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**Constraints on the Breadth of a Bankruptcy Trustee's Power to Demand a Turnover of
Assets**

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Introduction

Title 11 of the United States Code (the "Bankruptcy Code") empowers bankruptcy trustees to compel entities to turn over property to the bankruptcy estate.¹ Property subject to the turnover provision includes "all legal and equitable interests of the debtor in property at the commencement of the case."² Although the Bankruptcy Code is federal law, property interests are still defined by state law.³ Occasionally, bankruptcy trustees claim property as part of the estate that courts later deem is beyond the breadth of their authority.

This memorandum examines the extent of a bankruptcy trustee's power to compel turnover of assets. Part I scrutinizes the statutory bases for the turnover power and analyzes the interaction of 11 U.S.C. § 542(a), § 541(a)(1), and § 541(a)(6). Part II highlights the inconsistencies among the circuit courts and the various standards the circuit courts have established.

¹ 11 U.S.C. § 542(a).

² *Id.* §541(a)(1).

³ *See Butner v. United States*, 440 U.S. 48, 55 (1979).

I. The Bankruptcy Trustee's Power of Turnover

A. *The Trustee has a Broad Reach to Turnover Assets*

Under section 542(a) of the Bankruptcy Code, “an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease . . . shall deliver to the trustee, and account for, such property or the value of such property”⁴ Section 542(a) is limited in that turnover is not required when the property is of inconsequential value or benefit to the estate, when the holder of the property has transferred it in good faith without knowledge of the bankruptcy petition, or when the transfer of the property is automatic to pay a life insurance premium.⁵ However, of these limitations, “none requires that the debtor hold a possessory interest in the property at the commencement of the reorganization proceedings.”⁶

The property that is subject to turnover is not defined in section 542, but it is commonly understood to mean “property of the estate,” as defined in section 541.⁷ Section 541 of the Bankruptcy Code defines “property of the estate” as “all legal or equitable interests of the debtor in property as of the commencement of the case,” with few exceptions.⁸ Further, §541(a)(6) states that “proceeds, products, offspring, rents, or profits from services performed by Debtors prior to the commencement of their bankruptcy case are property of the estate.”⁹ The Supreme Court affirmed the expansive nature of § 541(a) in *United States v. Whiting Pools*: “[t]he House and Senate Reports on the Bankruptcy Code indicate that §541(a)’s scope is broad” and

⁴ 11 U.S.C. § 542(a).

⁵ *Id.*

⁶ *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 206 (1983).

⁷ *See* *Brown v. Pyatt (In re Pyatt)*, 486 F.3d 423, 427 (8th Cir. 2007); *Bracewell v. Kelley (In re Bracewell)*, 454 F.3d 1234, 1243 (11th Cir. 2006); *Affiliated Computer Sys. Inc. v. Sherman (In re Kemp)*, 52 F.3d 546, 550 (5th Cir. 1995).

⁸ 11 U.S.C. § 541(a)(1).

⁹ *See* *Anderson v. Win Realty, LLP (In re Anderson)*, No. AP 17-08040-JMM, 2018 WL 2179174, at *3 (Bankr. D. Idaho May 10, 2018).

additionally, many Bankruptcy Code provisions, such as §542(a), “bring into the estate property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced.”¹⁰ Due to the interaction of these provisions, when courts are faced with disputes about turnover, they often must determine relevant property interests.¹¹

B. The Role of State Property Law when Turnover is Contested

A debtor’s property interests are determined under state law.¹² While *Butner v. United States* confirmed this fact, it also acknowledged that the federal preemption doctrine still applies in bankruptcy cases.¹³ If, for example, the Bankruptcy Code provides for a rule that addresses the issue at hand directly, the Bankruptcy Code controls.¹⁴

II. Circuits Courts Have Established Varying Standards When Trustees Press the Limits of Their Authority

While courts must often rely on state law to determine property interests, ultimately, “[w]hether property is included in the bankruptcy estate is a question of law.”¹⁵ Additionally, Congress provided guidance on a general principle underlying § 541 of the Bankruptcy Code, stating in its legislative history that § 541 was “not intended to expand the debtor’s rights against others more than they exist at the commencement of the case.”¹⁶ Despite this, when facing

¹⁰ *Whiting Pools, Inc.*, 462 U.S. at 205.

¹¹ *See e.g., In re Anderson* at *3; *Whiting Pools, Inc.*, at 210-11; *Weinman v. Graves (In re Graves)*, 609 F.3d 1153, 1155 (10th Cir. 2010).

¹² *See In re Anderson* at *3 (stating that “[s]tate law generally governs property interests within the context of a bankruptcy case”).

¹³ *See Butner v. United States*, 440 U.S. 48, 55 (1979) (stating “[p]roperty interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding”).

¹⁴ *See Shamus Holdings, LLC v. LBM Financial, LLC (In re Shamus Holdings, LLC)*, 642 F.3d 263, 267 (1st Cir. 2011) (asserting “when federal bankruptcy law supplies a rule that speaks directly to the right at issue, that rule controls”).

¹⁵ *See Parsons v. Union Planters Bank (In re Parsons)*, 280 F.3d 1185, 1188 (8th Cir. 2002).

¹⁶ *See* 1978 U.S.C.C.A.N. 5787, 5868.

contested turnover, application of turnover standards by the circuit courts have been inconsistent.¹⁷

In the Eighth Circuit, trustees can compel turnover of compensation that is earned pre-petition and realized post-petition unless the debtor performs post-petition work that alters its protectable interest.¹⁸ In *In re Parsons*, a trustee objected to exemptions claimed by a debtor who argued that she was entitled to commissions paid post-petition because she rendered services post-petition that were “indispensable” to the closing of the contracts.¹⁹ The Eighth Circuit affirmed the trustee’s right to turnover of the commissions, allowing the debtor only an exemption of 9.7% of the commissions for her post-petition work – an amount that the court deemed equal to the wages she earned in post-petition work.²⁰ The Eighth Circuit rejected the debtor’s argument that the commissions were exempt under § 541(a)(6), reasoning that the debtor’s post-petition work did not alter the existing contract terms and, therefore, also failed to alter her protectable interest in the commissions.²¹

The Tenth Circuit will not compel turnover if doing so would grant the trustee a broader interest in the property than the existing interest of the debtor.²² In *In re Graves*, the Tenth Circuit stated that the trustee’s interest “must be limited to the same extent as the debtors’

¹⁷ Compare *Tidewater Finance v. Moffet (In re Moffett)*, 356 F.3d 518, 519–20 (4th Cir. 2004) (relying on Virginia’s version of the UCC to determine that a secured creditor was subject to the turnover provisions of the Bankruptcy Code and was compelled to turnover a repossessed vehicle), with *Charles R. Hall Motors, Inc. v. Lewis (In re Lewis)*, 137 F.3d 1280, 1282 (11th Cir. 1998) (disregarding Alabama’s version of the UCC and holding that the “mere existence of the estate’s ability to redeem the automobile” was insufficient to render the secured creditor subject to turnover provisions).

¹⁸ See *In re Parsons*, 280 F.3d at 1189.

¹⁹ *Id.* at 1187. The facts of this case are like those of *In re Anderson*, with a real estate agent debtor’s commissions at stake in both. Here, as in *In re Anderson*, the debtor also had to pay a cut of her commission to the real estate group she worked for, but the trustee here was less ambitious and did not even attempt to claim that part of the commission as property of the estate. See *In re Parsons*, 280 F.3d at 1188; *In re Anderson*, No. AP 17-08040-JMM, 2018 WL 2179174, at *1 (Bankr. D. Idaho May 10, 2018)

²⁰ *Id.* at 1189.

²¹ *Id.*

²² See *In re Graves*, 609 F.3d at 1155 (10th Cir. 2010).

interest.”²³ In *In re Graves*, the debtors elected, pre-petition, to irrevocably apply their federal tax refund to their tax liability the following year.²⁴ The bankruptcy trustee challenged this exemption and attempted to claim the refund as property of the estate.²⁵ The court noted that the debtors would not have any right to cash unless they were entitled to a refund after their next tax return was filed.²⁶ The court stated that § 542 could not be used to broaden the trustee’s interest, and therefore reasoned that the trustee’s interest in the refund would be limited by the same contingencies that the debtors’ interest had been.²⁷ As a result, the trustee would only be able to compel turnover if part of the initial refund exceeded the debtors’ tax liability the following year.²⁸

In the Fourth Circuit, a debtor’s mere equitable interest in property that was repossessed pre-petition, including a statutory right to redeem that property, is sufficient to allow a trustee to compel turnover of that property.²⁹ In *In re Moffet*, the Fourth Circuit stated that a debtor’s right to redeem repossessed property was “unquestionably a ‘legal or equitable interest.’”³⁰ The court reasoned that because the debtor’s reorganization plan called for her to exercise her right of redemption under Virginia’s version of the UCC, the creditor’s security interest was adequately protected, and the repossessed vehicle was subject to the turnover provision of the Bankruptcy Code.³¹ The court conceded that the debtor did not plan to make a lump sum payment of her outstanding debts on the vehicle, as Virginia’s UCC required, but it reasoned that § 1322(b)(2) of

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.* at 1157.

²⁷ *Id.* at 1157-58.

²⁸ *Id.* at 1159.

²⁹ See *In re Moffett*, 356 F.3d at 522 (4th Cir. 2004).

³⁰ *Id.*

³¹ *Id.* at 523.

the Bankruptcy Code allows debtors to modify claims of secured creditors, and because the plan called for the exercise of the right to redeem, the vehicle was subject to turnover.³²

Conversely, in the Eleventh Circuit, an estate's statutory right to redeem repossessed property is not enough to subject that property to a trustee's power to turn over assets.³³ In *In re Lewis*, the debtor's automobile was repossessed pre-petition, and, post-petition, he attempted to compel the creditor to turn over the vehicle to the estate.³⁴ The Eleventh Circuit determined that the debtor's statutory right to redeem his vehicle was property of the estate.³⁵ But the Eleventh Circuit reasoned that the "mere existence of the estate's ability to redeem the automobile" did not render the vehicle itself "property of the estate."³⁶ Instead, it held that to compel turnover of the vehicle, the trustee would have to fulfill the statutory obligations of the right of redemption as a debtor outside of bankruptcy would.³⁷

CONCLUSION

A trustee in bankruptcy has broad powers to recover property of the estate under § 541 and § 542 of the Bankruptcy Code. Section 542(a) of the Bankruptcy Code allows a bankruptcy trustee to compel turnover, and the property subject to the turnover provision is delineated by the "property of the estate" description in § 541(a). It is well-settled that barring an overriding federal interest, property interests are defined by state law, so the applicable standards vary by state when turnover is contested in bankruptcy. Despite the underlying principle that the Bankruptcy Code was not intended to expand a debtor's rights more than they exist at the commencement of the case, some trustees still attempt to apply the turnover provisions liberally.

³² *Id.*

³³ *See In re Lewis*, 137 F.3d at 1285 (11th Cir. 1998).

³⁴ *Id.* at 1281.

³⁵ *Id.* at 1284.

³⁶ *Id.*

³⁷ *Id.*

And even providing for varying state property laws, the circuit courts have been inconsistent in their applications of what property is subject to turnover, and have established differing standards.