

# Section 362(h) Does Not Deprive a Trustee of Standing to Avoid a Lien

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Many trustees are familiar with the general requirements of 11 U.S.C. § 521(a)(2)(A) and § 362(h). Under those sections of the Bankruptcy Code, an individual debtor is required to file a statement of intention with respect to secured property. If the statement is not filed, or if it is filed and the debtor does not act on his or her stated intent, then the automatic stay terminates as to the secured property and that property is no longer property of the estate. Trustees may not fully understand the potential impact those sections may have on their ability to avoid a lien on secured property.



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A recent decision from the Bankruptcy Court in the Southern District of Ohio holds that the operation of these sections can divest a trustee of standing to avoid a lien. While the utility of this case is dubious, secured

lenders have nevertheless seized upon it and successfully intimidated trustees into giving up their avoidance powers in those instances where the lender's lien is clearly avoidable, but the individual debtor has failed to comply with the mandates of § 362(h).

## Statutory Scheme

Prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the law was clear. An individual debtor was required to file a statement of intention indicating whether the debtor intended to retain or surrender property securing debt.<sup>1</sup> The statement of intention had to have been filed before the earlier of 30 days after the petition date, or on or before the meeting of creditors. In addition, a debtor was required to follow through on his or her stated intent by performing under the statement of intention within 45 days of filing the statement of intention.<sup>2</sup> The law was also clear that § 521(a)(2)(A)

<sup>1</sup> See 11 U.S.C. § 521(a)(2)(A).

<sup>2</sup> See 11 U.S.C. § 521(a)(2)(B).

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and (B) did not alter a debtor or a trustee's rights in the property subject to the debtor's statement of intention.

While the above procedures have remained in effect post-BAPCPA, BAPCPA created a link between § 521(a)(2)(A) and (B) and the termination of the automatic stay. BAPCPA added revised §§ 521(a)(2)(C) and 362(h), which have altered those sections' effect on a debtor's rights in the subject property. Section 362(h) provides that if an individual debtor does not file a statement of intention or timely

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perform under the same, then the automatic stay terminates with respect to the subject property and the property is no longer property of the estate.<sup>3</sup> Section 362(h)(2) provides a safe harbor whereby § 362(h)(1)(A) and (B) will not apply if the court determines, upon motion of the trustee, that the subject property is of consequential value or benefit to the estate, and orders adequate protection of the creditor's interest and the debtor to deliver the collateral to the trustee.<sup>4</sup>

This section means that if a debtor does not file a statement of intention before the earlier of 30 days after the petition date or on or before the meeting of creditors, then the automatic stay terminates and the property is no longer property of the estate. The automatic stay will also terminate and the property will cease being property of the estate if the debtor timely files his or her statement of intention, but nonetheless fails to perform under that statement within 30 days after the first date set for the meeting of

<sup>3</sup> See 11 U.S.C. § 362(h)(1)(A)(B).

<sup>4</sup> If a § 362(h) motion is filed by the trustee, but the court does not determine that the property is of consequential value or benefit to the estate, then the automatic stay terminates upon the conclusion of the hearing on the motion. See 11 U.S.C. § 362(h)(2).

creditors. However, if the trustee files a motion, pursuant to § 362(h)(2), within the above time periods, then the trustee can prevent the termination of the automatic stay and maintain the property as property of the estate.<sup>5</sup>

## In re Baine

At least one court has seized upon these BAPCPA provisions and held that the lifting of the automatic stay and removal of property from the estate under § 362(h) terminates a trustee's ability to exercise his avoidance powers based on a creditor's failure to perfect its security interest.<sup>6</sup> In *Baine*, the debtors entered into a loan repayment and security agreement with HSBC to refinance the purchase of a 2000 Ford F-150 truck. Although it had a security agreement, HSBC failed to properly perfect its security interest according to state law. The debtors defaulted on the note to HSBC and filed their chapter 7 case

soonafter. The debtors timely filed their statement of intention, which indicated that they intended to surrender the truck. Despite this, the debtors failed to surrender it, and HSBC thereafter repossessed the truck without seeking relief from stay. The trustee and the debtors then filed an adversary proceeding, asserting that HSBC violated the automatic stay and seeking to avoid HSBC's lien on the truck, pursuant to 11 U.S.C. § 544 and applicable law. The trustee never filed a § 362(h)(2) motion with the court.

The court ruled against the trustee on cross motions for summary judgment and held that the operation of § 362(h) rendered the trustee without authority to avoid HSBC's lien pursuant to § 544 and applicable law. In applying § 362(h) to that case, the court found that the debtors' failure to follow through on their statement of intention, coupled with the trustee's failure to file a § 362(h) motion, caused the automatic stay to terminate

<sup>5</sup> If the § 362(h) motion is denied, although the automatic stay terminates the property does not cease being property of the estate. See 11 U.S.C. § 362(h)(2). In light of § 362(h)(1), this result makes no sense.

<sup>6</sup> See *Noland v. HSBC Auto Finance Inc. (In re Baine)*, 393 B.R. 561 (Bankr. S.D. Ohio 2008).

and removed the truck from property of the estate. The court reasoned that the termination of the automatic stay allowed HSBC to pursue available state law remedies, including repossession of the truck, without violating the automatic stay. The court then held that “[b]ecause the statute renders the Vehicle no longer property of the estate, it has the same effect as if the trustee abandoned the property pursuant to 11 U.S.C. § 554.” Consequently, “[b]ecause the operation of § 362(h) is functionally equivalent to abandonment, it has the effect of divesting the estate of all its interests in the property.” The court then held that the divestiture of control upon abandonment includes the loss of a trustee’s right to avoid an unperfected lien pursuant to § 544.

### **Abandonment Cannot Occur through § 362(h)**

There are several problems in the *Baine* court’s reasoning. First and foremost, the court based its holding primarily on the dubious assumption that § 362(h)(1)’s removal of property from the estate is tantamount to the trustee’s abandonment of property under § 554. The two are simply not the same, and it is illogical that similar results would flow from each. It is well settled that abandonment can only occur after the formalities of § 554 have been met.<sup>7</sup> The specific abandonment provisions in § 554 must take priority over the more general provisions found in § 362(h).<sup>8</sup>

Abandonment is the formal relinquishment of property from the bankruptcy estate and requires notice and a hearing.<sup>9</sup> The requirement for formal notice and a hearing is important for two reasons. First, these “formalities are important because abandonment is revocable only in very limited circumstances.”<sup>10</sup> Second, the procedural requirement of notice and a hearing is important because it allows the court to consider the views of other parties in interest, including creditors of the debtor, prior to the abandonment of property of the estate. It provides a layer of oversight to ensure that property of the estate, which may be used to pay creditors, is properly used for the benefit of creditors. The court’s decision in *Baine* is fundamentally flawed because it provides for *de facto* abandonment of estate property through a mechanism other than § 554 and

without notice and a hearing. Equating § 362(h) with § 554 serves to “repudiate the express language of § 554.”<sup>11</sup> Moreover, the court’s decision robbed creditors and other parties in interest of the opportunity to review the trustee’s actions and ensure that property of the estate is properly utilized for their benefit.

### **A Trustee Has a Two-Year Statute of Limitations**

The *Baine* decision is also problematic because it inappropriately circumvents the statute of limitations contained in § 546—effectively turning a two-year statute of limitations into a 30-day period in which a trustee has to exercise his or her avoidance powers. This result, the shortening of the § 546 statute of limitations, is extremely problematic and has been rejected by courts in other contexts.<sup>12</sup> For example, in *Levine*, the debtors fraudulently transferred non-exempt assets to various insurance companies to purchase annuities that were exempt under state law. The court permitted the trustee to set aside this transfer, notwithstanding the trustee’s failure to object to the debtor’s claimed exemptions within the 30 days mandated by Bankruptcy Rule 4003(b). The *Levine* court found that the trustee’s commencement of an avoidance action was subject to the two-year statute of limitations governing adversary proceedings found in § 546, not the 30-day requirement found in Bankruptcy Rule 4003(b). Addressing this same issue in *Duncan*, the Tenth Circuit noted that “were we to hold otherwise, the two-year limitations period of [§ 546] would effectively become a 30-day limitations period, thereby rendering the provision meaningless.”<sup>13</sup> The court’s decision in *Baine* would have the same effect of shortening the statute of limitations contained in § 546, thereby rendering § 546 meaningless.

### **Trustees Can Avoid Transfers of Property That Are Not Property of the Estate**

A trustee is not limited to exercising his or her avoidance powers only over property of the estate. Section 362(h) simply provides that if the requisites of that section are not satisfied, then the automatic stay terminates and the property is no longer property of the estate.<sup>14</sup> It does not follow that simply because property is no longer

property of the estate that the trustee loses his or her avoidance powers as to that property. There is nothing in the Code that requires a trustee to seek avoidance of property of the estate. In fact, in the preference and fraudulent-transfer contexts, a trustee will almost never seek to avoid a transfer of property where that property is property of the estate. Additionally, the Code contemplates that the avoided transfers will become property of the estate. Section 541(a)(3) provides that property of the estate includes any interest in property the trustee recovers under § 550 (and by implication §§ 544, 547 and 548) of the Code. It is simply immaterial whether the property that is subject to an avoidance action is property of the estate.

### **Applying Baine Reasoning Would Produce Absurd Result**

The *Baine* decision is also flawed because applying § 362(h) in a manner consistent with the court’s decision would produce an absurd result. The court’s holding in *Baine* is broad enough to encompass the situation where the debtor completely failed to file a statement of intention. In such a situation, the secured property would cease to be property of the estate 30 days after the petition date and the trustee would lose his or her ability to avoid a lien on that property. Without the filing of a statement of intention, a trustee may never be alerted to the necessity of filing a § 362(h) motion.<sup>15</sup> Further, in such a situation, the trustee may have no knowledge of the property or the potential avoidance action, but would nonetheless be deemed to have abandoned the subject property 30 days after the petition date. In many cases, the abandonment would occur prior to the meeting of creditors required under 11 U.S.C. § 341(a)<sup>16</sup> and certainly before the trustee has had an opportunity to investigate assets. The practical effect of the *Baine* court’s interpretation of § 362(h) would be to strip the trustee’s ability to administer a secured asset if the debtor fails to file a statement of intention. This result would be completely absurd and at odds with the

<sup>7</sup> See *In re Catalano*, 279 F.3d 682, 687 (9th Cir. 2002) (“[P]roperty is not considered abandoned from the estate unless the procedures specified in § 554 are satisfied.”).

<sup>8</sup> See *In re Cervantes*, 219 F.2d 955, 961 (9th Cir. 2000) (statutes should not be construed in manner that robs specific provisions of independent effect).

<sup>9</sup> See 11 U.S.C. §§ 554(a) and (b); *In re Catalano*, 279 F.3d at 685.

<sup>10</sup> *In re Catalano*, 279 F.3d at 685.

<sup>11</sup> *In re Catalano*, 279 F.3d at 686.

<sup>12</sup> See, e.g., *In re Duncan*, 329 F.3d 1195 (10th Cir. 2003); *In re Levine*, 134 F.3d 1046 (11th Cir. 1998).

<sup>13</sup> *Duncan*, 329 B.R. at 1203.

<sup>14</sup> See 11 U.S.C. § 362(h).

<sup>15</sup> *Baine* involved a situation where the debtors filed a statement of intention, but failed to follow through on that intention. The court noted that a trustee could avoid the harsh result of its decision by filing a § 362(h) motion. It appears that the court viewed this as somewhat of a waiver by the trustee. This notion of “waiver” is dubious in the situation where the trustee is not even aware of the existence of the subject property.

<sup>16</sup> Under Fed. R. Bankr. P. 2003(a), the 341 meeting is to be held no fewer than 21 and no more than 40 days after the order for relief.

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reality of how trustees administer bankruptcy estates. Section 362(h) should not be applied in this manner.<sup>17</sup>

## Conclusion

Section 362(h) simply cannot deprive a trustee of standing to avoid a lien on property. The *Baine* decision is fundamentally flawed because it equates

the operation of § 362(h) to § 554. The court's analysis of these two Code sections is incorrect because the specific provisions of § 554 are the only means by which a trustee can abandon property of the estate. Abandonment simply cannot happen through the operation of § 362(h). On a more practical level, in many instances the *Baine* court's holding would strip a trustee of the ability to administer a secured asset 30 days after a case is filed, without any notice to credi-

tors or a hearing. This result prejudices creditors and other parties in interest, conflicts with specific Bankruptcy Code provisions, and produces a scenario that surely was not intended by the drafters. Moreover, it would inappropriately turn a trustee's two-year statute of limitations contained in § 546 into a 30-day statute of limitations. With all these problems, § 362(h) simply cannot deprive a trustee of standing to avoid a lien on property. ■

<sup>17</sup> See, e.g., *In re Silverman*, 616 F.3d 1001, 1006 (9th Cir. 2010) (statutes should not be interpreted in manner that would produce absurd result); *In re Jones*, 591 F.3d 308, 313 (4th Cir. 2010); *In re Lehman*, 223 B.R. 32 (Bankr. N.D. Ga. 1998) (same).

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