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PRACTITIONER'S FORUM:

PRE-PETITION REPOSSESSIONS REVISITED

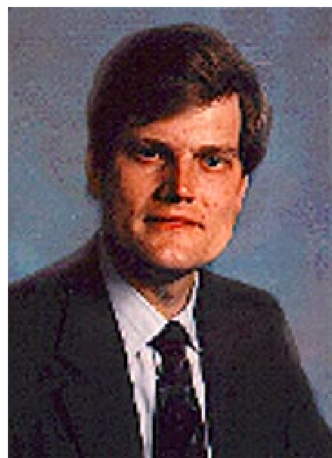
BY DONALD J. PAVELKA, JR.

A recurring problem which faces both creditors and debtors concerns when a creditor may retain collateral which it has repossessed prior to the debtor filing a bankruptcy. In the September, 1995 issue of the Chapter 13 Newsletter, I outlined some of the problems creditors face, should they decide to retain collateral after demand has been made by the debtor or his or her counsel.

Judge Mahoney has issued a new Chapter 13 case opinion issued October 10, 1996 entitled ***David and Mary Tarsikes***, Bk. 96-82095. The ***Tarsikes*** case involves a lease of a vehicle where the Lessor repossessed the vehicle prior to the Tarsikes filing Chapter 13. Demand was made by debtors' counsel, but the creditor refused to turn over the vehicle, arguing that debtors had no right to possession of the vehicle after default, and after the creditor had taken possession of the vehicle. The debtors then filed a motion for turnover of the vehicle and for sanctions against the creditor.

Pursuant to the terms of the lease, the Court had no trouble in finding that, although debtors were in default, the lease did not give absolute right of possession after default to the lessor, and that debtors could attempt to cure the default and retain possession of the vehicle. This being the case, the Court ruled that the creditor must immediately turn over the vehicle. The Court then determined what sanctions were to be imposed against the creditor for wrongful retention of the vehicle.

Citing ***In re Knaus,*** 889 F.2d 773 (8th Cir. 1989), Judge Mahoney determined that the creditor's retention of the vehicle was willful, and that debtors were entitled to actual damages and attorney fees. Judge Mahoney ruled that punitive



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damages were not appropriate under the facts of this case, so long as the creditor immediately turned over the vehicle.

In my previous article, I postulated that a creditor might be able to hold on to a vehicle, if the debtor was not providing the creditor with adequate protection. Judge Mahoney's opinion in the ***Tarsikes*** case contains language which implies that a creditor cannot demand adequate protection before turning over a vehicle.

> "In this case, the debtors have filed a Chapter 13 Plan which proposes to cure the default in payment. The debtors have a need for the vehicle. The vehicle was insured for the benefit of the Lessor. The Lessor, although having some grounds for believing that its possessory interest was superior to any rights of the debtors to possession, willfully refused to turn the vehicle over to the debtors and thereby exercised control over property of the estate in violation of Section 362(a). That exercise of control was a willful violation of the automatic stay. The proper procedure for the creditor, if concerned over the matter, was to turn the property over and immediately file a motion for relief from the automatic stay or adequate protection. The issue concerning the contractual right to possession versus the statutory provisions contained in Section 362 could then have been resolved by the Court. The creditor does not have the unilateral right to decide that its interest in the vehicle is superior to that of the bankruptcy estate." (Emphasis added)

Tarsikes, at page 5.

It is assumed that Judge Mahoney is relying upon ***In re Knaus***, if it is in fact the Court's position that a creditor must always turn the vehicle over and then file a motion for adequate protection. ***Knaus*** has been severely criticized by critics and courts alike. ***See*** generally, ***In re Young***, 193 B.R. 620 (Bkrtcy. D.C. 1996); John C. Chobot, ***Some Bankruptcy Metes and Bounds***, 99 Com.L.J., 301, 309 (1994). Critics of ***Knaus*** state that it is wrong because 1) Section 362(a)(3) (exercising control over estate property) does not apply to pre-petition repossessions where the creditor is maintaining the status quo, and 2) that ***Knaus*** does not take into account that delivery of the property is dependent upon the debtor providing to the creditor adequate protection.

The first criticism is dubious at best, as Section 362(a)(3) is not ambiguous, and the plain language of this section is consistent with the broad reach of the automatic stay ***See*** generally, ***Dewsnup v. Timm***, 502 U.S. 410, 112 S.Ct. 773 (1992) (Absent ambiguity in the text, it is not appropriate to resort to legislative history and past practice.)

The second criticism is misplaced, because under the facts in ***Knaus***, the Eighth Circuit never had to consider whether adequate protection was required prior to a turn over of collateral by the creditor to the debtor.

Knaus involved a trade creditor who obtained a judgment against the debtor who then had the Sheriff take possession of machinery and equipment under a writ of execution. After the debtor filed its Chapter 11 Petition, the creditor refused to turn over the equipment, and the debtor filed a motion with the Bankruptcy Court for return of the property. "At the turnover proceeding, the creditor admitted the property was property of the estate and consented to its turnover." ***Knaus***, ***supra***, at 774. Nowhere in the ***Knaus*** opinion is it ever stated that the creditor was seeking adequate protection prior to turnover of the equipment.

Knaus certainly stands for the proposition that failure to turnover collateral after request by the debtor can constitute a willful violation of the automatic stay, but the Court simply never addressed whether a creditor

can first require adequate protection from the debtor. In fact, ***Knaus*** cites the United States Supreme Court case of ***U.S. v Whiting Pools, Inc***., 462 U.S. 198 (1983) for the proposition that a creditor who seizes pre-petition must turn over the estate property to the debtor. However, ***Whiting Pools*** also clearly states that as a condition for turnover, the debtor must supply the creditor with adequate protection.

In ***Whiting Pools***, the United States Supreme Court affirmed the First Circuit decision which agreed with the Bankruptcy Court, that before the debtor could require the IRS to turnover property seized pre-petition, the debtor, Whiting Pools, had to do the following: 1) pay the IRS as adequate protection under 11 U.S.C. Section 361, the sum of $20,000.00 before the turnover of the equipment, 2) pay to the IRS the sum of $1,000.00 a month until the tax is paid. During this period of time, 3) the IRS shall retain its lien upon the property seized, and 4) if the debtor fails to make the payments required after the IRS turnover of the property, the stay shall be lifted. ***In re Whiting Pools. Inc.***, 10 B.R. 755 (Bkrtcy. W.D.N.Y. 1981).

Getting back to Judge Mahoney's opinion in ***Tarsikes***, it must be remembered that the creditor was not seeking adequate protection, but rather was arguing that debtors had no rights whatsoever to the car. This being the case, Judge Mahoney's decision is clearly correct, but the language in his opinion regarding a creditor having to turn over the vehicle first and then move for adequate protection under Section 362 is troublesome, since ***Whiting Pools*** sets forth that a creditor may require adequate protection, and the Eighth Circuit did not directly consider this issue in ***Knaus***. ***See also, In re Gilroy***, 92-80804, May 20, 1992; "Purina's interest is as an executing judgment creditor, and not as a co-owner. Purina may have a right to adequate protection of its interest, but it cannot withhold possession to enforce that right."

As stated previously, ***Knaus*** never addressed the issue of whether or not a creditor must first turn over collateral and then move for adequate protection. Most courts have uniformly held that under ***U.S. v. Whiting Pools, Inc.***, ***supra***, a creditor does not have to turn over collateral to the debtor, until at such time as the issue of adequate protection is resolved. ***See*** generally, ***In re Empire for HIM, Inc.***, I F.3d 1156, 1160 (llth Cir. 1993); ***In re Lott***, 196 B.R. 768, 777 (Bkrtcy.W.D.Mich. 1996); ***In re Young***, ***supra***., at 624: ***In re Lyons***, 193 B.R. 637, 644 (Bkrtcy.D.Mass. 1996). ***Accord***, ***In re Giaimo***, 194 B.R. 210, 214 (E.D.Mo. 1996) (IRS was not entitled to adequate protection before turnover of funds to the debtor with the Court stating that the IRS will have the opportunity to address any adequate protection argument once the funds are returned).

As stated in my article of September 15, 1995, I believe the best course of action for both creditors and debtors is a common sense approach. If all the creditor is seeking is adequate protection payments to compensate the creditor for the decline in value of the vehicle prior to any payments being received under a bankruptcy plan, the better course appears to be to turn over the vehicle while also contacting debtor's counsel to request adequate protection payments. On the other hand, if there is, in fact, a legitimate concern regarding the maintaining or viability of the creditor's collateral (i.e., no insurance, debtor is unemployed and files a bare-bones petition with no schedules or plan), then I stand by my previous position that the creditor should be able to refuse to turnover the vehicle to the debtor, while filing an immediate motion for relief on an expedited basis to bring to the Court's attention the creditor's legitimate concerns. I know of no case where a Bankruptcy Court required a creditor to immediately turnover a vehicle in a situation where the debtor was not maintaining insurance on the collateral. ***In re Jackson***, 142 B.R. 172 (Bkrtcy.N.D.Ohio 1992): ***In re Richardson***, 135 B.R. 256 (Bkrtcy.E.D. Texas 1992); ***In re Caldwell,*** 81 B.R. 164 (Bkrtcy.M.D.Ga. 1988).

We can all hope that at some point the Eighth Circuit will revisit the issue of turnover of collateral versus adequate protection.

This month's article reflects a "Creditor's" Perspective. Next month. . . Howard Duncan discusses the "Debtor's" side.

Happy Halloween
from the "BOOS Brothers"

Marianne B. Culhane **and** ***Michaela M. White*** of the Creighton Law faculty report that they are conducting a comparative study of Chapter 7 cases filed in 1995 in five judicial districts, including Nebraska, Colorado, and the Western District of Wisconsin. They are analyzing data drawn from the petitions, schedules and other documents in the case files, plus interviews with attorneys for debtors and creditors. The current study focuses on reaffirmation and retention of collateral without reaffirmation, but a very broad range of data is being collected and stored in a computer data base to allow other studies in the future.

While the Nebraska file data has not yet been fully analyzed, ***Culhane and White*** report some preliminary impressions. First, almost 40 percent of Nebraska Ch 7 debtors reaffirmed at least one debt, and many reaffirmed two, three and four debts. Some reaffirmed as many as eight. This is a big increase in reaffirmation frequency over the 20 percent reaffirmation rate discovered in studies done before the 1984 amendments eased reaffirmatlon requirements. Reaffirmation frequency may rise again soon, for some national credit card companies plan to seek reaffirmations more aggressively as part of a campaign to stem their rising bankruptcy losses.

Second, it is clear that reaffirmation is creditor driven. While debtors express in their Section 521 Statement of Intentions their willingness to reaffirm debts owed to many different creditors, only a few creditors consistently get a signed reaffirmation contract on file. Among "top sellers in the reaffirmation area locally are Sears, Nebraska Furniture Mart and Norwest. On the other hand, many secured creditors allow retention of collateral without reaffirmation, choosing to rely on voluntary post-bankruptcy payment. This is most often a car or home loan where the debtor has not been in serious default.

Most of the reaffirmation agreements examined appear to comply with the Code's section 524 prerequisites to enforceability, such as reciting the debtor's right to rescind and including a declaration from the debtor's attorney that the agreement is in the debtor's best interest. One common problem is failure to get the agreement on file before the discharge order has been entered. A creditor's attorney said that the practice is to mail a proposed agreement to the attorney for the debtor, with the creditor having little or no control over when it is signed and returned. ***Culhane and White*** noted that in the Western District of Wisconsin, creditors sometimes file a request that the court delay entry of discharge pending negotiation of reaffirmation.

One surprise in the files was the frequency of fee credit extended by debtor's attorneys in Chapter 7. Conventional wisdom is that Chapter 7 fees must be paid in advance, and that Chapter 13 is used (or abused) to allow installment payment of attorney fees. However, many Nebraska files indicated on the 2016(b) disclosure statement that fee credit had been extended. ***Culhane and White*** would be very interested in hearing whether these fees are usually collected.

In follow-up interviews with attorneys, ***Culhane and White*** hope to explore post-bankruptcy matters such as rescission rates, debtors' compliance or default on reaffirmed debts and creditor response to default. The costs of seeking reaffirmation agreements and relative success rates for secured and unsecured debts will also be explored

While formal interviews will not begin until the spring of 1997, ***Culhane and White*** would be very interested to discuss their project and reaffirmation practices with anyone interested in the area. They can be reached at Creighton Law School at ***(402) 280-3154 (Culhane)*** and ***(402) 280-5515 (White).***

EDITOR'S COMMENT

This newsletter is being published to facilitate communication between the Chapter 13 Trustee's Office and the many people we serve. The information is not meant to constitute legal advice to individuals. If you would like to contribute an article, conference or program information, law review article, book review, comment, or question for further feedback from others, please call me directly or mail your item to:

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