually filed a separate return, they each would have been entitled to a $4,000 credit, notwithstanding that the debtor's wife paid no withholding or estimated taxes for the 2010 tax year. Thus, the court found that the debtor's wife had an interest in $4,000 of the $8,000 first-time homebuyer credit that was refunded, and that her interest was not property of the estate subject to turnover to the trustee.[106] By contrast, since there was no tax withheld from the debtor's wife's income, and her income alone resulted in no tax liability, the debtor had an interest in the entire portion of the tax refund attributed to overpayment of withholding taxes. Thus, the debtor's $4,000 share of the credit and the entire tax refund were subject to turnover by the debtor to the Chapter 7 trustee.[107]

In *In re Rynda*, the debtor came into possession of certain tax refunds during the case that arose from prepetition overpayment of taxes. The bankruptcy court ordered turnover, and the debtor

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[102] *In re Ruiz*, 455 B.R. 745, 750. 755 (10th Cir. BAP 2011).

[103] *In re Rood*, 2011 WL 4459094 *17.

[104] *In re McCrory*, 2011 WL 4005455 *1 (Bankr.N.D.Ohio).

[105] *In re McCrory*, 2011 WL 4005455 *3.

[106] *In re McCrory*, 2011 WL 4005455 *4.

[107] *In re McCrory*, 2011 WL 4005455 *5.

appealed, contending that the turnover order "should be set aside because she accounted for the costs to prepare and file the tax returns, notified the Trustee she no longer possessed the Refunds, and offered the Trustee monthly payments to repay the amount of the Refunds." The debtor provided "no legal authority to support her argument that 'accounting for' the property" meant that she could "simply offer to pay the Trustee in whatever manner or time" she chose. The 9th Circuit BAP affirmed the bankruptcy court's turnover order.[108]

Avoidable Transfers

Avoided transfers are subject to turnover, but the courts continue to divide on the question of whether a transfer that is merely avoidable is subject to turnover.

In *In re Innovative Communication Corp.* the court held that a Chapter 11 trustee who was pursuing turnover and avoidance was "pursuing alternative theories to achieve recovery based upon the same facts." Accordingly, he was not seeking inconsistent remedies and was not precluded from proceeding on both counts, based upon the election of remedies doctrine.[109]

Similarly, in *In re Garrison*, the trustee's counterclaim against the purported secured party sought both avoidance of that party's lien and turnover. The court found that the lien had not been perfected and ordered turnover.[110]

By contrast, the court in *In re Financial Resources Mortg., Inc.* held that the complaint sufficiently alleged an action for prepetition fraudulent transfers, but failed to state a claim for turnover, since the property was transferred prepetition and thus was not property of the estate.[111] This approach would appear to require a 2-step process—first obtaining a judgment on the avoidance actions, and second seeking turnover of such property in the defendant's possession or the value of such property if the defendant has disposed of it.

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[108] *In re Rynda*, 2012 WL 603657 *2–3 (9th Cir.BAP).

[109] *In re Innovative Communication Corp.*, 2011 WL 3439291*4 (Bankr.D. Virgin Islands).

[110] *In re Garrison*, 2011 WL 5593025 *18 (Bankr.W.D.Ark.).

[111] *In re Financial Resources Mortg., Inc.*, 454 B.R. 6 (Bankr.D.N.H. 2011).

Disputed Title and Disputed Claims

Code sections 542 and 543 "may not be used to determine the rights of parties, however, where the interest in property is disputed" or where the parties "dispute title to the assets."[112]

"Section 542 presumes the property sought to be turned over is clearly the property of the Debtor that simply is in the possession of another. A turnover proceeding cannot be used to determine 'rights of the parties in legitimate contract disputes.' "[113] In *In re Southern Hosiery Mill, Inc.* the trustee sought to recover the credit balance held by CIT, the debtor's factor. The court held that "the proper cause of action [was] a suit on the contract, the Factoring Agreement." Neither party specifically pled the contract claim. Each acknowledged that the debtor was owed a credit balance, but disagreed about whether certain commission fees, ledger debts and the factor's attorney's fees could be deducted from that sum. Accordingly, while the trustee's request for turnover of the credit balance was denied, and summary judgment was granted to CIT, the court "entertain[ed] the underlying contract claim."[114]

In *In re National Jockey Club*, the bankruptcy member of an LLC sought turnover from the LLC's president of funds that the president allegedly misappropriated. The bankruptcy court considered to the claim to be more in the nature of a breach of contract claim. The court stated that a "breach of contract action may not be transformed into an action for turnover," and that by asserting a turnover claim, the plaintiff had put "the cart before the horse." The plaintiff's assertion that its allegation that the president's alleged misappropriation of $1.2 million entitled it to recover those funds, even when backed by a resolution of the LLC's board, did "not create a legally enforceable obligation of the type contemplated by § 542(a). There is a difference between property potentially *owed to* a debtor and property *owned by* the debtor."[115] The court dismissed the turnover count with prejudice because the plaintiff had failed to allege "a basis upon which to

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[112]*In re Moshannon Valley Citizens, Inc.*, 2009 WL 522906 *3 (Bankr.M.D. Pa. 2009).

[113]*In re Southern Hosiery Mill, Inc.*, 2011 WL 2651580 *6 (Bankr.W.D.N.C.), quoting *FLR Co. v. United States (In re FLR Co.)*, 58 B.R. 632, 634 (Bankr.W.D. Pa.1985).

[114]*In re Southern Hosiery Mill, Inc.*, 2011 WL 2651580 *6–7.

[115]*In re National Jockey Club*, 451 B.R. 825, 830 (Bankr.N.D.Ill. 2011).

believe the misappropriated funds were property of the estate on the date Debtor filed bankruptcy."[116]

In *In re Las Vegas Casino Lines, LLC* the debtor operated "cruises to nowhere," on which their customers could gamble beyond the three-mile territorial limit of U.S. coastal waters. The customers typically purchased gambling cards which denoted the balance available to the customer for further gambling, or which could be cashed out by the customer at the end of the cruise. One customer hit a completely unexpected jackpot, but not at the slots or the tables, when the debtor inadvertently issued to him a card with a $99,999,999.99 initial balance. The customer transferred money between that gambling card and other gambling cards that he had obtained from the debtor; "he put money on cards; he cashed out some portions of card balances; he purchased gambling tokens; and he tipped" the debtor's "employees with cash and gambling tokens," all while the ship was in waters beyond Florida's three-mile territorial limit."[117]

When the ship docked in at Port Canaveral, the customer's luck took a turn toward the losing side when the debtor's employees prevented him from leaving the disembarkation area and took him to the office of Mr. Giles Malone, the debtor's managing partner. The customer—a NASA employee—was inside Malone's office "for approximately two hours. Brevard County Sheriff's deputies stood outside the office while Malone and three others" in the debtor's employ accused the customer of using gambling cards to commit theft on the ship. The customer "felt remorseful and admitted some wrongdoing. He knew he had improperly used gambling cards and might have taken more money off the ship than he should have, but he thought [the debtor's] assertion that he had stolen $70,000.00 was outrageous. He felt threatened by the presence of the deputies" and by the debtor's "employees' references to the harm this could do to his career." The customer signed a written agreement to pay the debtor $70,000.00 "in order to avoid being arrested or fired." He and Malone left the office and went to the customer's home, where the customer gave Malone $15,100.00 in cash, a $9,900.00 check, and title to a car. The customer stopped payment on the check the next day.[118]

The customer denied that he owed the debtor any money. He correctly asserted, in the court's view, that "all of the alleged

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[116]*In re National Jockey Club*, 451 B.R. 831.

[117]*In re Las Vegas Casino Lines, LLC*, 454 B.R. 223, 225 (Bankr.M.D.Fla. 2011).

[118]*In re Las Vegas Casino Lines, LLC*, 454 B.R. at 225–226.

theft occurred more than three miles off the shore of Florida, outside of Florida's territorial waters." Though he admitted that he wrongfully took $15,000.00 from the debtor, he contended that he satisfied that debt when he paid the debtor $15,000.000 and gave the debtor title to the car. He further argued that the agreement he signed in Malone's office was unenforceable because it was the product of extortion and lacked consideration by the customer.[119]

The court stated that turnover under section 542 "is an appropriate cause of action only where title to the tangible property or money due is not in dispute." The debtor relied on "the ship's records for its allegation it suffered damages of $86,000.00" through the customer's use of the gambling cards, and that the $86,000.00 was property of the bankruptcy estate subject to turnover. But the ship's records did not establish what funds of the debtor's, if any, the defendant had obtained through his use of the gambling cards. "There were hundreds of transactions on the cards with money flowing off and onto the cards. Some of the funds were [the customer's] winnings and cash infusions," and the customer disputed that he was liable to the debtor for $86,000.00. Since the debtor had failed to identify property in the customer's possession that was clearly property of the debtor, no action for turnover existed.[120]

In *In re Century City Doctors Hosp., LLC* the Chapter 7 trustee sought turnover, but "made no allegations in the complaint or submitted any evidence in opposition to the summary judgment motion to suggest that the transferred funds [were] *indisputably* estate property subject to the turnover requirements under section 542. To the contrary, the party from whom turnover was sought disputed that the trustee had "any right to the refund under any theory of recovery." Accordingly, the defendant was entitled to summary judgment on the section 542 count, "because there simply [was] no legal basis for a stand-alone 'turnover' claim in this case."[121]

See also the discussion of cases in § II, above, and § X of this article, below.

Garnishment, Pawn Transactions, Repossession, Execution, Foreclosure, and Abandonment

The question of when in the course of a garnishment, pawn

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[119]*In re Las Vegas Casino Lines, LLC*, 454 B.R. at 226.

[120]*In re Las Vegas Casino Lines, LLC*, 454 B.R. at 227–228.

[121]*In re Century City Doctors Hosp., LLC*, 466 B.R. 1, 19 (Bankr.C.D.Cal. 2012).

transaction, repossession, execution, or foreclosure proceeding property of the estate is metamorphosed into property of the lender, and accordingly is not subject to turnover, is a question of state law under *Butner v. U.S.*[122]

In *In re DiGregorio* the debtor's condominium association took away her condominium unit prepetition for her failure to pay her condominium assessments. Illinois law, which applied, permitted such actions by the association, and also provided that the debtor as unit owner "retain[ed], in addition to her ownership interest, the right to reclaim the unit by satisfying the final judgment pursuant to which the Order for Possession was entered and then having that judgment vacated."[123] The debtor commenced her Chapter 11 bankruptcy proceeding, and asserted that section 542 "restore[d] her right to possession in the unit," citing *Whiting Pools* for the proposition that the statute works to "bring into the estate property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced."[124] The *DiGregorio* court held that *Whiting Pools* was distinguishable, however, "because in that case no final judgment of any court had terminated Debtor's right to possession. In this case, the Debtor's property right to possession of her unit was terminated upon execution of the state court Order for Possession." This was not an interest that could "be reclaimed" by the debtor "under § 542 because it was terminated prebankruptcy by judgment subject to her right to pay the required money and get the judgment vacated."[125]

In *In re Bolton*, the Chapter 13 debtor sought turnover of her car that Quick Cash company had repossessed prepetition. The court concluded that, under applicable Mississippi law, the ownership of the debtor's car had been transferred by operation of law "such that only Bolton's right to redeem, not the vehicle itself," was included in property of the estate. Hence, the car was not subject to turnover and Quick Cash did not violate the stay by refusing to return it to vehicle to Bolton. The court further found that Bolton's right to redeem was exercisable only by payment in full on within the statutory redemption period, "not

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

[123]*In re DiGregorio*, 2011 WL 4494215 *4 (Bankr.N.D.Ill.).

[124]*In re DiGregorio*, 2011 WL 4494215 *4 (Bankr.N.D.Ill.), quoting *United States v. Whiting Pools*, 462 U.S. 198, 204, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983).

[125]*In re DiGregorio*, 2011 WL 4494215 *4 (Bankr.N.D.Ill.).

through her Chapter 13 plan." Should she fail to timely redeem, the court continued, she would forfeit her right to redeem and any potential interest in the vehicle, and Quick Cash would retain its absolute ownership interest in the vehicle under Mississippi state law. Accordingly, the complaint was denied "in that the right to redeem ha[d] not been exercised."[126]

See also *In re Holiday Tree and Trim, Co.* in this § VII, "Property of Others," below.

Property in Trust or IRAs

A debtor's beneficial interest in a spendthrift trust is excluded from property of the estate under Code § 541(c)(2)[127] and thus is not subject to turnover under section 542 or 543.

In *In re Stasz*, the debtor had self-settled a trust prepetition and the trustee sought turnover. The bankruptcy court "found that the trust was either a sham, or that it had been rescinded before the filing of Stasz's bankruptcy petition."[128] Stasz appealed.

The BAP found that the trustee had "submitted evidence that all funds in the [trust] came from Stasz and that there had been no trustee of that trust since 2006. Together with the evidence that the trust did not comply with the requirements of Nevada law to establish a trust and that Stasz had contributed all funds in the trust," the BAP concluded "that the bankruptcy court did not err in determining that the [trust] was a sham."[129] The BAP further affirmed the bankruptcy court's holding that the debtor had rescinded the trust, based on Stasz's failure to dispute that determination in her brief, and on its concluding that such determination was law of the case, having been made previously by the bankruptcy court and affirmed by the BAP and the 9th Circuit, following which certiorari was denied by the Supreme Court.[130]

Property of Others

Property of others is not property of the estate and thus is not subject to turnover.

Funds in escrow nonetheless may be property in which a debtor has an interest. In *In re Holiday Tree and Trim, Co.* the debtor sold certain property prepetition and voluntarily placed some of the sale proceeds in escrow for the benefit of Ms. Nancy Minchello

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[126] *In re Bolton*, 2012 WL 27497 *7 (Bankr.S.D.Miss.).

[127] 11 U.S.C.A. § 541(c)(2).

[128] *In re Stasz*, 2011 WL 3299162 *4.

[129] *In re Stasz*, 2011 WL 3299162 *6.

[130] *In re Stasz*, 2011 WL 3299162 *7.

in connection with a dispute regarding a retirement agreement with her.[131]

Nancy commenced an action in the state court in an effort to obtain her interest in the proceeds, and obtained a judgment in her favor in the amount of $945,739.40. The accompanying letter opinion by the state court judge, however, "was limited to the issue of how much Nancy was owed." The state court "did not decide whether Nancy had a right to any specific funds," including the escrow account. At Ms. Minchello's request, the sheriff levied on the escrow account, and Ms. Minchello filed a motion for turnover of the funds in the state court. That motion was pending when the debtor filed its bankruptcy petition, and the debtor's trustee sought turnover of the funds.[132]

The court held that the prepetition state court levy did not cut off the debtor's equitable interest in the funds, and since the state court motion for turnover had not been decided at the time the debtor filed its petition the debtor "retained at the very least an equitable interest" in the escrow account as of the filing date. The court further held that the retirement agreement simply gave "Nancy a right to be paid. It [did] not make forty percent (40%) of the sale proceeds her property or grant her a security interest in those specific funds. The Debtor could have paid Nancy out of any source of funds. While the Court [was] sympathetic to her interest, Nancy [was] simply a general unsecured creditor under state law and the Bankruptcy Code." The escrow account was held in trust in the debtor's name "with no evidence that it was created for Ms. Minchello's sole or primary benefit." The court ordered turnover of the funds to the trustee.[133] below.

Community Property; Prenuptial Agreements

Community property held by a debtor and his non-debtor spouse is property of the estate, subject to turnover, as was held by the bankruptcy court in *In re Mastro*.[134]

Prenuptial agreements may create property of a bankruptcy estate. In *In re Fritch* the debtor Sharon and her husband David Fritch entered into a prenuptial agreement and were married. David subsequently sought to dissolve the marriage, following which Sharon filed her Chapter 7 petition, and after that, the

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[131]*In re Holiday Tree and Trim, Co.*, 2011 WL 1885688 *1 (Bankr.D.N.J.).

[132]*In re Holiday Tree and Trim, Co.*, 2011 WL 1885688 *2.

[133]*In re Holiday Tree and Trim, Co.*, 2011 WL 1885688 *3.

[134]*In re Mastro*, 2011 WL 4498834 *25–26 (Bankr.W.D.Wash.); *In re Mastro*, 2011 WL 5552949 *25–26 (Bkrtcy.W.D.Wash.).

state court entered its order dissolving the marriage. The trustee sought turnover of the amount to which the debtor was entitled under the prenuptial agreement.[135]

The bankruptcy court found that, "[b]ecause a marital estate is created upon the filing of a petition for dissolution of marriage in Indiana, . . . the Debtor's interest in the proceeds from the prenuptial agreement constituted a legal and/or equitable interest in property as of the commencement of the case regardless of when the divorce became final." Accordingly, the debtor's interest in the prenuptial agreement in the amount of $130,000.00 was property of the bankruptcy estate and subject to turnover.[136]

VIII. Section 542(a)—Deliver to the Trustee and Account for the Property or the Value of Such Property in Possession, Custody, or Control During the Case of the Entity, Other Than a Custodian, from Whom Turnover is Sought

The party from whom turnover is sought under section 542(a) must be "in possession, custody, or control, during the case, of the property,"[137] that is, at some point "during the case."[138]

Possession at some time during the case is essential if the turnover action is to succeed. In *In re Indian Capitol Distributing, Inc.* the court stated that, despite its "distrust of Defendant's

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[135] *In re Fritch*, 2011 WL 2181661 *1 (Bankr.S.D.Ind.).

[136] *In re Fritch*, 2011 WL 2181661 *4.

[137] 11 U.S.C.A. § 542(a). In addition, the party may not be a custodian. Turnover from a custodian is pursuant to section 543 as discussed in § XIII of this article.

[138] *In re JMC Telecom LLC*, 416 B.R. 738, 745 (C.D.Cal.,2009) (account into which funds, turnover of which was sought, were deposited was closed in 2000; bankruptcy case commenced in 2007; party from whom turnover was sought was never in custody, control or possession of the funds during the case). *See also, In re Bancredit Cayman Ltd.*, 419 B.R. 898, 917 (Bankr.S.D.Fla. 2009) ("Even if the Plaintiff had a viable claim against the Defendant arising from the allegedly unauthorized Funds Transfer, the Defendant never had funds in its possession that would have been subject to turnover under 11 U.S.C. § 542."); *In re Schneider*, 417 B.R. 907, 919–920 (Bankr.N.D.Ill. 2009) ("There is no evidence in the record, however, that [the defendant] was in possession of any of the Artwork and Furnishings at any time during the pendency of the bankruptcy case. Indeed, the Trustee state[d] in his post-trial brief that '[t]here is no evidence at all that the [Artwork and Furnishings] has ever been in the possession of anyone but the Debtor.' The Trustee has not shown that [the defendant] was in possession of the Artwork and Furnishings at any time since the Petition Date. The Trustee has therefore failed to demonstrate one required element of his turnover claim. Accordingly, judgment will be entered in [the defendant's] favor on Count IV.").

testimony, it was consistent in two respects: 1) he claimed to have no idea where the vehicles were and 2) he was very clear that they were not in his possession." Though the plaintiff "did a great job documenting what Defendant had or should have had in his possession or control before the bankruptcy case, . . . there was nothing that showed he had control or possession after the filing of the case." Therefore, the court was compelled to enter judgment in favor of the defendant and dismiss the plaintiff's case with prejudice.[139]

In *In re Financial Resources Mortg., Inc.* the court held that because the complaint lacked any allegations that, "as of the commencement of the case, the Debtors had any legal or equitable interests in the property the Trustee" sought "to include as part of the Debtors' bankruptcy estates," and because, in fact, the complaint alleged that the property at issue hadbeen transferred by the debtors prepetition, the court found that that count of the complaint failed to state a claim under § 541(a) and § 542(a) upon which relief could be granted."[140]

Similarly, in *In re Asif*, the only evidence presented at trial was the funds sought to be turned over were used by the debtor to repay personal loans to friends who had lent him money. The trustee had not advanced any other basis for judgment in the amount sought, and did not show that the debtor had these funds, or any other unreported assets, in his possession on the date of filing. Therefore, the court found there was no basis for awarding the trustee a monetary judgment.[141]

In *In re Rood*, the bankruptcy court held that funds in the defendant's possession at any time during the case are subject to turnover, "provided that they still exist and can be located."[142] The court the clarified that the "trustee is not limited to recovering specific property or its proceeds. Instead, the trustee is also given the ability to recover 'the value of such property.' Defendants cannot equate 'the absence of present possession with the absence of liability, as this would require the court to disregard the language of section 542(a) which makes the statute applicable to anyone who possessed property of the estate during the case

[139] *In re Indian Capitol Distributing, Inc.*, 2011 WL 4543954 *3 (Bankr.D.N. M.).

[140] *In re Financial Resources Mortg., Inc.*, 454 B.R. at 15–16.

[141] *In re Asif*, 455 B.R. at 798.

[142] *In re Rood*, 2011 WL 4459094 *17.

and gives the trustee the ability to recover 'the value of such property.' "[143]

Some courts have concluded that, notwithstanding the clear language of the statute, property that comes into a third party's possession after the commencement of the case is not subject to turnover. In *In re Minh Vu Hoang* the debtor had hidden real estate in various partnerships prior to the commencement of her bankruptcy case. Certain of the real estate was sold postpetition without disclosure to or authorization by the court. The Chapter 7 trustee sought turnover of the proceeds of sale from a title company, a law firm and other defendants. The bankruptcy court held that section 542 is limited in its application to property that is in the defendant's possession at the time of the filing of the bankruptcy case, and denied turnover, noting nonetheless that "the issue of whether § 542 can be applied to a post-petition transfer is not free from doubt."[144]

The court in *In re Olson* stated the Eighth Circuit's rule, that "an entity lacking possession of the property or its proceeds *at the time of a turnover demand* cannot be the subject of a motion to compel turnover,"[145] which would appear to be at odds with the plain language of section 542(a).

Deliver to the Trustee Property or the Value of Such Property

Most courts have held that the defendant must have possessed at some time in the case the property turnover of which is sought, and that even if the property itself has been transferred or dissipated, the value may be recovered under section 542(a).

The court in *In re Stewart* held that, "[i]f property that should have been turned over but wasn't is subsequently spent or dissipated, a trustee may nevertheless recover the 'value of such property.' "[146]

In *In re Ostendorf*, the debtor's stock that was subject to turnover to the Chapter 7 trustee increased in value after the petition date, at which time the debtor sold some of it. The debtor delivered to the trustee not the appreciated value as of the sale date, but the lower value as of the petition date. The trustee

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[143] *In re Rood*, 2011 WL 4459094 *17, quoting *In re USA Diversified Prods., Co.*, 193 B.R. 868, 878 (BC.N.D.Ind.1995).

[144] *In re Minh Vu Hoang*, 2011 WL 3879493 *2 (Bankr.D.Md.).

[145] *In re Olson*, 2011 WL 6010226 *2 (Bankr.D.Neb.) (emphasis added), citing *In re Pyatt*, 486 F.3d 423, 429 (8th Cir. 2007).

[146] *In re Stewart*, 452 B.R. 726, 744 (Bankr.C.D.Ill. 2011).

sought turnover of the full value. The court found that the debtor had "attempted to thwart the trustee's efforts by selling some of the stock and paying the estate less than the current value thereof. By doing so, Debtor ha[d] ignored the fact that only the trustee ha[d] the right to determine, with court approval, whether and when to sell the property." The court ordered turnover of the remaining stock and the full appreciated value of the stock that had been sold.[147]

The reverse is also true, as shown by *In re Mastro*. If the proceeds subject to turnover arose from the transfer of fully encumbered property, then the value subject to turnover is zero.[148]

See also *In re Henson* and *In re Ruiz*, discussed in § VII, "Bank and Checking Account Balances," above, *In re Rynda* discussed in § VII, "Tax Payments and Refunds," above, and *In re American Home Mortg. Holding* discussed in § X, below.

Action for Accounting

Section 542(a) also requires an entity to account for property subject to turnover.[149]

Seeking an accounting under section 542(a) is preferable to seeking an equitable accounting under state or common law, since any equitable remedy "requires the absence of an adequate remedy at law." The court in *In re Rood* held that its having ordered the turnover constituted such an adequate remedy and denied the plaintiff's request for an accounting.[150]

See also *In re Rynda* discussed in § VII, "Tax Payments and Refunds," above, regarding a debtor's inability to use an accounting offensively to pay in installments the amounts ordered to be turned over to the trustee.

A custodian also is obligated to account, under section 543.

IX. Unless Such Property is of Inconsequential Value or Benefit to the Estate

Section 542(a) does not require turnover of "property that is of inconsequential value or benefit to the estate."[151]

In *In re C.W. Min. Co.* the Chapter 7 trustee sought recovery of $384,000 that the debtor had deposited with its bank to secure a

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[147] *In re Ostendorf*, 2011 WL 1060992 (Bankr.D.Neb.).

[148] *In re Mastro*, 2011 WL 5552949 *26.

[149] 11 U.S.C.A. § 542(a).

[150] *In re Rood*, 2011 WL 4459094 *17.

[151] 11 U.S.C.A. § 542(a).

letter of credit that the bank issued to a third party. The transaction was structured by the bank's delivering a certificate of deposit to the debtor that the debtor then assigned to the bank. The certificate of deposit was cross-collaterized to secure the debtor's other loan obligations to the bank.[152] The debtor filed its Chapter 11 petition, and its case was converted to Chapter 7. The bank did not renew the letter of credit, and postpetition it "liquidated" the certificate of deposit and applied the proceeds in partial payment of the loan. The Chapter 7 trustee filed a complaint seeking turnover and recovery of the funds.[153] The court held that the bank was not required to turn over the funds because the certificate of deposit was fully encumbered at the time it was liquidated, the debtor had no equity in it, and thus it was of inconsequential value to the estate.[154]

The bankruptcy court in *In re Iuliano* also held that fully encumbered property, in which the debtor has no equity, is of inconsequential value and is not subject to turnover. Simply put, "[w]here there is no equity, it makes no sense for a Bankruptcy Court to order the surrender of possession of property to the Trustee."[155]

See also *In re DBSI, Inc.*, discussed in § VII, "Property That the Debtor May Use, Lease, Sell or Exempt," and *In re Mastro*, discussed in § VIII, "Deliver to the Trustee Property or the Value of Such Property," above.

X. Section 542(b)—Debts Matured or Payable on Demand or Order But § 542 not Available to Liquidate Disputed Contract Claims

Bankruptcy Code section 542(b) provides that, subject to the exceptions in section 542(c) and (d) and to offset under section 553, "an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee."[156] "The terms 'matured, payable on demand, or payable on order' create a strong textual inference than an action should be regarded as a turn-

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[152] *In re C.W. Min. Co.*, 2011 WL 4597443 *1 (Bankr.D.Utah).

[153] *In re C.W. Min. Co.*, 2011 WL 4597443 *2.

[154] *In re C.W. Min. Co.*, 2011 WL 4597443 *4, n. 30, *11.

[155] *In re Iuliano*, 2011 WL 1627172 *3 (M.D.Fla.).

[156] 11 U.S.C.A. § 542(b).

over only when there is no legitimate dispute over what is owed to the debtor."[157]

The court in *In re Randolph Towers Cooperative, Inc.* held that an action for turnover of a bank account must be brought under section 542(b). The court further noted that section 542(a) governs the turnover of tangible personal property.[158]

In *In re Smith*, the trustee sought payment on a note that was made to the debtor in connection with the buyout of his membership interest in an LLC that was developing a real estate project. The defendants argued that they were excused from making any further payments under the note because the debtor had materially breached a non-disparagement clause in his agreement with the defendants entered into on the date that the note was made.[159] The court found that the debtor had not breached the agreement, and even if he had, that such breach did not constitute grounds for not paying on the note, and ordered turnover of the amount due.[160]

By comparison, the defendant in *In re Las Vegas Casino Lines, LLC*, also discussed in § VII above, disputed the enforceability of the note he signed promising to pay $70,000.00 to the plaintiff "because it was the product of extortion and lacked consideration." Because the plaintiff had failed to establish that the defendant owed an undisputed debt to the plaintiff that was property of the bankruptcy estate, the court held that no action for turnover existed under section 542(b).[161]

The Eighth Circuit BAP in *In re Falzerano* held that "§ 542(b) applies only to debts that are 'matured, payable on demand, or payable on order.' An action to collect a disputed debt based on unjust enrichment is not any of these."[162]

Similarly, in *In re Heller Ehrman LLP*, also discussed in § II, "Jurisdiction—Generally," above, the court held that, whatever the label, the action was "not an action for turnover of estate property." Essentially, it was an action to recover an account receivable, for breach of contract and quantuum meruit. "Turnover actions involve the 'return of undisputed funds.' " The defendants

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[157]*In re Andrew Velez Const., Inc.*, 373 B.R. 262, 273 (Bankr. S.D. N.Y. 2007) (quoting *In re CIS Corp.*, 172 B.R. 748, 760 (S.D. N.Y. 1994)).

[158]*In re Randolph Towers Cooperative, Inc.*, 2011 WL 2940664 *3.

[159]*In re Smith*, 2011 WL 2518890 *1–3 (Bankr.D.Colo.).

[160]*In re Smith*, 2011 WL 2518890 *4–5.

[161]*In re Las Vegas Casino Lines, LLC*, 454 B.R. at 228.

[162]*In re Falzerano*, 454 B.R. 81, 84–85 (8th Cir. BAP 2011).

disputed liability to Heller. The estate's property was "the claim for damages itself, which [was] not subject to turnover. There [was] no specific, identifiable fund belonging to Heller in Defendants' possession. A suit by a debtor against a non-creditor arising out of breach of contract," absent more than had been alleged by Heller, was "not a turnover action under "§ 542."[163]

The debtor in possession in *In re American Home Mortg. Holding* sought turnover by adversary proceeding of funds that it alleged were its property. The debtor alleged that the funds had been transferred from the debtor's account to an account of a co-member of an LLC in which the debtor also was a member, and that the funds were in the possession of the defendants, the co-member and the co-member's president. The defendants moved to dismiss. The bankruptcy court noted that "Section 542 of the Bankruptcy Code provides the cause of action for turnover, which requires an entity in possession of property of the estate to deliver the property, or value thereof, to the trustee. A properly pled complaint asserting a claim for turnover must allege an undisputed right to recover the claimed debt. Turnover is not appropriate where there is a legitimate dispute over ownership of the property." Accepting the "allegations as true and all inferences in the light most favorable" to the debtor, the debtor had "sufficiently pled a cause of action for turnover." The debtor "had alleged that its funds were held in its member's" account and in a second account, and that the co-member and the president were in possession of the funds and that they had no right to such possession. The complaint failed to "indicate or imply any dispute over ownership" of the funds. While a legitimate dispute might have existed, the motion to dismiss was "limited to the facts alleged in the complaint." The court denied the motion to dismiss as to the turnover count.[164]

Further, if the court can resolve the underlying claim in favor of the trustee or debtor in possession seeking turnover, it is a more efficient use of judicial resources for the court to order turnover in connection with its judgment on that claim. The court in *In re Dorsey* followed this path, finding that the trustee had proven that the debtor's property transfers to his wife in the six years preceding the bankruptcy case were done "with the actual intent to hinder, delay, and defraud his creditors" under state law, and that the facts proved constructive fraud under state law

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[163]*In re Heller Ehrman LLP*, 2011 WL 3878347 *1.

[164]*In re American Home Mortg. Holding*, 2011 WL 4863894 *3 (Bankr.D. Del.).

in regards to those transfers. As such, the transfers being fraudulent were avoided under state law. Accordingly, the court ordered that the property of the voided transfers be turned over to the trustee for sale pursuant sections 542 and 363(h).[165]

In *Martin v. DirectBuy, Inc.*, the complaint was labeled as a turnover claim. The court determined that they were in actually breach of contract claims and dismissed that count of the complaint, but gave the plaintiff the opportunity to amend the complaint to plead that count as a breach of contract claim.[166]

In *In re All Season Gallery, Inc.* the trustee sought turnover on what was essentially a claim for an unpaid invoice. The complaint did not specify whether the action was brought under section 542(a) or section 542(b). The defendant disputed that the amount was payable. Rather than dismiss the action as inappropriate for turnover, the court held a trial, determined the matter on its merits, and dismissed the trustee's action.[167]

In *In re Al Muehlberger Concrete Const., Inc.* the debtor sought turnover of amounts it claimed were owing on a construtction contract, and moved for summary judgment. The debtor, again, did not specify whether the action was brought under section 542(a) or section 542(b). The court found that there were facts in dispute, and denied the debtor's summary judgment motion.[168]

See also *In re AFY, Inc.*, discussed in § II, "Jurisdiction—Generally," above, in which the court held that even a request for turnover of a debt that is property of the estate and that is matured, payable on demand, or payable on order, is not subject to the bankruptcy court's core jurisdiction.

See also *In re Randolph Towers Cooperative, Inc.* discussed in § IV, above.

See also cases discussed in § VII, "Disputed Title and Disputed Claims," above.

XI. Section 542(c)—the "Good Faith" Exception to Turnover

Bankruptcy Code section 542(c) provides that:

> Except as provided in § 362(a)(7) of this title [setoffs of prepetition debts owing to a debtor against any claim against a debtor are

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[165]*In re Dorsey*, 2011 WL 2313158 *16 (Bankr.M.D.Ala.).

[166]*Martin v. DirectBuy, Inc.*, 2011 WL 5101913 *3 (N.D.Ind.).

[167]*In re All Season Gallery, Inc.*, 2011 WL 710461 (Bankr.E.D.N.Y.).

[168]*In re Al Muehlberger Concrete Const., Inc.*, 2011 WL 560483 (Bankr.D. Kan.).

> subject to the automatic stay], 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.[169]

The author is not aware of any cases involving the "good faith" exception since last year's Annual Survey.

XII. Section 542(e)—Obligation to Turn Over Recorded Information

Bankruptcy Code section 542(e) provides that "[s]ubject to any applicable privilege, after notice and a hearing, the court may order an attorney, accountant, or other person that holds recorded information, . . . to turn over or disclose such recorded information to the trustee."[170]

The court in *In re Marathe* noted that it had "abundant legal authority to order the retrieval of information concerning a debtor and his estate from persons and entities who are not parties in a bankruptcy case, i.e., persons or entities who have neither filed a voluntary petition under 11 U.S.C. § 301 nor filed a proof of claim or interest under § 501."[171]

In *In re Hotels Nevada, LLC*, the trustee sought turnover of client files held by the debtors' outside counsel. The court found that there was "no doubt" that the law firm represented the debtors and held recorded information about them. There also was no doubt that under Nevada law, which governed, clients such as the debtors "have a property right in their attorneys' files," and under Nevada law "the file amassed by an attorney in representing a client belongs to the client." The court also noted that even attorney notes and research memoranda that were prepared in representing the debtors are property of the estate under section 541.[172]

Section 542(e), however, qualifies the trustee's powers. The ability to compel turnover is subject to any applicable privilege. The law firm asserted "the privilege of a nondebtor in the files and items." The court observed that this was not the situation

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[169] 11 U.S.C.A. § 542(c).

[170] 11 U.S.C.A. § 542(e).

[171] *In re Marathe*, 459 B.R. 850, 859 (Bankr.M.D.Fla. 2011), citing § 542.

[172] *In re Hotels Nevada, LLC*, 2011 WL 4344551 *3 (Bankr.D.Nev.).

"Congress had in mind when qualifying the turnover obligation. Section 542(e)'s legislative history suggests that it 'was designed to prevent attorneys and accountants from coercing debtors to pay claims in full ahead of other creditors.' "[173]

The court found that the law firm had "failed in at least three showings." It had not shown that the joint-client privilege applied to the items it sought to shield from turnover. It had not shown that, even if the joint-client privilege did apply, why that privilege precluded the trustee, "as the debtors' successor," from obtaining items to which the debtors were privy and which were claimed privileged. Finally, the firm had not shown that the adversary exception to the joint-client privilege did not apply on these facts. Finally, as "a separate and sufficient holding," even if the firm had shown that the joint-client privilege applied, it had not met its burden to demonstrate that the individual items on the privilege log produced were protected by the privilege. The court ordered the firm to turn over all documents referred to in the privilege log.[174]

The court in *In re Crescent Resources, LLC* noted that "upon filing bankruptcy, control of the company changed from the former owners . . . to the new bankruptcy estate. The privilege then passed to the Litigation Trust by operation of the plan of reorganization."[175] The *Crescent* court also considered the applicability of a joint-privilege asserted by the debtor's parent on the litigation trustee's turnover request. The court found a joint representation and privilege between the debtor and its parent with respect to certain transactions with respect to which the files were sought. The court held that the litigation trust could "not unilaterally waive the joint-client privilege and use jointly privileged information in proceedings involving third parties, absent a waiver" from the parent, but could use the files in matters between the parent and the trust.[176]

In *In re Michael S. Goldberg, L.L.C.* the trustee sought turnover of certain financial records delivered to a divorce mediator.

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[173] *In re Hotels Nevada, LLC*, 2011 WL 4344551 *3, citing *In re Norsom Med. Ref. Lab., Inc.*, 10 B.R. 165, 168 (Bankr.N.D.Ill.1981); H. REP. NO. 95–595, at 369–70 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6325–26; S. REP. NO. 95-989, at 84 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5870; *Am. Metrocomm Corp. v. Duane Morris & Heckscher LLP (In re American Metrocomm Corp.)*, 274 B.R. 641, 652 (Bankr.D.Del.2002); and *In re Highland Park Assoc. Ltd. P'ship.*, 132 B.R. 358, 358 (Bankr.N.D.Ill.1991).

[174] *In re Hotels Nevada, LLC*, 2011 WL 4344551 *14–15.

[175] *In re Crescent Resources, LLC*, 2011 WL 3022554 *18 (Bankr.W.D.Tex.).

[176] *In re Crescent Resources, LLC*, 2011 WL 3022554 *22.

The mediator filed a motion to quash asserting that the records were privileged because they were delivered in connection with the mediation.[177] The court found that, "[n]otwithstanding the importance of confidentiality in the mediation process, the 'special significance' of mediation materials, and the 'heightened protection' attending such materials to preserve the value of the mediation process," such concerns were "clearly outweighed by complete and full financial disclosure of the documents presently demanded. The disclosure of assets is a component of every bankruptcy case." A "complete and accurate portrait of the Debtor's assets and financial condition, as well as the disposition and corroboration thereof," was "essential to the Trustee's discharge of his fiduciary duties" and to "the interests of justice, and fairness to creditors." The court "having carefully weighed the concerns of confidentiality in mediation and the requisite necessity for complete and accurate financial disclosure in bankruptcy, and in light of the particular circumstances," found and determined "that the interest of justice outweigh[ed] the need for confidentiality in the mediation process, in accordance with which, and pursuant to Bankruptcy Code section 542(e) and Connecticut state law.[178]

The bankruptcy court in *In re McKenzie* held simply that "the Bankruptcy Code requires files pertaining to the debtor's interests to be turned over to the trustee."[179] Further, it was not necessary for the trustee to specify section § 542(e) in his complaint seeking turnover of records—a reference to section 542(a) was sufficient.[180]

In *In re Rapid Freight Systems, Inc.* the bankruptcy court noted that the "majority of courts to have considered the issue conclude that an attorney who turns over the documents to a trustee, as required under 11 U.S.C. § 542(e) 'may be entitled to a replacement lien or administrative expense measured by the value the documents provide, if any, in revealing assets or assisting in the administration of the estate.' "[181] Thus, because the firm that turned over the files "had a retaining lien over Debtor's business records and files and because Debtor's bankruptcy did not void said retaining lien," the law firm was "entitled to a replacement

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[177]*In re Michael S. Goldberg, L.L.C.*, 2012 WL 71594 *1 (Bankr.D.Conn.).

[178]*In re Michael S. Goldberg, L.L.C.*, 2012 WL 71594 *1.

[179]*In re McKenzie*, 2011 WL 4600407 *13.

[180]*In re McKenzie*, 2011 WL 4600407 *7.

[181]*In re Rapid Freight Systems, Inc.*, 2011 WL 1300441 *11 (Bankr.D.N.J.), quoting *In re Herrera*, 390 B.R. 746, 748–49 (Bankr.S.D.Fla 2008).

lien/administrative expense claim measured by the value of the documents provided." The value was to determined based on "the documents' role in revealing assets or assisting in the administration of the estate," and would "not be the full one third (1/3) contingency fee" the law firm alleged it was owed on any postpetition recovery of the debtor's assets. The court stated that, unless the parties consensually resolved this issue, they would be given the opportunity to participate in a valuation hearing to determine the value of documents subject to the retaining lien.[182]

XIII. Section 543—Turnover of Property by a Custodian

Bankruptcy Code section 543[183] is entitled "Turnover of Property by a Custodian" and is the parallel to section 542. The party from whom the turnover is sought must be a custodian for section 543 to apply. A "custodian" is defined in Code section 101(11) as:

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;
(B) assignee under a general assignment for the benefit of the debtor's creditors; or
(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.[184]

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

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

[182] *In re Rapid Freight Systems, Inc.*, 2011 WL 1300441 *11.

[183] 11 U.S.C.A. § 543.

[184] 11 U.S.C.A. § 101(11).

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.[185]

As in the case of section 542, the property turnover of which is sought under section § 543 must be property of the debtor or the estate.

The court may delay the requirement that the custodian turn over the property. Section 543(d) provides that, "[a]fter 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."[186]

In *In re China Village, LLC*, the bankruptcy court noted that "[d]espite the apparent automatic nature of the turnover obligation, one leading bankruptcy treatise explains that, 'courts have recognized that this provision contains no time limit in which property must be turned over. As a practical matter, most custodians retain the property until requested or ordered to turn it over to the trustee or debtor-in-possession.' "[187] Further, "efforts expended by a state court receiver resisting an involuntary bankruptcy have been found to be non-compensable because they provided no benefit to the estate," while, "[o]n the other hand, reasonable compensation for expenses incurred in preparation for or in effectuating a turnover is allowable under Code § 543(c)(2), which mandates that the court 'shall provide for the payment of reasonable compensation for services rendered and cost and expenses incurred" by a superseded custodian.' " The question for the China Village court was whether the fees that the receiver incurred "were reasonably necessary to preserve the receivership estate or to effectuate the turnover."[188] The court found no evidence that the receiver "ever resisted turning over the property." To the contrary, emails indicated his "growing frustration with the sluggishness of the process," and the evidence indicated that

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[185]11 U.S.C.A. § 543.

[186]11 U.S.C.A. § 543(d).

[187]*In re China Village, LLC*, 2012 WL 32684 *8 (Bankr.N.D.Cal.), quoting 4 Norton Bankruptcy Law and Practice § 62.10 (3d ed.2008),

[188]*In re China Village, LLC*, 2012 WL 32684 *8, quoting 11 U.S.C. § 543(c)(2).

the receiver's "efforts were directed at facilitating the turnover, not opposing it." The court concluded that there was "no basis for a wholesale denial of all fees and costs associated with the services of the receiver" following denial of the bank's motion to excuse turnover. "The better question under § 543(c) [was] whether the tasks that the receiver performed were necessary and whether the fees incurred were reasonable."[189] The court then considered the fees and expenses of the receiver under section 503(b), which it noted governed the award of compensation to both the receiver and his counsel.[190]

See also *In re Jefferson County, Ala.* regarding turnover in a Chapter 9 case from a receiver appointed prepetition, discussed in § II above.

XIV. Automatic Stay/Adequate Protection

The courts in the last year continued to address the nexus between turnover under sections 542 and 543 and the automatic stay under section 362.

Adequate Protection

Most courts have held that a secured party's right to adequate protection does not excuse its obligation to turn the property over to the debtor if the requirements of section 542 are met.

Damages Under §§ 362(k) and 105(a)

A debtor may recover damages for violation of the automatic stay in the context of a third party's exercising of control over property of the estate subject to a turnover proceeding or demand. The Bankruptcy Code section providing for damages for a stay violation was section 362(h) prior to the October 2005 Amendments. It is now section 362(k).

The bankruptcy court in *In re DiGregorio* observed that section 362(k) "allows a party aggrieved by a willful violation of the stay to recover actual damages, including costs and attorney's fees and, in some cases, punitive damages. Read in conjunction with § 542 of the Code, the failure of a third party to turn over property of the estate to the trustee or debtor constitutes a violation of the automatic stay. However, § 362 protects only property of the estate or property in possession of the estate from actions to collect or that interfere with that property." Where, as in the *DiGregorio* case, "the property right in question is not property of the estate because Debtor's right thereto was terminated pre-

[189] *In re China Village, LLC*, 2012 WL 32684 *8–9.

[190] *In re China Village, LLC*, 2012 WL 32684 *9.

bankruptcy, the automatic stay does not apply." The property right implicated in *DiGregorio* was the right of possession that was transferred to the homeowners association by judgment of the state court. The debtor retained title to her unit but she could regain possession only by paying the assessment fees and expenses as adjudicated. Accordingly, since the stay did not apply, it was not violated, and the debtor was not entitled to any damages.[191]

A depository bank's freezing a debtor's deposit account at the commencement of the bankruptcy case does not constitute a stay violation, as stated by the bankruptcy court in *In re St. Vincent*, citing *Citizens Bank v. Strumpf*.[192]

XV. Setoff

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

> Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.[193]

The author is not aware of any significant opinions since the last Annual Survey involving the nexus between section 542 and setoff.

XVI. Fourth and Fifth Amendment Privilege

The author is not aware of any significant opinions since the last Annual Survey addressing the nexus between Fourth or Fifth Amendment privilege and turnover actions.

XVII. Seventh Amendment—Right to Jury Trial

In *In re Ballway*, the bankruptcy court held that the defendant had no right to a jury trial on the section 542 claim against it. "There was no common law turnover action before the enactment

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[191] *In re DiGregorio*, 2011 WL 4494215 *4–5 (Bankr.N.D.Ill.).

[192] *In re St. Vincent*, 2011 WL 1258479 *3–4 (Bankr.N.D.Ill.), citing *Citizens Bank v. Strumpf*, 516 U.S. 16, 21, 116 S.Ct. 286, 290 (1995).

[193] 11 U.S.C.A. § 553.

of the Seventh Amendment, and the turnover remedy is equitable."[194]

A defendant may waive its right to a jury trial, or may step into the shoes of a party who waived, and thus find itself bound by the waiver. In *In re ImagePoint, Inc.*, the court struck Wells Fargo Bank's jury demand on the section 542 claim against it because its predecessor in interest waived its right to a jury trial by filing proofs of claim, thereby submitting itself to the jurisdiction of the court. But because no legal basis had been presented for extending Wells Fargo Bank's waiver to its parent Wells Fargo & Company, the trustee's motion to strike the latter's jury demand was denied. Accordingly, the trustee's claim against Wells Fargo Bank would be decided by the court, and the trustee's claim against Wells Fargo & Company would be decided by a jury.[195]

XVIII. Revocation or Denial of Discharge and Other Sanctions for Failure to Turnover or Comply with Turnover Order

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

The bankruptcy "court has few more powerful remedies at its disposal than those provided in § 727(d). That section allows a court to revoke a debtor's discharge when the trustee demonstrates that the debtor has refused to obey a court order and acquired, but failed to account for property of the estate."[196] Bankruptcy Code section 727(d)(3) incorporates by reference section 727(a)(6)(A) which provides that a debtor may not be granted a discharge if he has refused to obey a lawful order of the court.[197]

The claims of a party who has failed to turn over property which is recoverable under section 542 may be disallowed under section 502(d), unless such party has turned over any such property.[198]

The non-debtor who fails to comply with the dictates of section

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[194]*In re Ballway*, 2011 WL 1770996 *2 (Bankr.D.Kan.), citing *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 1090 S.Ct. 2782, 106 L.Ed.2d 26 (1989).

[195]*In re ImagePoint, Inc.*, 2011 WL 1500124 *4 (Bankr.E.D.Tenn.).

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

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

[198]11 U.S.C. § 502(d). See e.g., *In re Paschall*, 2011 WL 5553483 *7 (Bankr. E.D.Va.).

542 or section 542 may be held in contempt or sanctioned. Some courts have held, nonetheless, that section 542(b) "is not self-executing, and a refusal to honor a trustee's demand for turnover pursuant to § 542(b) cannot give rise to a finding of contempt. The statute is self-operative only in the sense of vesting in the trustee (in lieu of the debtor), without the necessity of a court order, the right to receive payments of obligations that are otherwise payable on demand." Instead, a "trustee's remedy when an account obligor fails to comply with 11 U.S.C. § 542(b) is to sue to enforce that provision. If the account obligor proceeds to defend in bad faith, the trustee may be entitled to recover attorney's fees in accordance with an exception to the American rule or pursuant to Fed. R. Bankr. P. 9011. If, however, the account debtor does not defend or defends on plausible grounds, attorney's fees ought not be recoverable." "Nor ought a refusal to comply with § 542(b) constitute a violation of § 362(a)(3). The failure to pay remains just that, and, under the rationale of *Strumpf,* not an exercise of control over property of the estate."[199] For these reasons and others, the court disagreed with the conclusion of the Ninth Circuit BAP in *Mwangi* that a violation of section 542(b) gives rise to contempt.[200]

See also the discussion under § XIV of this article above for cases addressing damages under Code section 362(k).

XIX. Time Limitations for Action; Claim Preclusion

The Bankruptcy Code contains no express time limitation for the commencement of a turnover proceeding.

Laches may apply to time bar the claim if there has been an unreasonably delay by the plaintiff or movant in bringing the claim. In *In re American Home Mortg. Holding*, also discussed in § X above, the defendants raised the defense of laches to the debtors' turnover claim among others. The bankruptcy court held that the "determination of unreasonable delay is left to the discretion of the court." The defendants had "not cited any case law holding that a delay of two and one-half years is unreasonable *per se,*" and the complaint itself did not show an unreasonable delay. The court also noted "the chaotic nature of the circumstances surrounding the Debtors' bankruptcy filing. The Debtors were in the business of investing in mortgage-backed securities that resulted from the securitization of mortgage loans originated

[199] *In re Randolph Towers Cooperative, Inc.*, 2011 WL 2940664 *5.

[200] *In re Randolph Towers Cooperative, Inc.*, 2011 WL 2940664 *6, citing *In re Mwangi*, 432 B.R. 812, 820 (B.A.P. 9th Cir.2010).

by its subsidiaries and other companies. In 2007, as a result of declining real estate prices and increasing defaults on mortgage obligations, the Debtors closed their origination business, terminated the majority of their employees and filed for Chapter 11 protection, seeking to sell substantially all of their assets. With the sudden bankruptcy filing and deterioration of the secondary mortgage market, the Debtors were faced with having to referee inter-creditor disputes and manage the influx of creditors' and clients' attempts to exercise remedies against the Debtors while endeavoring to conduct due diligence to determine the value of the bankruptcy estate and successfully sell the assets." The debtors postpetition "were soon faced with a barrage of turnover motions and motions for relief from the automatic stay as well as the need to defend against several objections to the asset sales. Despite being inundated with large amounts of litigation, the Debtors still managed to file the present action within the prescribed statutes of limitation." The defendants had not shown there was an unreasonable delay by the debtors. "Moreover, the circumstances surrounding the Debtors' bankruptcy filing and the plethora of litigation during the bankruptcy proceedings further support[ed] the conclusion that the imposition of laches" was not appropriate. The defendants' motion was denied as to the defense of the equitable doctrine of laches.[201]

In *In re C.R. Stone Concrete Contractors, Inc.* the Chapter 7 trustee brought a turnover claim among others against Anderson and other defendants. Anderson died, the debtor sought to substitute the executor of his estate, and the executor sought to dismiss including on the ground that the turnover claim did not survive Anderson's death.[202] The bankruptcy court noted that the "first step in assessing whether a federal claim survives the death of a party is to look to the statute underlying the cause of action to determine the intent of Congress." There is no express provision of the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure providing for the survival of an action for turnover under section 542 after the death of the defendant. Because the statute did not provide the answer, the court had to turn to the federal common law.[203]

Generally, "causes of action based on 'penal' statutes abate,

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[201]*In re American Home Mortg. Holding*, 2011 WL 4863894 *6.

[202]*In re C.R. Stone Concrete Contractors, Inc.*, 2011 WL 6330168 *1 (Bankr. D.Mass.).

[203]*In re C.R. Stone Concrete Contractors, Inc.*, 2011 WL 6330168 *12.

while those based on 'remedial' statutes survive."[204] Generally speaking, "[a] remedial action is one that compensates an individual for a specific harm suffered, while a penal action imposes damages upon the defendant for a general wrong to the public."[205] A main purpose of the Bankruptcy Code is to secure equal distribution among creditors. The turnover provisions of the Code invoke the court's "most basic equitable powers to gather and manage property of the estate."[206] "In this sense, an action for turnover merely seeks to put the Trustee in possession of property which 11 U.S.C. § 541(a) has already defined as property of the estate so that it may be properly distributed for the benefit of all creditors." Accordingly, the court found that the turnover count was "not penal, but remedial in nature," and survived the death of Anderson.[207]

XX. Appeals

The bankruptcy court in *In re Protron Digital Corp.* ordered a law firm to turn over documents under section 542(e), and the law firm appealed. The district court held that it lacked jurisdiction over the law firm's appeal pursuant to 28 U.S.C. § 158(a)(1) because the bankruptcy court's order that was at issue was not final.[208] The court also declined to exercise jurisdiction pursuant to 28 U.S.C. § 158(a)(3), which vests district courts with jurisdiction over appeals of "other interlocutory orders and decrees" when district courts grant leave to file such appeals, because the order neither involved a controlling question of law where there was substantial ground for difference of opinion, nor was the appeal in the interest of judicial economy because an immediate appeal might materially advance the ultimate termination of the litigation.[209]

Finally, in *Livecchi v. Gordon* the debtor stated, "without citing any authority, that '[a]nytime that a case is brought before the court on appeal, any act conducted by the Bankruptcy court that was illegal is deemed proper to be brought to the attention of the

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[204] *In re C.R. Stone Concrete Contractors, Inc.*, 2011 WL 6330168 *12, quoting *Hawkins v. Eads (In re Eads)*, 135 B.R. 380, 385 (Bankr.E.D.Cal.1991).

[205] *In re C.R. Stone Concrete Contractors, Inc.*, 2011 WL 6330168 *12, quoting *United States v. NEC Corp.*, 11 F.3d 136, 137 (11th Cir.1993).

[206] *In re C.R. Stone Concrete Contractors, Inc.*, 2011 WL 6330168 *12, quoting *Braunstein v. McCabe (In re McCabe)*, 571 F.3d 108, 122 (1st Cir. 2009).

[207] *In re C.R. Stone Concrete Contractors, Inc.*, 2011 WL 6330168 *12.

[208] *In re Protron Digital Corp.*, 2011 WL 1585564 *3 (C.D.Cal.).

[209] *In re Protron Digital Corp.*, 2011 WL 1585564 *4.

appealing judge.' " The court observed that while it certainly could take notice of the Bankruptcy Court's prior orders in the case, insofar as they related to the appeal, the appeal was "nonetheless limited in scope to review of the order appealed from, i.e., the turnover order. Other orders and acts, such as the order converting the case from Chapter 11 to Chapter 7, the Trustee's alleged failure to maximize the value of Debtor's estate, and so on," were not directly before the court, and the debtor could not use his interlocutory appeal "as a vehicle to challenge virtually everything that has occurred thus far in his bankruptcy case."[210] The court saw no basis for reversal of the bankruptcy court's turnover order, and affirmed.[211]

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[210] *Livecchi v. Gordon*, 2011 WL 6148627 *1 (W.D.N.Y.).

[211] *Livecchi v. Gordon*, 2011 WL 6148627 *2.