Summer 2000

The Bankruptcy Trust as a Legal Person

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WAKE FOREST LAW REVIEW

VOLUME 35 2000 NUMBER 2

ARTICLES

THE BANKRUPTCY TRUST AS A LEGAL PERSON

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The filing of a petition under the Bankruptcy Code ("the Code") creates a bankruptcy "estate" that is expressly defined as a corpus of property interests. The Code, however, occasionally speaks of the estate as a legal person, and many courts and scholars have characterized the estate as a separate legal entity. This treatment of the estate as a separate entity reflects what the Code implies: the entry of an order for relief under the Code creates an entity that has the essential attributes of an artificial legal person.

Although one could consider the "estate" to be this legal person, it is technically more accurate and conceptually more useful to characterize this legal person as the "bankruptcy trust." The concept of the "bankruptcy trust" more accurately reflects the

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I thank Ralph Brubaker, David Gray Carlson, Tom Davies, Amy Hess, John Langbein, and Elizabeth Warren for their comments on drafts of this Article and their discussions about the ideas expressed in this article. I also thank James May for his excellent research assistance.

substance and structure of the Code. The Code provides for (1) the creation of a trust estate dedicated to a specific use, (2) the appointment of a trustee in control of this estate for the benefit of specified persons, and (3) the empowerment of the trustee to engage in a wide range of business activities for which the estate and not the trustee has personal liability. These provisions give to the bankruptcy trust all of the essential attributes of the business trust, which has long been recognized as a legal person.

Recognizing the bankruptcy trust as a legal person answers important bankruptcy questions and provides a framework for resolving other important bankruptcy issues. It also brings greater coherence to understanding the status of the debtor in possession as the same entity as the debtor that nevertheless serves as, and fully qualifies as, the trustee of the bankruptcy trust.

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INTRODUCTION

The filing of a petition under the Bankruptcy Code[1] (the "Code") creates an "estate" consisting of enumerated property interests.[2]

1. *See* 11 U.S.C. §§ 101-1330 (1994) (originally enacted by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978)).

2. *See id.* § 541(a).

The Code also provides for the appointment of a trustee[3]—a separate bankruptcy trustee or, in Chapter 11 or Chapter 12 cases, the debtor in possession—with broad powers to control the estate for the benefit of the creditors and the debtor.[4] The Code does not, however, expressly define the status of the estate as a legal entity. Although the Code occasionally speaks of the estate as though it were a legal person, it explicitly defines the estate as a corpus of property interests.[5] Nevertheless, many courts and scholars have characterized the estate as a separate entity or legal person.[6] For example, Professor Ralph Brubaker has argued that the estate is a federal entity sufficient to establish the constitutional basis for granting federal courts jurisdiction over bankruptcy.[7] One court and at least one scholar, however, have rejected the characterization of the estate as a separate entity or legal person.[8]

The conflict about the status of the estate is unnecessary. The treatment of the bankruptcy estate as a separate entity by courts and scholars reflects what is implicit in the Code: the Code provides for the creation of a separate entity upon the filing of a voluntary bankruptcy petition or, in the case of an involuntary petition, the entry of an order for relief. This entity has the essential attributes of an artificial legal person, such as a corporation or a partnership.

Although one could consider the "estate" to be this legal person, it is technically more accurate and conceptually more useful to characterize this legal person as the "bankruptcy trust." As a preliminary matter, using the terminology of "bankruptcy trust" instead of "estate" avoids the need to distinguish between the estate as a collection of assets and the estate as a legal person. The significance of the characterization of this legal person, however, goes beyond a question of terminology. The concept of the "bankruptcy trust" more accurately reflects the substance and structure of the Code than the estate as a legal person. Specifically, the Code creates an entity that has all of the attributes—and more—of a business trust. American law recognizes the business trust as a legal person.[9] Accordingly,

3. *See infra* Part II.B.

4. *See infra* Part II.C.

5. *See infra* note 69 and accompanying text (discussing the Code's definition of the estate and describing the property interests that become part of the estate).

6. *See infra* notes 145-47, 169, 183, and accompanying text.

7. Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 800-16 (2000) (*discussed infra* Part III.A).

8. *See infra* notes 148-49 and accompanying text.

9. *See infra* notes 52-59 and accompanying text.

the bankruptcy trust should be recognized as a legal person.[10]

Understanding that the bankruptcy trust is a legal person answers important questions. Specifically, the bankruptcy trust is a sufficient federal entity to provide a constitutional basis, as explained by Professor Brubaker, for giving federal courts jurisdiction over bankruptcy to the same extent that federal courts may constitutionally have jurisdiction over cases involving national banks.[11] This understanding will also bring greater coherence to the effort to resolve many other bankruptcy questions. It will focus courts' attention on the most relevant issues and prevent courts from misconstruing the Code.[12]

A prerequisite to understanding the existence of the bankruptcy trust is comprehending the status of the debtor in possession. The Code explicitly defines the debtor in possession for Chapter 11 cases as the debtor[13] and treats the debtor in Chapters 12 and 13 as a "debtor in possession."[14] It nevertheless gives the debtor in all these Chapters the powers and duties of a trustee.[15] The delegation of new duties to the same entity—the debtor—has confused many courts.[16] Some courts characterize the debtor in possession as the same entity as the debtor but fail to appreciate its new role.[17] Other courts characterize the debtor in possession as a separate entity without regard to its statutory definition.[18] This confusion is also unnecessary. The debtor in possession is the same person as the debtor, but it serves as, and fully qualifies as, a trustee. Recognizing the debtor in possession as a trustee confirms the existence of the bankruptcy trust,

10. Frequently, the term "legal entity" is used to refer to a legal person, like an individual, a corporation, or a partnership. The term "entity," however, could connote any number of legal constructs, like a traditional trust, that do not qualify as a legal person. Accordingly, although some of the sources that I cite use the term "entity" in the same sense as legal "person," I will use the term "person" throughout this Article. This convention reflects the usage of the Code, which distinguishes between "person" and "entity." *See* 11 U.S.C. § 101(15), (41) (1994). A "person" includes an "individual, partnership, and corporation." *Id.* § 101(41). An "entity" includes a "person, estate, trust, governmental unit, and United States trustee." *Id.* § 101(15).

11. *See infra* notes 163, 169 and accompanying text.

12. *See* discussion *infra* Part III.

13. *See* 11 U.S.C. § 1101(1).

14. Several sections of Chapter 12 refer to the "debtor in possession," but the Chapter does not define the term. *See id.* §§ 1202(b)(5), 1203, 1204. Chapter 13 does not use the term "debtor in possession" but provides that the debtor retains possession of the estate. *See id.* § 1306.

15. *See id.* § 1107(a).

16. *See infra* notes 152-55 and accompanying text.

17. *See infra* notes 152-53 and accompanying text.

18. *See infra* note 154 and accompanying text.

and understanding the existence of the bankruptcy trust illuminates the status and role of the debtor in possession.

The purpose of this Article is to show how the Code authorizes the creation of the bankruptcy trust as a legal person under all four chapters of the Code.[19] Part I of this Article reviews the creation of business trusts as legal persons under American law. Part II analyzes the attributes of the bankruptcy trust that all business trusts have: (1) a trust estate, (2) appointment of a trustee in control of the estate, and (3) a grant to the trustee of broad powers to engage in business activities for which it–as opposed to the trustee or the beneficiaries of the trust–may incur liability as an enterprise. This Part also shows that the debtor in possession is fully qualified to act as the trustee of the bankruptcy trust. Finally, Part III discusses how the existence of the bankruptcy trust answers important bankruptcy issues and facilitates sound interpretation of the Code.

I. BUSINESS TRUSTS

Trusts have been around for many hundreds of years.[20] They initially were used for the immediate or delayed conveyance of property.[21] Today, law schools and most legal commentators focus on trusts used for family wealth transfers.[22] The *Restatement (Second) of Trusts* specifically excludes trusts for commercial or business purposes.[23] Nevertheless, Professor John Langbein has estimated that more than ninety percent of the wealth in America that is held in trust is held in commercial trusts, not in donative trusts.[24] Moreover, despite the exclusion of commercial trusts from the *Restatement (Second) of Trusts*,[25] courts have applied the *Restatement* to commercial trusts.[26]

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19. I am excluding Chapter 9 for the reorganization of municipalities.

20. *See* GEORGE GLEASON BOGERT ET AL., THE LAW OF TRUSTS AND TRUSTEES §§ 2-7, at 13-35 (1984); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 632-33 (1995) [hereinafter *Law of Trusts*].

21. *See* Langbein, *Law of Trusts*, *supra* note 20, at 632-33; John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L.J. 165, 165 (1997) [hereinafter *Commercial Trusts*].

22. *See* Langbein, *Commercial Trusts*, *supra* note 21, at 165.

23. RESTATEMENT (SECOND) OF TRUSTS § 1 cmt. b (1959). Professor Langbein has criticized this exclusion as unwarranted. Langbein, *Commercial Trusts*, *supra* note 21, at 166. This exclusion will likely be continued in the *Restatement (Third) of Trusts*. RESTATEMENT (THIRD) OF TRUSTS § 1 cmt. b (Tentative Draft No. 1, Apr. 5, 1996).

24. Langbein, *Commercial Trusts*, *supra* note 21, at 178.

25. *See supra* note 23.

26. *See* Markham v. Fay, 74 F.3d 1347, 1355 (1st Cir. 1996) (applying *Restatement (Second) of Trusts* to business trusts); Schuman-Heink v. Folsom, 159

Commercial trusts come in two distinct forms. One form is the traditional trust used for commercial purposes. The other form is the "business trust," which is organized to conduct a business. The traditional commercial trust provides for the preservation of the trust estate, the appointment of a trustee who acts for the beneficiaries, and the distribution of the trust estate to those beneficiaries.[27] The trustee acquires legal title to the trust estate and acts on behalf of the beneficiaries.[28] The trustee sues, defends suits, and conveys property on behalf of the beneficiaries.[29] Typically, the primary activity of the trustee is to collect, to preserve, and to distribute the trust estate.[30] The trustee does not engage in broader business activities.[31] Contract and tort liability incurred in connection with the

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N.E. 250, 252-53 (Ill. 1927) (discussing the applicability of general trust law to business trusts); *see also* CONN. GEN. STAT. ANN. § 34-519 (West 1997) (providing that, except to the extent otherwise provided in the statute authorizing business trusts [designated "statutory trusts" in the statute], the laws of the state pertaining to trusts apply to business trusts); DEL. CODE ANN. tit. 12, § 3809 (1995) (providing that, "[e]xcept to the extent otherwise provided in the governing instrument of a business trust or in this subchapter, the laws of [Delaware] pertaining to trusts are hereby made applicable to business trusts"); BOGERT ET AL., *supra* note 20, § 247(U), at 225-29 (discussing the applicability of general trust law to business trusts).

27. *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS § 2 (1959).

> A trust, as the term is used in the Restatement . . . is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.

Id.

28. *See id.* § 17 (stating that the means of creation of a trust include a declaration by an owner that the owner holds property in trust for another, or a transfer inter vivos or by will to a separate trustee for the benefit of a third person).

29. *See id.* §§ 177, 178, 189, 190. *See generally* BOGERT ET AL., *supra* note 20, § 551 (discussing the express and implied powers of the trustee).

30. *See* RESTATEMENT (SECOND) OF TRUSTS §§ 169, 172-73, 175-82, 227 (1959).

31. A trustee of a traditional trust may be involved in some business activities. *See* Shawmut Bank Conn. Nat'l Ass'n v. First Fidelity Bank (*In re* Secured Equip. Trust of Eastern Airlines, Inc.), 38 F.3d 86, 89-90 (2d Cir. 1994) (holding that a trust established as a financing device is not a business trust eligible to be a debtor under the Code); RESTATEMENT (SECOND) OF TRUSTS § 188 cmt. d (1959) (explaining that the trustee may incur expenses in management of real estate or a business). Accordingly, drawing the line between a traditional trust and a business trust may be difficult. *Compare In re* Westgate Village Realty Trust, 156 B.R. 363, 365 (Bankr. D.N.H. 1993) (holding that a trust organized to own "sizeable" apartment complex and to make distributions to beneficiaries was not a "business trust" eligible to be a debtor under the Code) *with In re* Metro Palms I Trust, 153 B.R. 922, 923-24 (Bankr. M.D. Fla. 1993) (holding that a trust organized to own and lease a commercial office building was a

trust is generally the personal liability of the trustee and becomes the liability of the trust estate only in limited circumstances.[32] The traditional commercial trust, like the donative trust, is not treated as a legal person as is a corporation.[33] Examples include an indenture trust, in which a borrower pledges a trust estate to the trustee as security for the obligations of the borrower,[34] and—common in the

"business trust" eligible to be a debtor under the Code). In addition, the dissent in *In re Secured Equipment Trust of Eastern Airlines, Inc.* made a strong case that the trust was a business trust. 38 F.3d at 91-93 (Kearse, J., dissenting).

32. *See* RESTATEMENT (SECOND) OF TRUSTS §§ 261-264 (1959). If liability arises solely as title holder, the trustee retains liability "but only to the extent to which the trust estate is sufficient to indemnify him." *Id.* § 265. Trust property may also be reached in certain equitable circumstances. *See id.* §§ 266-271A; *see also* BOGERT ET AL., *supra* note 20, § 712, at 258-68 (discussing the common law rule that contract liability incurred in connection with the trust is generally the personal liability of the trustee); §§ 731, 732, at 359-71 (discussing the predominant view holding the trustee personally liable for the torts committed by the trustee in connection with the trust). Nevertheless, there is a movement in some states away from personal liability for a trustee and toward representative liability. *See id.* § 712, at 268-76; *id.* § 732, at 371-79.

33. *See* Morrison v. Lennett, 616 N.E.2d 92, 94 (Mass. 1993) (noting that, in suit against a trust and its trustees, with the exception of a business trust, a trust is not a legal entity that may be sued); BOGERT ET AL., *supra* note 20, § 712, at 265 & n.23 (stating that, at common law, neither a trust nor trust property is a legal person); *id.* § 731, at 359-60; RESTATEMENT (SECOND) OF TRUSTS § 2 (1959), *quoted supra* note 27 (defining a trust as a "fiduciary relationship with respect to property"); *cf. id.* § 16A. The *Restatement (Third) of Trusts*, however, has noted, with favor, a movement toward treating traditional trusts as separate entities for some purposes. RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. a, at 21 (Tentative Draft No. 1, April 5, 1996) ("Increasingly, modern common law and statutory concepts and terminology tacitly recognize the trust as a legal 'entity,' consisting of the trust estate and the associated fiduciary relation between the trustee and the beneficiaries."); *see also id.* § 2 reporter's note on cmt. i, at 39-41 (noting that trusts are increasingly being recognized as legal entities); RESTATEMENT (THIRD) OF TRUSTS § 40 reporter's note, at 184 (Tentative Draft No. 2, March 10, 1999) (stating that the position on trust property "has been modernized and changed to reflect the development and recognition of the trust as an entity"); Jeffrey A. Schoenblum, *The Hague Convention of Trusts: Much Ado About Very Little*, 3 J. INT'L TRUST & CORP. PLANNING 5, 14 (1994) ("The Convention . . . requires recognition of the trust as a distinct legal entity.").

34. In many corporate bond transactions, such as those secured by assets of the issuer that remain in its possession, the trustee will not have possession. *See, e.g.*, Langbein, *Commercial Trusts, supra* note 21, at 173-74. In other bond transactions in which the assets are financial assets, however, the trustee will have possession of the assets, and the collections from the assets provide the source of payment for debt obligations. *See, e.g.*, Continental Ill. Nat'l Bank & Tr. Co. v. Chicago, Rock Island & Pac. Ry., 294 U.S. 648, 661 (1935) (holding that the district court sitting as a court of bankruptcy had the power to enjoin indenture trustees holding mortgage bonds as collateral from selling the collat-

securitization industry[35]—a grantor trust used for the issuance of pass-through certificates representing the beneficial ownership interest in a fixed pool of mortgage loans, automobile loans, and other financial assets that generate cash flow.[36]

The business trust, on the other hand, is an extension of the traditional trust. In a business trust, as in a traditional trust, property is conveyed pursuant to a trust agreement to one or more trustees for the benefit of a defined group of beneficiaries. Nevertheless, the business trust differs from the traditional trust in several distinct ways. The business trustee uses the assets of the business trust to operate a business.[37] The trust agreement not only prescribes the assets of the trust, the duties and responsibilities of the trustee, and the rights of the beneficiaries; it also prescribes the permissible business activities of the trust.[38] Business trusts engage

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eral to repay their debts); STANDARD & POOR'S RATING SERVICES, LEGAL ISSUES IN RATING STRUCTURED FINANCE TRANSACTIONS 168-76 (1998) (requiring delivery of mortgages, notes, and contracts securing rated debt securities).

35. Securitization is the transformation of residential or commercial mortgage loans, automobile loans, credit card receivables, equipment leases and loans, trade receivables, and other receivables into securities that can be sold in the capital markets. The securitization industry involves many hundreds of billions of dollars of securities transactions. *See* Board of Governors of the Federal Reserve System, *Domestic Financial Statistics*, 86 FED. RES. BULL. A35, tbl. 1.54 (Mar. 2000) (showing that, of the $6.0 trillion of mortgage loans outstanding as of the end of June 1999, $678 billion was held in the form of private pools of securitized assets); Board of Governors of the Federal Reserve System, *Domestic Financial Statistics*, 86 FED. RES. BULL. A36, tbl. 1.55 (Mar. 2000) (showing that, of the approximately $1.4 trillion of consumer credit loans outstanding as of the end of November 1999, $436 billion was held in the form of pools of securitized assets (not seasonably adjusted figures)). A substantial portion of these securities are issued through the use of grantor trusts or business trusts.

36. *See* Committee on Bankruptcy and Corporate Reorganization, Association of the Bar of the City of New York, *Structured Financing Techniques*, 50 BUS. LAW. 527, 570-71 (1995) [hereinafter *Structured Financing Techniques*]; Jason H.P. Kravitt et al., *A Brief Summary of Structures Utilized in the Securitization of Financial Assets*, *in* 1 SECURITIZATION OF FINANCIAL ASSETS § 4.02[B] (Jason H.P. Kravitt ed., 2d ed. 1999) [hereinafter SECURITIZATION OF FINANCIAL ASSETS]; William A. Schmalzi et al., *Tax Issues*, *in* 1 SECURITIZATION OF FINANCIAL ASSETS, *supra*, at § 10.02[B][iii].

37. *See generally* BOGERT ET AL., *supra* note 20, §§ 247-255 (detailing how the trustee may use the assets of the business trust to operate a business); ALLAN R. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP § 33, at 167-70 (1968) (describing the use of the business trust).

38. *See* BOGERT ET AL., *supra* note 20, § 1162, at 558-61; *id.* § 1163, at 570-76; *id.* § 1164, at 599-600; *id.* § 1166, at 612-13, 617-18; *id.* § 1168, at 644-50; *id.* § 1171, at 744-49; *see also* Martin I. Lubaroff, *Form of Delaware Business Trust Agreement* § 2.5(b), *in* 2 THE BEST ENTITY FOR DOING THE DEAL 393, 400 (Prac-

in an unlimited range of business activities.[39] Common examples include an open-end mutual fund organized as a trust;[40] a real estate investment trust in which the trustee must actively manage real property;[41] and—again common in the securitization industry—a business trust that issues debt to acquire financial assets on a revolving basis.[42]

The business trust has been with us for more than one hundred years.[43] The use of business trusts is said to have begun in Massachusetts in the nineteenth century in response to a prohibition under Massachusetts law against a corporation owning real property.[44] Promoters formed business trusts to obtain the limited liability of a corporate form of business without complying with some of the restrictions contained in local corporation acts.[45] Although these efforts achieved mixed results,[46] the business trust today retains many

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tising Law Institute ed., 1996).

39. *See, e.g.*, BOGERT ET AL., *supra* note 20, § 247, at 166-67 & nn.14-17; *id.* § 248, at 229-33 (investment trusts); *id.* §§ 249-255 (real estate investment trusts); *id.* § 249 (real estate development).

40. *See* Philip H. Newman, *Legal Considerations in Forming a Mutual Fund*, *in* INVESTMENT COMPANY REGULATION AND COMPLIANCE 23, 25-26, 28-29 (ALI-ABA CLE 1999) (discussing advantages of organizing mutual fund as a business trust instead of a corporation).

41. *See, e.g.*, Lafayette Bank & Trust Co. v. Branchini & Sons Constr. Co., 342 A.2d 916, 917 (Conn. Super. Ct. 1975) (discussing a real estate investment trust organized under Maryland law).

42. *See, e.g.*, Financial Sec. Assurance Inc. v. T-H New Orleans Ltd. Partnership, 116 F.3d 790, 794 (5th Cir. 1997) (involving a business trust issuer of $87,000,000 of bonds secured by mortgage loans refinancing six hotels); *Structured Financing Techniques*, *supra* note 36, at 571-72; Kravitt, *supra* note 36, § 4.02[E].

43. *See, e.g.*, Schumann-Heink v. Folsom, 159 N.E. 250, 252 (Ill. 1927) (stating that the legality of the business trust has been recognized in England since 1880 and has been in use in Massachusetts since before 1890); State St. Trust Co. v. Hall, 41 N.E.2d 30, 34 (Mass. 1942) (discussing the history of the business trust).

44. *See State St. Trust Co.*, 41 N.E.2d at 34; BOGERT ET AL., *supra* note 20, § 247, at 168; Sheldon A. Jones et al., *The Massachusetts Business Trust and Registered Investment Companies*, 13 DEL. J. CORP. L. 421, 426 (1988).

45. *See, e.g.*, Goldwater v. Oltman, 292 P. 624, 627 (Cal. 1930) (exploring and summarizing the development of business trusts).

46. A few courts held that a business trust created by contract could not obtain the benefits of limited liability for the beneficial owners. *See, e.g.*, Weber Engine Co. v. Alter, 245 P. 143, 145-46 (Kan. 1926) (holding that owners of business trust in business of mining who fail to incorporate under state law are personally liable on a contract); Thompson v. Schmitt, 274 S.W. 554, 559-61 (Tex. 1925) (holding owner of business trust liable as general partner of partnership). In other cases, the courts held that the trust was effective to isolate

advantages over a corporation.[47] Because of the growing use of business trusts as legal entities engaged in commerce, many states enacted legislation authorizing and governing business trusts.[48]

Initially, promoters also used the business trust to avoid federal taxation as a corporation.[49] These early efforts failed as the courts held that, to the extent that the business trust was organized to conduct business, it would be taxable as a corporation.[50] Nevertheless, business trusts today can be organized to avoid taxation as a separate taxable entity under the Internal Revenue Code,[51] even though business trusts will be treated as legal persons for other purposes.

Unlike the traditional trust, the business trust is designed to be a legal person, similar to a corporation, partnership, or limited liability company, and is considered a legal person in many contexts.[52]

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the beneficial owners from liability. *See Goldwater*, 292 P. at 629 (holding that the beneficiaries of a business trust in California were not personally liable for a debt contracted by the trustees of the business trust); BOGERT ET AL., *supra* note 20, § 247, at 176-87.

47. *See* Newman, *supra* note 40, at 25-26, 28-29.

48. *See* BOGERT ET AL., *supra* note 20, § 247, at 156-63 n.5, 172-75 n.42. In 1988, Delaware enacted a comprehensive business trust statute authorizing the creation of a statutory business trust as a legal person, and, in 1996, Connecticut enacted a substantially similar statute. *See* CONN. GEN. STAT. ANN. §§ 34-501 through -547 (West 1997 & Supp. 1999); DEL. CODE ANN. tit. 12, §§ 3801-3814 (1995 & Supp. 1998).

49. *See* Jones et al., *supra* note 44, at 447.

50. *See, e.g.*, Morrissey v. Commissioner, 296 U.S. 344, 360-61 (1935); Hecht v. Malley, 265 U.S. 144, 156-61 (1924).

51. If the business trust has more than one beneficial owner, it can qualify for treatment as a partnership under the Internal Revenue Code. *See* Treas. Reg. § 301.7701-3(b)(1)(i) & 4(b); *see also Structured Financing Techniques*, *supra* note 36, at 572 (noting the common practice of structuring these trusts so they are characterized as a partnership for tax purposes); Schmalzi, *supra* note 36, § 10.02[B][iv]. If the business trust has only one beneficial owner, the business trust may be treated as a disregarded entity. *See* Treas. Reg. § 301.7701-3(b)(1)(ii); *see also* Schmalzi, *supra* note 36, § 10.02[B][iv]; *cf.* Commissioner v. Bollinger, 485 U.S. 340 (1988) (holding that when corporation holds property as agent for its shareholders, tax items associated with the property are attributed to shareholders and not the corporation). Corporations may also be organized to avoid taxation as a separate taxable entity under Subchapter S of the Internal Revenue Code. *See* I.R.C. § 1363(a) (1994). Partnerships are not subject to federal income tax as separate legal entities. *See id.* § 701. Therefore, whether an entity is a separate entity for tax purposes has very little relevance to whether the entity is a separate juridical person for other purposes.

52. *See, e.g.*, CONN. GEN. STAT. ANN. § 34-501(2) (West Supp. 1999) (providing that a statutory trust, which includes a business trust, shall be "a separate legal entity"); DEL. CODE ANN. tit. 12, § 3801(a) (1995 & Supp. 1998) (providing that a trust shall be "a separate legal entity"); MINN. STAT. ANN. §

Like a corporation or partnership,[53] the business trust has developed a legal existence separate from the persons who comprise it, the business trust trustee and the business trust's beneficiaries. The business trust sues,[54] defends suits,[55] or conveys property in its own

318.02.1 (West 1996) (providing that an association organized under the statute "shall be a business trust and a separate unincorporated legal entity"); OHIO REV. CODE ANN. § 1746.02 (Anderson 1997) (providing that "[a] business trust is a separate unincorporated legal entity"); *In re* Vento Dev. Corp., 560 F.2d 2, 4-5 (1st Cir. 1977) (holding that a business organized under Puerto Rican law is a legal entity capable, as a creditor, of filing an involuntary bankruptcy petition against debtor); Goldwater v. Oltman, 292 P. 624, 627, 629 (Cal. 1930) (stating that "we see no reason why such organizations [business trusts] with their limited liability should not be recognized in this state"); Erisman v. McCarty, 236 P. 777, 782 (Colo. 1925) (reversing judgment against business trust conducting mining business for fraud in sale of beneficial interests and stating that there is no objection to a business trust organized under Colorado common law); Lafayette Bank & Trust Co. v. Branchini & Sons Constr. Co., 342 A.2d 916, 917 (Conn. Super. Ct. 1975) (holding that a real investment trust organized under Maryland law is a legal entity capable of being sued); Vischer v. Dow Jones & Co., 59 N.E.2d 884, 892 (Ill. App. 1945) (providing that, notwithstanding an earlier decision that a business trust was not a legal entity under Illinois law, a business trust organized under Massachusetts law was a legal entity capable of being sued in Illinois); Hemphill v. Orloff, 213 N.W. 867, 872 (Mich. 1927) (finding that the business trust was a legal entity, which did not file under the corporation laws and, therefore, was not entitled to file suit in Michigan); Pacific Am. Realty Trust v. Lonctot, 381 P.2d 123, 125-27 (Wash. 1963) (stating that a business trust organized under the laws of Massachusetts may sell securities in Washington if it qualifies under applicable Washington law); *see also* 12 U.S.C. § 1841(a)(1) (1994) (stating that a business trust is included within definition of a bank holding company); 12 U.S.C. §§ 377, 378 (1994) (stating that a business trust is included in prohibitions of Glass-Steagall Act); 29 U.S.C. § 203(a) (1994) (stating that a business trust is a "person" subject to the Fair Labor Standards Act); STANDARD & POOR'S, *supra* note 34, at 37 (requiring that bankruptcy remote special purpose business trusts meet all of Standard & Poor's criteria for bankruptcy remote special purpose entities); *infra* note 57 and accompanying text (discussing the fact that a business trust, not a traditional trust, is eligible to be a debtor under the Bankruptcy Code).

53. Corporations, authorized by statutes, are treated as separate, legal entities. *See* 1 WILLIAM MEADE FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5, at 411, § 7, at 414-15 (Perm. ed. 1999). General partnerships have been treated either as entities or merely aggregates of individual persons; the entity idea has predominated. *See* BROMBERG, *supra* note 37, § 3, at 16-29.

54. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-1879 (West 1996); CONN. GEN. STAT. ANN. § 34-502b (West Supp. 1999); DEL. CODE ANN. tit. 12, § 3804(a) (1995 & Supp. 1998); MINN. STAT. ANN. § 318.02.3(2) (West 1996); N.C. GEN. STAT. §§ 39-45 (1999); OHIO REV. CODE ANN. § 1746.09(A)(7) (Anderson 1997); Eastern Enter. v. Apfel, 524 U.S. 498 (1998) (a former coal operator, a business trust, successfully challenging the application of Coal Industry Retiree Health Benefit Act as an unconstitutional taking); Mercer Int'l v. United States Fidelity & Guar. Co., No. CV-96-00824-WTM, 1999 WL 594813, at *1 (9th Cir. Aug. 6, 1999) (a Washington business trust suing an insurer on insurance contract); RTC Commercial Assets Trust 1995-NP3-1 v. Phoenix Bond & Indem. Co., 169

name, although sometimes it may take these actions in the name of the trustee.[56] Significantly, a business trust can be a debtor under the Code while a traditional trust cannot.[57] As a result of its busi-

F.3d 448 (7th Cir. 1999) (a declaratory judgment action by Delaware business trust); Franklin High Yield Tax-Free Income Fund v. County of Martin, 152 F.3d 736, 738 (8th Cir. 1998) (a contract and securities fraud action brought by Massachusetts trust); Associated Mortgage Inv. v. G.P. Kent Constr. Co., 548 P.2d 558, 559 (Wash. App. 1976) (an action by business trust to foreclose deed of trust).

55. *See, e.g.*, ALA. CODE § 19-3-66 (1997); ARIZ. REV. STAT. ANN. § 10-1879 (West 1996); CONN. GEN. STAT. ANN. § 34-502b (West Supp. 1999); DEL. CODE ANN. tit. 12, § 3804(a) (1995 & Supp. 1998); MASS. GEN. LAWS ANN. ch. 182, § 6 (West 1996); MINN. STAT. ANN. § 318.02.3(2) (West 1996); N.C. GEN. STAT. §§ 39-45 (1999); OHIO REV. CODE ANN. § 1746.09(A)(7) (Anderson 1997); United States v. Hughes, 191 F.3d 1317, 1319 (10th Cir. 1999) (criminal conviction of a business trust for conspiracy to defraud the government); DeRosier v. 5931 Business Trust, 870 F. Supp. 941, 944 (D. Minn. 1994) (business trust as a defendant in a trademark infringement action); *In re* Rainbow Trust, 207 B.R. 70, 72-73 (Bankr. D. Vt. 1997) (business trust subject to a prejudgment attachment action).

56. *See, e.g.*, Navarro Sav. Assoc. v. Lee, 446 U.S. 458, 459 (1980) (holding that business trust trustee suing for breach of contract on behalf of real estate investment trust was empowered to sue in name of trust or in name of trustee); BOGERT ET AL., *supra* note 20, § 1162, at 558-59, § 1166, at 611, § 1168, at 650 (discussing form of business trust agreement when title to property in name of trustee); *id.* § 1163, at 572 (discussing form of business trust agreement when property in name of trust or trustee).

57. Only a "person" or a municipality may be a debtor under the Code. *See* 11 U.S.C. §§ 101(13), 109(a) (1994). "Person" includes an individual, partnership, corporation, and, in certain limited instances, a governmental unit. *See id.* § 101(41). A corporation includes a "business trust." *See id.* § 101(9)(A)(v); *see also In re Rainbow Trust,* 207 B.R. at 72-73 (business trust; Chapter 11); *In re* Lemley Estate Bus. Trust, 65 B.R. 185, 188 (Bankr. N.D. Tex. 1996) (business trusts serving as general partners of a partnership operating a farm; Chapter 11); *In re* Affiliated Food Stores, Inc. Group Benefit Trust, 134 B.R. 215, 217 (Bankr. N.D. Tex. 1991) (a trust established to provide health benefits for employees of business and families; Chapter 11); Carr. v. Michigan Real Estate Ins. Trust (*In re* Michigan Real Estate Ins. Trust), 87 B.R. 447, 449 (Bankr. E.D. Mich. 1988) (an insurance trust; Chapter 7 proceeding); Merrill v. Allen (*In re* Universal Clearing House Co.), 60 B.R. 985, 989-93 (Bankr. D. Utah 1986) (finding clearinghouse a business trust eligible for relief under the Code); *In re* Arehart, 52 B.R. 308, 311 (Bankr. M.D. Fla. 1985) (a trust for developing, operating, leasing, and selling trust property); *In re* Gonic Realty Trust, 50 B.R. 710, 714 (Bankr. D. N.H. 1985) (a business trust for leasing portions of a mill); *In re* Dreske Greenway Trust, 14 B.R. 618, 623 (Bankr. E.D. Wis. 1981) (discussing a trust to purchase and lease motel). The courts have held that the term "person" does not include a trust established for the preservation of assets. *See, e.g.*, Shawmut Bank Conn. Nat'l Ass'n v. First Fidelity Bank (*In re* Secured Equip. Trust of Eastern Airlines, Inc.), 38 F.3d 86, 89-90 (2d Cir. 1994) (a trust established to finance aircraft in leveraged lease transaction where the trustee had legal title to and was lessor of aircraft); *In re* Sung Soo Rim Irrevocable Intervivos Trust, 177 B.R. 673, 678 (Bankr. C.D. Cal. 1995) (a spendthrift trust holding multi-unit retail complex facing imminent foreclosure before transfer to the

ness activities, a business trust may incur direct liability for its activities,[58] and the trustee may avoid liability for trust activities.[59]

Business trusts have three essential elements. First, like a traditional trust, there must be an identifiable corpus of the trust—the trust estate—under the control of a trustee.[60] Second, similar to a traditional trust, there must be a trustee who controls the trust estate not for her own interest but for beneficiaries of the trust.[61] Third, unlike a traditional trust, a business trust may engage in business, for which it may incur liability for its activities.[62]

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trust); *In re* Treasure Island Land Trust, 2 B.R. 332, 334-35 (Bankr. M.D. Fla. 1980) (a trust established to develop land where the trustee held legal title); *see also supra* notes 31, 42 and accompanying text. In addition, a purported business trust that fails to qualify as a business trust under state law may not be a debtor under the Code. *See In re* Heritage North Dunlap Trust, 120 B.R. 252, 254-55 (Bankr. D. Mass. 1990).

58. *See, e.g.*, ALA. CODE §§ 19-3-62, 19-3-66 (1997); CONN. GEN. STAT. ANN. § 34-502b (West 1997); DEL. CODE ANN. tit. 12, § 3804(a) (1995 & Supp. 1998); KY. REV. STAT. ANN. § 386.39 (Lexis 1999); MASS. GEN. LAWS ANN. ch. 182, § 6 (West 1996); N.Y. GEN. ASS'NS LAW § 15 (McKinney 1994); OHIO REV. CODE ANN. § 1746.13(A) (Anderson 1997); S.C. CODE ANN. § 33-53-40 (Law. Co-op. 1990); Carpenter v. Elmer R. Sly Co., 293 P. 162, 165 (Cal. Dist. Ct. App. 1930); *see also* ARIZ. REV. STAT. ANN. § 10-1879 (West 1996) (providing that a business trust may be sued and that beneficial owners do not have personal liability).

59. The common law rule of personal liability for trustees applies to the business trust. *See* Goldwater v. Oltman, 292 P. 624, 631 (Cal. 1930) (holding that the trustees of a common law business trust who executed a note are personally liable on the note); Town of Hull v. Tong, 442 N.E.2d 427, 429 (Mass. App. Ct. 1982); *see also* BOGERT ET AL., *supra* note 20, § 247(K), at 190-94. Nevertheless, some states provide that the trustees do not have personal liability to persons other than the trust or the beneficiaries. *See, e.g.*, ALA. CODE § 19-3-62 (1997); CONN. GEN. STAT. ANN. § 34-523 (West 1997); DEL. CODE ANN. tit. 12, § 3803(b) (1995); KY. REV. STAT. ANN. § 386.39 (Lexis 1999); MINN. STAT. ANN. § 318.02.4 (West 1996); OHIO REV. CODE ANN. § 1746.13(A) (Anderson 1997). Other states authorize the trust agreement to limit the liability of the trustee. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-1877 B (West 1996); S.C. CODE ANN. § 33-53-40 (Law. Co-op. 1990).

60. *See* BOGERT ET AL., *supra* note 20, § 1, at 4.

61. *See id.*; *see also* Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 465-66 (1980) (noting that a business trust is an express trust and that the trustees of a business trust in the business of real estate investment, like trustees of all express trusts, had real and substantial control over the trust assets held in their names and, therefore, were the real parties in interest for purposes of federal diversity jurisdiction); Lenon v. St. Paul Mercury Ins. Co., 136 F.3d 1365, 1370-71 (10th Cir. 1998) (holding that four multi-employer welfare and benefit plans under the Employment Retirement Income Security Act were express trusts and, therefore, the trustees could maintain a federal diversity action); RESTATEMENT (SECOND) OF TRUSTS § 2 (1959) (discussing duties of trustees); *supra* note 37, § 33, at 170-71.

62. *See supra* notes 37-42, 58-59, and accompanying text.

II. THE EXISTENCE OF THE BANKRUPTCY TRUST

When an order for relief has been entered in a bankruptcy case as a result of the filing of a petition by a debtor or creditors,[63] the Code has the effect of creating a bankruptcy trust[64] that satisfies all of the essential attributes of a business trust.[65] The Code provides for (1) the creation of a trust estate dedicated to a specific use, (2) the appointment in every case of a person that serves as a trustee who controls and uses this estate for the benefit of different classes of persons, and (3) the empowerment of the trustee to engage

63. *See infra* note 67 and accompanying text.

64. Professor Langbein excludes the bankruptcy trust from his discussion of the commercial trust. Langbein, *Commercial Trusts, supra* note 21, at 168. His treatment is consistent with the purpose of his article discussing commercial trusts created by contract. Further, certain features of the bankruptcy trust suggest that it should not be considered a traditional trust. Professor Langbein stated that one reason he excludes the bankruptcy trust from a commercial trust is the bankruptcy trustee's status as an officer of the court. *See id.* In addition, the bankruptcy trustee's duties are prescribed by statute, not by agreement, and in this regard, bankruptcy trustees resemble administrators of estates of intestates, executors under a will, and guardians under a guardianship. These latter persons have fiduciary duties over an estate, but they are not considered trustees of a traditional trust. *See* RESTATEMENT (SECOND) OF TRUSTS §§ 6-7 (1959); BOGERT ET AL., *supra* note 20, §§ 12-13, at 128-54. Nevertheless, the bankruptcy trustee's powers and duties are much more extensive than those of administrators, executors, and guardians. Even if a bankruptcy trust should not be considered a traditional trust, it may still be considered sufficiently like a business trust, which, unlike a traditional trust, is considered a legal person, to itself be considered a legal person for many purposes.

65. One difference is that the bankruptcy trust is not created by an express agreement. I do not consider this to be a disqualifying difference because the bankruptcy trust is created by the voluntary act of the debtor in almost all cases or by creditors of the debtor in a few cases. Of course, a voluntary petition may not be voluntary in one sense since a voluntary petition often follows some creditor enforcement action. *See, e.g.,* Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 496 n.34 (1996). Alternatively, the action may be taken in response to other outside pressures. *See, e.g., In re* Johns-Manville Corp., 36 B.R. 727, 729-30 (Bankr. S.D.N.Y. 1984) (analyzing the good faith of a Chapter 11 petition that was filed after debtor facing 16,000 lawsuits for personal injury from asbestos was informed that it would be required to book a reserve of $1.9 billion to cover potential liability). Nevertheless, debtors who file do so to achieve one or more specific goals, including orderly liquidation or reorganization. Debtors are not forced to file the petition in the same way as an administrator, executor, or guardian is required to be appointed upon the death or disability of an individual. In the case of an involuntary filing, the creditors impose the bankruptcy trust on the debtor. Nevertheless, the trust that results is empowered to operate in ways that far exceed the scope of operations and duties of a resulting or traditional trust and that resemble the business trust.

in a wide range of activities for the liquidation of the debtor's assets or rehabilitation of the debtor's business or affairs, for which the assets of the estate and not the trustee will incur liability.[66]

A. *The Estate as the Trust Res*

The commencement of a case by the filing of a voluntary, joint, or involuntary petition[67] creates an estate.[68] This estate consists primarily of "all legal or equitable interests of the debtor in property" as of the commencement of the case.[69] This definition, which pervades the Code,[70] specifies the assets of the estate. It does not purport to create the estate as a legal person.[71]

A few provisions of the Code, however, appear to treat the estate as a person who may act.[72] For example, property of the estate

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66. A bankruptcy trustee will be liable for its own negligence in carrying out its duties. *See infra* notes 82, 133-39 and accompanying text.

67. *See* 11 U.S.C. § 301 (1994) ("The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter."); *id.* § 302 ("The commencement of a joint case [by the filing of a single petition by an individual and the individual's spouse] under a chapter of this title constitutes an order for relief under such chapter."); *id.* § 303(h) (providing that, if an involuntary petition is not controverted, the court will order relief against the debtor in an involuntary case; otherwise, after trial, the court will order relief against the debtor if the debtor is generally not paying its undisputed debts as they become due).

68. *See id.* § 541(a).

69. *Id.*

> The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held: (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

Id. See generally Thomas E. Plank, *The Outer Boundaries of the Bankruptcy Estate*, 47 EMORY L.J. 1193, 1207 (1998) [hereinafter *Bankruptcy Estate*]. The other enumerated items refer to community property and to property added to the estate after the commencement of the case. *See* 11 U.S.C. § 541(a)(2)-(7). For the adjustment of debts under Chapter 12 (family farmers) and Chapter 13 (individuals with regular income), property of the estate also includes property of the kind specified in § 541 acquired by the debtor and earnings from services performed after the commencement of the case until the case is closed, dismissed, or converted. *See id.* §§ 1207, 1306.

70. *See* Plank, *Bankruptcy Estate, supra* note 69, at 1207-09.

71. *Cf.* 11 U.S.C. § 349(b)(3) (providing that dismissal of a case "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case"); *id.* § 350(a) (closing of the case after the estate is fully administered); *id.* § 1141(b)(3) ("[C]onfirmation of a plan vests all of the property of the estate in the debtor.").

72. *See, e.g., id.* § 507(a)(4)(B)(ii) (providing that amount "paid by the es-

includes "[a]ny interest in property that the estate *acquires* after the commencement of the case."[73] Also, a few sections of the Code speak of property in which the estate has an interest and property in which an entity other than the estate has an interest.[74] This usage could suggest that the estate is a person that owns a property interest. In other cases, the use of the term "estate" is compatible with either the estate as a collection of property interests or the estate as a legal person.[75] Although many commentators and courts have treated the "estate" as a legal person,[76] it is neither necessary nor appropriate.[77] The other sections of the Code provide the essential ingredients for creating a bankruptcy trust as a legal person.

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tate" is to be taken into consideration in calculating priority for payment of claims held by employee benefit plan); *id.* § 552(a) (validity of liens on property "acquired by the estate"); *id.* § 558 (providing that "the estate shall have the benefit" of defenses available to the debtor).

73. *Id.* § 541(a)(7) (emphasis added).

74. *See id.* § 363(a) (defining "cash collateral"); *id.* § 506(a) (defining a secured claim); *id.* § 724(b) (providing for the avoidance of certain liens); *id.* § 725 (providing for the disposition of property); *see also id.* § 363(f), (h), (j) (authorizing sales of property in which the estate has an interest).

75. *See, e.g., id.* § 327(a) (authorizing the employment of professionals who hold no "interest adverse to the estate"); *id.* § 345(a) (providing for the investment of "money of the estate"); *id.* § 362(a)(3) (imposing a stay of acts "to obtain possession of property . . . from the estate"); *id.* § 365(k) (providing that the assignment of assumed contract or lease releases trustee and estate from liability for post assignment breach of the contract or lease); *id.* § 551 (preserving avoided transfers "for the benefit of the estate."); *id.* § 554(a), (b) (empowering the trustee to abandon property that is burdensome or "of inconsequential value and benefit to the estate"); *id.* § 704(7), (9) (requiring the trustee to provide information about the administration of the estate); *id.* § 1104(a)(2), (c)(1) (providing for the appointment of a trustee or an examiner if such appointment is in the best interests of the estate); *id.* § 1112(b), (e) (providing for the conversion or dismissal of a Chapter 11 case if in the best interests of the estate).

76. *See infra* notes 145-47 and accompanying text.

77. The legislative history of the Code does not suggest any intent to create the estate as a legal entity. An electronic search for the word "estate" in the legislative history reveals that references to the estate reflect the usage of the word in the Code. *See generally* H.R. REP. NO. 95-595, at 104 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963; S. REP. NO. 95-989, at 10-11 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787; 124 CONG. REC. H11089 (Sept. 28, 1978) (statement of Rep. Edwards), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6455 (referring to the addition of clause (7) to § 541(a) to include in property of the estate property that the estate "acquires" after the commencement of the case); 124 CONG. REC. S17406 (Oct. 6, 1978) (statement of Sen. DeConcini), *reprinted in* 1978 U.S.C.C.A.N. 6505, 6523-24 (same).

B. The Appointment of a Trustee

The Code provides for the prompt appointment of a bankruptcy trustee in Chapter 7 and Chapter 13 cases.[78] The trustee may be an individual or a corporation competent to act as a trustee.[79] Upon the filing of a petition under Chapter 11 or Chapter 12, the debtor, as the debtor in possession, assumes substantially all of the powers and duties of a trustee.[80] Under some circumstances, a separate trustee may be appointed in Chapter 11 and Chapter 12 cases.[81] The bankruptcy trustee, whether a separate person or the debtor in possession, has the same fiduciary duties of loyalty and care that

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78. *See* 11 U.S.C. § 701(a)(1) (1994) (providing for the appointment of an interim trustee by United States trustee promptly after the order for relief in Chapter 7 cases); *id.* § 702 (providing for the election of a trustee at the meeting of creditors and the continuation of the interim trustee if no other trustee is so elected); *id.* § 1302 (providing for the appointment of a trustee by the United States trustee in Chapter 13 cases).

79. *See id.* § 321(a). The relevant portion of § 321 states:

> (a) A person may serve as trustee in a case under this title only if such person is—
> (1) an individual that is competent to perform the duties of trustee and, in a case under chapter 7, 12, or 13 of this title, resides or has an office in the judicial district within which the case is pending, or in any judicial district adjacent to such district; or
> (2) a corporation authorized by such corporation's charter or bylaws to act as trustee, and, in a case under chapter 7, 12, or 13 of this title, having an office in at least one of such districts.

Id.

80. *See id.* §§ 1107(a), 1203. Section 1107(a) states:

> Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

Id. § 1107(a). Similarly, § 1203 states:

> Subject to such limitations as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330, and powers, and shall perform all the functions and duties, except the duties specified in paragraphs (3) and (4) of section 1106(a), of a trustee serving in a case under chapter 11, including operating the debtor's farm.

Id. § 1203.

81. *See id.* § 1104 (providing for the appointment of a trustee in Chapter 11 if the debtor in possession is removed by the court); *id.* § 1202(a) (providing for the appointment of a trustee by the United States trustee in Chapter 12 cases if the debtor is removed as the debtor in possession by § 1204(a)). In addition, a trustee must be appointed for railroad reorganizations. *See id.* § 1163. In this case, a debtor does not become a debtor in possession, and the trustee, not the debtor, operates the debtor's business. *See id.* § 1161.

any trustee of a traditional trust or a business trust has.[82]

The debtor in possession differs from a separate trustee in two significant ways. First, unless removed, the debtor, as debtor in possession, retains control of the business of the debtor.[83] In enacting the Code, Congress rejected the mandatory appointment of reorganization trustees that had been required by Chapter X of the Bankruptcy Act of 1898, the reorganization chapter for large corporations.[84] Instead, it followed Chapter XI of the Bankruptcy Act, which did not require appointment of a trustee.[85] Congress deliber-

82. *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355-56 (describing the duties of a Chapter 7 trustee); United States Trustee v. Bloom (*In re* Palm Coast, Matanza Shores Ltd. Partnership), 101 F.3d 253, 257-58 (2d Cir. 1996) (applying the common law of trusts, which requires a trustee to be disinterested and prohibits a trustee from obtaining interests adverse to the estate, to hold that a Chapter 11 trustee could not hire his own firm as a real estate broker for selling property of the estate); United States *ex rel.* Block v. Aldrich (*In re* Rigden), 795 F.2d 727, 730 (9th Cir. 1986) (stating that, in a Chapter 7 case, a bankruptcy "trustee has a duty to exercise that measure of care and diligence that an ordinary prudent person would exercise under similar circumstances . . . [and] a fiduciary obligation to conserve the assets of the estate and to maximize distribution to creditors"); Rushton v. American Pac. Wood Products, Inc. (*In re* Americana Expressways, Inc.), 192 B.R. 763, 766-67 (D. Utah 1996) (stating that, when a debtor became a debtor in possession in a Chapter 11 case, it became a fiduciary who owes the same fiduciary duties that a separate bankruptcy trustee would owe).

Although not liable for mistakes in judgment where discretion is allowed, a trustee is liable for not only intentional, but also negligent, violations of duties imposed upon him by law. *See* Hall v. Perry (*In re* Cochise College Park, Inc.), 703 F.2d 1339, 1357 (9th Cir. 1983); *see also* C.R. Bowles, Jr. & Nancy B. Rapoport, *Has the DIP's Attorney Become the Ultimate Creditors' Lawyer in Bankruptcy Reorganization Cases?*, 5 AM. BANKR. INST. L. REV. 47, 52-58 (1997) (explaining the fiduciary duties of a debtor in possession under the "common-law trustee" standard); Carlos J. Cuevas, *The Myth of Fiduciary Duties in Corporate Reorganization Cases*, 73 NOTRE DAME L. REV. 385, 388-93 (1998) (arguing that the remedies for breach of these fiduciary obligations are insufficient to protect the interests of unsecured creditors in Chapter 11 cases).

83. In Chapter 13 cases, a separate trustee is appointed. *See* 11 U.S.C. § 1302(a). However, the debtor retains control over his or her property and business and has certain of the express duties of a trustee. *See id.* §§ 1306(b), 1304(b), 1303. Thus, the separate trustee and the debtor act as co-trustees with different powers.

84. Trustees had to be appointed if the debtor owed $250,000 or more. *See* Bankruptcy Act, § 156, *as added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 888 (1938) (codified as amended at 11 U.S.C. § 556 (1976) (repealed 1978)).

85. Chapter XI was intended to be used for smaller companies. *See* COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, pt. 1, at 264 (1973). It did not allow the restructuring of secured debt. *See id.* at 259; *see also* Bankruptcy Act, §§ 356, 371, *as added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 910, 912 (codified as amended at 11 U.S.C. §§ 756, 771 (1976) (repealed 1978)) (allowing the arrangement of only the claims of unsecured creditors of the corporation). Nevertheless, Chapter XI was used

ately chose this approach in the belief that existing management could reorganize a failing but salvageable business better than an outside trustee.[86] Second, unlike the separate trustee, the debtor is a potential beneficiary of the bankruptcy trust. As the result of a confirmed and consummated plan, the reorganization may produce a viable entity in which the interest holders—an individual debtor or the shareholders of a corporate debtor—retain some valuable interest.[87]

Nevertheless, neither the debtor's control over the estate as debtor in possession nor the debtor's potential status as a beneficiary disqualifies the debtor in possession from being the trustee of the bankruptcy trust. First, the settlor of any trust may also be the trustee of the trust.[88] Any person may, in effect, convey any of her property to herself as trustee for the benefit of third parties by simply declaring that she holds the property in trust for the beneficiaries.[89] When a debtor files a petition in Chapters 11, 12 or 13, she subjects all of her property to the bankruptcy trust. Furthermore, as the trustee of the bankruptcy trust, the debtor in possession, like

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more often than Chapter X because of its flexibility. *See* COMMISSION ON THE BANKRUPTCY LAWS, *supra*, pt. 1, at 265-66.

86. *See* H.R. REP. NO. 95-595, at 104, 220-21, 231-34 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6065, 6180-81, 6191-93. The Senate originally proposed retaining the mandatory appointment of a trustee for "public companies." *See* S. REP. NO. 95-989, at 10-11, 115 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5796-97, 5901. The House position prevailed. *See* 124 CONG. REC. H11089 (Sept. 28, 1978) (statement of Rep. Edwards), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6465-70; 124 CONG. REC. S17406 (Oct. 6, 1978) (statement of Sen. DeConcini), *reprinted in* 1978 U.S.C.C.A.N. 6505, 6534-39.

87. Chapter 11 cases, however, do not usually result in confirmed and consummated plans and most often end in failure instead of a reorganized debtor. *See, e.g.*, NATIONAL BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 610-14 (1997); Steven H. Ancel & Bruce A. Markell, *Hope in the Heartland: Chapter 11 Dispositions in Indiana and Southern Illinois, 1990-1996*, 50 S.C. L. REV. 343, 348-49 (1999) (noting that, of the 2374 Chapter 11 filings in Region 10 of the United States Trustee system during 1990-1996, 913, or roughly 38%, ended in confirmed plans; approximately 62% converted to Chapter 7 or were dismissed, and a few were left still open); Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and Analysis of the Law*, 97 COM. L.J. 297, 318-19, 323-25, 329 (1992) (noting that only 17% of 260 Chapter 11 petitions filed in the Bankruptcy Court for the Southern District of New York in the Poughkeepsie Study resulted in confirmed plans, comparable to that found in a national study; only 6.5% resulted in consummated plans and rehabilitated debtors).

88. *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS § 100 (1959); Markham v. Fay, 74 F.3d 1347, 1356 (1st Cir. 1996) (applying the *Restatement (Second) of Trusts* to business trusts).

89. *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS § 17 (1959) (stating that the means for creating a trust include a declaration by the owner that it holds property in trust for another).

any settlor acting as trustee, is no longer acting in the interests of the debtor. The debtor has specific fiduciary duties and powers that she did not have before filing and that she will not have after the consummation of a confirmed reorganization plan.[90] Second, the settlor of any trust, even if it is the trustee, may also be one of the beneficiaries of the trust.[91]

The treatment of the debtor in possession as a trustee extends beyond the Code. Generally, whenever any statute, regulation, or document requires action or imposes a liability or condition upon the appointment of a "trustee" or "receiver" or "fiduciary," the filing of a petition for reorganization under Chapters 11 through 13 and the assumption by the debtor in possession of the duties of the trustee of the bankruptcy trust should be considered, absent special reasons to the contrary, the appointment of such a "trustee."[92]

C. The Activities of the Bankruptcy Trust

The powers and duties of the bankruptcy trustee to engage in wide-ranging activities resemble and exceed the powers and duties of a trustee in any business trust. These include the following pow-

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90. *See supra* note 82 and accompanying text.

91. *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS §§ 99, 115 (1959); *Markham*, 74 F.3d at 1356. The courts respect the validity of a trust established by a settlor in which the settlor retains a beneficial interest when an unrelated third party also has a beneficial interest in the trust and abrogation of the trust would destroy that interest. *See* Canal Corp. v. Finman (*In re* Johnson), 960 F.2d 396, 401-02 (4th Cir. 1992); City Nat'l Bank v. General Coffee Corp. (*In re* General Coffee Corp.), 828 F.2d 699, 706 (11th Cir. 1987); N.S. Garrott & Sons v. Union Planters Nat'l Bank (*In re* N.S. Garrott & Sons), 772 F.2d 462, 467 (8th Cir. 1985); Wickham v. United Am. Bank (*In re* Property Leasing & Management), 50 B.R. 804, 809 (Bankr. E.D. Tenn. 1985); *In re* North American Mktg. Corp., 24 B.R. 16, 18 (Bankr. S.D. Fla. 1982). If the settlor is the sole beneficiary, creditors may reach the trust assets directly and render the trust ineffective. *See, e.g.*, N.Y EST. POWERS & TRUSTS LAW § 7-3.1(a) (McKinney 1992) ("A disposition in trust for the use of the creator is void as against the existing or subsequent creditors of the creator."); Schenck v. Barnes, 50 N.E. 967, 968-69 (N.Y. 1898).

92. *See, e.g.*, Rushton v. American Pac. Wood Products Inc. (*In re* Americana Expressways, Inc.), 192 B.R. 763, 766-67 (D. Utah 1996) (holding that a common carrier operating as the debtor in possession in a Chapter 11 case was subject to a federal regulation that required the filing of an adoption notice whenever a "fiduciary (receiver, trustee, etc.) assumes possession and control of a carrier's property" and the carrier wants to continue to use the old carrier's tariff, and therefore, the debtor in possession who had not filed such an adoption notice could not charge rates based on the debtor's pre-petition tariffs that had been filed with the Interstate Commerce Commission); *cf.* Murray v. Mobil Chem. Co. (*In re* Chicago, Mo. & W. Ry.), 156 B.R. 567, 575 (Bankr. N.D. Ill. 1993) (the failure of the trustee for a reorganizing railroad in Chapter 11 to comply with the federal regulation requiring adoption of a tariff for a carrier upon the appointment of a "fiduciary" for the carrier precluded the trustee from collecting shipping charges on the railroad's pre-petition tariff).

ers and duties in cases under all four chapters. The bankruptcy trustee is the representative of the bankruptcy "estate"[93] and has the capacity to sue and be sued.[94] The trustee may employ professionals;[95] use, sell, or lease property of the estate;[96] invest money of the estate;[97] borrow money;[98] and recover certain property interests from third parties.[99] The trustee (other than the debtor in possession) may examine the debtor.[100] The trustee for a person other than an individual may waive the person's attorney-client privilege.[101] The trustee must use estate assets to comply with requirements of state and federal environmental protection orders and other requirements of law.[102]

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93. *See* 11 U.S.C. § 323(a) (1994).

94. *See id.* § 323(b).

95. *See id.* § 327 (including attorneys, accountants, appraisers, and auctioneers).

96. The trustee may use, sell, or lease property of the estate in the ordinary course of business and, with court approval, other than in the ordinary course of business, and, if certain conditions are met, sell property in which the estate has an interest. *See id.* § 363(b). *See generally* Thomas E. Plank, *The Creditor in Possession Under the Bankruptcy Code: History, Text, and Policy*, 59 MD. L. REV. 253 (2000) [hereinafter *Creditor in Possession*] (discussing the ability of the trustee to sell property interests of the estate); Plank, *Bankruptcy Estate*, *supra* note 69, at 1223-24 (same).

97. *See* 11 U.S.C. § 345.

98. *See id.* § 364(a)-(d) (providing that the trustee may obtain credit in the ordinary course of business without court approval or otherwise with court approval, including credit secured by property of the estate).

99. *See id.* §§ 542(a)-(b), 543(b). The trustee may recover property that the trustee may use, sell, or lease from an entity in possession or control of that property. *See id.* § 542(a). This provision was most likely enacted to enable the trustee to recover property items (a) in the possession of third parties who had no right to possession, similar to the turnover powers of a trustee under the Bankruptcy Act of 1898, and (b) property items in which the bankruptcy trust and a third party have an interest for purposes of sale if certain conditions were met. *See generally* Plank, *Creditor in Possession*, *supra* note 96. The Supreme Court has held, however, that § 542(a) also authorized the trustee to recover property items rightfully in the possession of a creditor. *See* United States v. Whiting Pools, Inc., 462 U.S. 198, 209 (1983). This decision was incorrect as a matter of law and, in my view, should no longer be considered good law. *See* Plank, *Creditor in Possession*, *supra* note 96; Plank, *Bankruptcy Estate*, *supra* note 70, at 1234-54. The trustee may also recover the payment of a matured or demand debt owned by a third party to the debtor. *See* 11 U.S.C. § 542(b). The trustee also may recover property of the debtor transferred pre-petition to certain "custodians." *See id.* § 543(b); *see also* Plank, *Creditor in Possession*, *supra* note 96 (describing the scope of § 543(b)).

100. *See id.* § 343.

101. *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 358 (1985).

102. *See* Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474

In addition, the trustee under each chapter has powers and duties appropriate for the purposes of the chapter. In Chapter 7 liquidations, the trustee has the duty to: collect and reduce to money the property of the estate;[103] be accountable for the property that it collects;[104] dispose of property in which others have an interest;[105] distribute property of the estate to creditors and, if any property is left, to the debtor;[106] "investigate the financial affairs of the debtor;"[107] "examine proofs of claims and object to the allowance of any claim that is improper;"[108] "oppose the discharge of the debtor"[109] and request the revocation of the discharge;[110] furnish information, reports, summaries, and accounts to the appropriate persons;[111] and if

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U.S. 494, 507 (1986) (holding that Chapter 7 trustee may not abandon contaminated real and personal property); Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267, 277 (3d Cir. 1984) (holding that a post-petition state court injunction to Chapter 7 debtor to comply with environmental consent order and agreement did not violate the automatic stay); *In re* Lauriat's, Inc., 219 B.R. 648, 649 (Bankr. D. Mass. 1998) (holding that, in the context of a request by Chapter 11 debtors to authorize store closing sales that were not in ordinary course of debtors' business, the bankruptcy court lacked authority to exempt debtors from state law requirements regarding closing-out sales in order to maximize recovery for estate); *In re* Consumer Health Servs. of Am., Inc., 171 B.R. 917, 925 (Bankr. D.C. 1994) (holding that debtor-provider continues to be subject to the Medicare system's health and safety standards post-petition but before assumption or rejection).

103. *See* 11 U.S.C. § 704(1) (also requiring the trustee to close the estate expeditiously). The trustee may also assert against any general partner a claim for any deficiency in the estate of a partnership debtor to pay the claims owed by such debtor. *See id.* § 723(a).

104. *See id.* § 704(2).

105. *See id.* § 725.

106. *See id.* § 726.

107. *Id.* § 704(4). In addition, the trustee must ensure that an individual debtor performs any stated intention by the debtor to retain, surrender, or redeem property of the estate securing consumer debts. *See id.* § 704(3).

108. *Id.* § 704(5).

109. *Id.* § 704(6).

110. *See id.* § 727(d).

111. *See id.* § 704. In relevant part, this provision states:

> The trustee shall—
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> . . . .
>
> (7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;
>
> (8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United

authorized by the court, operate the business of the debtor.[112]

Because these powers and duties transcend the duties of a trustee of a traditional trust of simply preserving and distributing the trust estate, the bankruptcy trust in a Chapter 7 liquidation resembles a business trust and, thus, qualifies as a legal person to the same extent.[113]

In Chapter 11 and Chapter 12 cases, the debtor in possession has substantially all of the powers and duties of the "trustee."[114] Moreover, the Code expressly describes these powers and duties primarily as those of a "trustee." The "trustee" may operate the debtor's business unless the court orders otherwise.[115] The "trustee" also has many of the powers and duties of a trustee under Chapter 7 described above.[116] Even when the Code allows the "debtor" to take actions, the Code constrains the debtor. For example, the debtor has exclusive power to file a reorganization plan for at least 120 days.[117] Nevertheless, the debtor's plan must meet the standards set forth in the Code.[118]

States trustee or the court requires; and

(9) make a final report and file a final account of the administration of the estate with the court and with the United States trustee.

Id.

112. *See id.* § 721.

113. *See, e.g., In re* Captran Creditors Trust, 53 B.R. 741, 744 (Bankr. M.D. Fla. 1985) (holding that a liquidating trust may be a debtor under the Code); *In re* Tru Block Concrete Prods., Inc., 27 B.R. 486, 491 (Bankr. S.D. Cal. 1983) (holding that a liquidating trust may be a debtor under the Code). *But see, e.g., In re* Hemex Liquidation Trust, 129 B.R. 91, 96-98 (Bankr. W.D. La. 1991) (holding that a liquidating trust not conducting any business is not a debtor under the Code).

114. 11 U.S.C. § 1107(a) (1994), *quoted supra* note 80; *see also id.* § 1203, *quoted supra* note 80. Sections 1107(a) and 1203 exclude the separate trustee's right to compensation and duty to investigate and report on the debtor's activities. *See id.* §§ 330(a)(1)(A), 1106(3).

115. *See id.* § 1108; *see also id.* § 1105 (providing for the termination of the trustee's appointment and restoration of "the debtor to possession and management of the property of the estate and of the operation of the debtor's business").

116. *See id.* § 1106(a)(1). These duties include being accountable for the property that the trustee collects, examining proofs of claims and objecting to the allowance of any improper claim, and furnishing information, reports, summaries, and accounts to the appropriate persons. *See supra* notes 104, 108, 111 and accompanying text.

117. *See* 11 U.S.C. § 1121(b).

118. *See, e.g., id.* § 1129(a). This provision states in part:

The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(2) The proponent of the plan complies with the applicable provisions

If a trustee other than the debtor in possession is appointed in a Chapter 11 case, the trustee must file a reorganization plan.[119] A separate trustee must also file the information required to be filed by the debtor if the debtor has not done so[120] and investigate the conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business, and the desirability of continuing the business.[121]

Chapter 12 specifies the duties and powers of both the debtor and a separate trustee, if one is appointed.[122] Chapter 13 allocates powers and duties between the separate trustee and the debtor,[123] and hence the debtor and the trustee in Chapter 13 cases act as co-trustees. Chapters 12 and 13 give the trustee a few additional duties that a trustee under Chapter 11 does not have. In Chapter 12, the trustee (including the debtor in possession) may sell farm property free of another party's interest without complying with the limitations of § 363.[124] In cases under both Chapters 12 and 13, a separate trustee may object to the confirmation of a plan proposed by the debtor or request modification of a confirmed plan.[125]

Finally, the trustee under all four chapters has powers that a normal business person does not. The trustee's prerogatives include

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of this title.

(3) The plan has been proposed in good faith and not by any means forbidden by law.

Id.

119. *See id.* § 1106(a)(5). Instead of filing a plan, the trustee may file a report of why the trustee will not file a plan, "or recommend conversion of the case to a case under Chapter 7, 12, or 13" or dismissal of the case. *Id.* Further, the trustee must furnish certain information to taxing authorities, and, after confirmation of a plan, file necessary reports. *See id.* § 1106(a)(6), (7).

120. *See id.* §§ 1106(a)(2), 1107(a) (referring to the information to be filed under § 521(1)).

121. *See id.* §§ 1106(a)(3), 1107(a). In addition, the trustee must "file a statement of any investigation conducted under [this paragraph and] transmit a copy or a summary . . . to any creditors' committee or equity security holders' committee, to any indenture trustee," and to any other entity that the court designates. *Id.* § 1106(a)(4).

122. *See id.* §§ 1202(b), 1203.

123. *See id.* §§ 1302(b), 1303, 1304.

124. *See id.* § 1206. The limitations in 11 U.S.C. § 363(f) on selling property free of the interest of another entity in the property require that (1) applicable non-bankruptcy law permit sale of the property free of that interest; (2) the other entity consent; (3) that interest is a lien and the price at which the property is to be sold be greater than the aggregate value of all liens on the property; (4) the interest be in bona fide dispute; or (5) the other entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of the interest. *Id.* § 363(f)(1)-(5).

125. *See id.* §§ 1202(b)(3)(B)-(C), 1224, 1229, 1302(b)(2)(B)-(C), 1329.

powers that the creditors under non-bankruptcy law could exercise, such as the power to avoid unperfected liens[126] or to avoid fraudulent transfers.[127] They also include powers that are given to the trustee to further the goals of bankruptcy, such as the power to assume or reject executory contracts,[128] to avoid preferential transfers[129] and certain other transfers,[130] and to abandon to the debtors burdensome or inconsequential property.[131] In exercising all of these powers, the trustee owes a fiduciary duty to enhance the bankruptcy estate for the benefit of the creditors and, in the rare case when the assets exceed the liabilities, for the benefit of an individual debtor or of the holders of equity interests in a debtor who is not an individual.[132]

Upon the commencement of a case, the bankruptcy trust incurs liability for its activities. In Chapter 7 liquidations, property of the estate must be distributed to pay administrative expenses allowed under § 503(b)(1).[133] Similarly, under Chapters 11, 12, and 13, the debtor's plan must provide for the payment of administrative expenses out of the estate.[134] Administrative expenses include, but are not limited to, "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case."[135] Administrative expenses include liability for torts committed by representatives of the bankruptcy trust.[136] Further, any debt borrowed by the trustee

126. *See id.* § 544.

127. *See id.* § 548.

128. *See id.* § 365. The trustee is subject to additional requirements if it wishes to reject a collective bargaining agreement in a Chapter 11 case. *See id.* § 1113.

129. *See id.* § 547.

130. *See id.* § 545 (statutory liens); *id.* § 549 (most unauthorized post-petition transfers of property); *id.* § 553(b) (preferential setoffs); *id.* § 724(a) (liens securing punitive damage awards).

131. *See id.* § 554.

132. *See supra* note 82 and accompanying text.

133. 11 U.S.C. § 503(b)(1) (1994). Property of the estate is distributed first to the payment of claims specified in § 507. *See id.* § 726(a)(1). Under § 507(a)(1), the first expenses and claims to be paid are administrative expenses allowed under § 503(b). *Id.* § 507(a)(1).

134. Under Chapter 11, the confirmed plan must provide for cash payment of claims entitled to payment under 11 U.S.C. § 507(a)(1), which requires payment of administrative expenses. *See id.* § 1129(a)(9)(A). Under Chapters 12 and 13, the plan must provide for deferred cash payments of claims entitled to priority under 11 U.S.C. § 507. *See id.* §§ 1222(a)(2), 1322(a)(2).

135. *Id.* § 503(b)(1)(A).

136. *See* Reading Co. v. Brown, 391 U.S. 471, 482 (1968) (holding that damages resulting from the negligence of a receiver acting within the scope of his authority as receiver give rise to actual and necessary expenses of a Chapter XI

will be repaid as an administrative expense.[137] Furthermore, unlike the trustee of a traditional trust, but like a trustee of a statutory business trust,[138] the bankruptcy trustee—including the debtor in possession—does not incur personal liability for the activities of the trust unless the trustee violates its duties of loyalty and care.[139]

The bankruptcy trust has all of the attributes of a business trust that constitutes a legal person. Although it is not created by an express agreement, private parties may create a bankruptcy trust by filing a bankruptcy petition. A trustee in control of trust assets conducts a business, albeit a specialized type of business, of gathering property of the estate and either liquidating or reorganizing the debtor and its assets.[140] In the course of this business activity, the bankruptcy trust incurs liability as an enterprise.[141] It is more than just a relationship between the trustee and the beneficiaries of the trust.[142] It is more than just a judicial officer in control of specified assets.[143] It has an existence separate from its settlor, its trustee, and its beneficiaries. Accordingly, the bankruptcy trust should be treated as a legal person.[144]

III. THE SIGNIFICANCE OF THE BANKRUPTCY TRUST

Courts and scholars disagree about the status of the bankruptcy estate as a separate legal entity. Many scholars have stated, as a

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arrangement).

137. *See* 11 U.S.C. § 364(a), (b), (c)(1).

138. *See supra* note 59 and accompanying text.

139. *See, e.g.*, Tenn-Fla Partners v. First Union Nat'l Bank, 229 B.R. 720, 737-38 (Bankr. W.D. Tenn. 1999) (affirming the revocation of a confirmed plan for reorganization because of the failure of the debtor in possession to disclose a contract to purchase the primary property item in the estate and affirming an award of $90,000 compensatory damages plus attorneys fees, but not punitive damages, against the debtor in possession); *In re* McRae, 181 B.R. 866, 869 (Bankr. S.D. Tex. 1994) (holding that, when debtor in possession abuses his fiduciary duty to bankruptcy estate by misappropriating funds intended for use of the estate, the estate does not have constructive receipt of those funds, and debtors are personally liable for any taxes on such income); *In re* Rollins, 175 B.R. 69, 73-78 (Bankr. E.D. Cal. 1994) (surcharging Chapter 7 trustee $22,378.41 for negligence in breaching his duty of care that caused a loss to the creditors); *supra* note 83.

140. *See generally supra* notes 93-132 and accompanying text.

141. *See supra* notes 133-39 and accompanying text.

142. This feature distinguishes the bankruptcy trust from the traditional trust. *See supra* notes 65-66 and accompanying text.

143. *See id.*

144. The taxation of the bankruptcy trust is not relevant to the status of the bankruptcy trust as a legal person. *See supra* note 51.

general proposition[145] or in specific contexts,[146] that the bankruptcy estate is a new entity separate from the debtor. Many courts have also relied on the estate as a new entity to reach conclusions on specific issues.[147] On the other hand, one scholar has argued that the bankruptcy estate is not a separate legal person.[148] One court has also held that the estate is not a new entity.[149]

The Code does not expressly create the estate as a legal person with power to act on its own behalf. The estate by definition is a collection of property interests[150] under the control of the bankruptcy trustee. Therefore, one could argue that the estate is not a separate legal person. However, the Code, on occasion, uses language that

145. *See* CHARLES J. TABB, THE LAW OF BANKRUPTCY § 5.1, at 271 (1997) (describing the estate as a separate and distinct legal entity); ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 220 (3d ed. 1996) (commenting that the creation of the estate is "as if a new corporation or a new trust had been established"); ELIZABETH WARREN, BUSINESS BANKRUPTCY 41 (1993); Donald P. Board, *Retooling "A Bankruptcy Machine That Would Go of Itself"*, 72 B.U. L. REV. 243, 260-63 (1992) (reviewing DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY (2d ed. 1990)); Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 721-22, 769-72 (1991).

146. *See, e.g.*, Jesse M. Fried, *Executory Contracts and Performance Decisions in Bankruptcy*, 46 DUKE L.J. 517 (1996) (referring to the status of the bankruptcy estate in the context of executory contracts).

147. *See, e.g.*, *In re* Osborn, 176 B.R. 217, 219 (Bankr. E.D. Okla. 1994) (holding that a malpractice action against an attorney hired by a debtor in possession belonged to the estate and not to the debtor personally; debtor, however, may exempt that portion of the cause of action relating to the homestead exemption); Patton v. John Deere Co. (*In re* Durham), 87 B.R. 300, 302 (Bankr. D. Del. 1988), *discussed infra* Part III.B; *In re* Strangis, 67 B.R. 243, 246 (Bankr. D. Minn. 1986) (holding that the estate is an "entity wholly separate" from a Chapter 7 individual debtor, and therefore, a settlement agreement by creditor in a non-bankruptcy proceeding releasing the debtor did not preclude payment from the estate of claims filed by that creditor in the bankruptcy case); cases cited *infra* notes 158 & 160.

148. *See* Stephen McJohn, *Person or Property? On the Legal Nature of the Bankruptcy Estate*, 10 BANKR. DEV. J. 465, 470-71 (1994).

149. *See* Snell & Wilmer, L.L.P. v. Segal (*In re* Hansen, Jones & Leta), 220 B.R. 434, 453 (Bankr. D. Utah 1998). In this case, the court held that the "estate" is not a new entity and, therefore, cannot be a client to whom the attorney hired by the debtor in possession owes fiduciary duties. *See id.* at 451. The court relied on the definition of the estate as a collection of property interests and on the fact that, in some cases, the estate is not a separate taxable entity. *See id.* at 60. Reliance on the taxation of the estate, however, was erroneous. The taxation of an entity is not an indicator of the status of the entity as a legal person. *See supra* note 51.

150. *See supra* notes 69-71 and accompanying text.

suggests that the estate acts as a legal person.[151]

The confusion about the status of the estate increases when there is a debtor in possession. When a person separate from the debtor acts as trustee, there is a clear separation between the debtor and the post-petition bankruptcy trust controlled by the trustee. When the debtor is acting as debtor in possession, the separation between the debtor and the bankruptcy trust is less apparent. The control of the estate by the debtor in possession sometimes blinds courts to the distinct roles of the pre-petition debtor and the post-petition debtor in possession.[152] The plain language of the Code that the debtor in possession is the debtor and the ruling by the United States Supreme Court in *NLRB v. Bildisco*[153] that the debtor in possession is the same entity as the debtor also causes courts to fail to appreciate the distinction. Other courts, however, fail to honor the definition of the debtor in possession as the debtor and rely on the debtor in possession as an entity separate from the debtor to resolve legal issues.[154] An excellent illustration of this confusion appears in the dictum of one state court, turning the debtor in possession on its head, stating that the "debtor and the debtor in possession, while remaining the same business entity, are no longer the same legal entity."[155]

Recognizing the existence of the bankruptcy trust resolves the

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151. *See supra* notes 72-73 and accompanying text.

152. *See infra* Part III.D-E; *infra* note 220 and accompanying text.

153. 465 U.S. 513, 528-29 (1984). In the relevant part of its opinion, the Court stated:

> For our purposes, it is sensible to view the debtor-in-possession as the same "entity" which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have employed absent the bankruptcy filing.

Id.

In this case, the debtor filed a Chapter 11 petition and as debtor in possession attempted to reject a collective bargaining agreement with a union. *See id.* at 518. The union argued that the debtor in possession could not reject the collective bargaining agreement without following the procedures required by the National Labor Relations Act. *See id.* at 519. The debtor in possession argued that it need not comply with that act, because, under the Bankruptcy Code, it was a different entity and was not a party to the collective bargaining agreement. *See id.* at 521. The Court rejected the argument that the debtor in possession is a different entity from the debtor and, therefore, not a party to a collective bargaining agreement. *See id.* at 544. It allowed the rejection because it held that § 365 of the Code authorized the debtor in possession to reject the agreement notwithstanding the National Labor Relations Act. *See id.* at 524-30.

154. *See infra* notes 185, 200, 215, 232 and accompanying text.

155. Kernan v. One Wash. Park Urban Renewal Assoc., 713 A.2d 411, 416 (N.J. 1998).

conflicts about the status of the estate and the debtor in possession. The bankruptcy trust, not the debtor in possession, is the new legal person. The debtor in possession is the same legal person as the debtor. The debtor in possession, however, has a different role. It is the trustee of the bankruptcy trust with a fiduciary obligation to exercise its powers and duties not for its own benefit but for the benefit of the beneficiaries of the bankruptcy trust.

In some instances, the status of the bankruptcy trust will provide the basis for resolving specific issues that arise in a bankruptcy case. In other instances, recognizing the existence of the bankruptcy trust as the legal person will not answer specific questions but will help focus the issues. In these cases, courts should not simply rely on a determination of the status of the bankruptcy trust as a legal person but should conduct a thorough analysis of the relevant issues. The resolution of these issues requires an analysis of the powers that the bankruptcy trust may exercise as a successor in interest and the liabilities that it takes up.

The bankruptcy trust succeeds to almost all of the debtor's interests in property.[156] Its purpose is to provide for the payment of the allowed pre-petition claims of creditors.[157] The bankruptcy trust, whether it is operating the debtor's business or not, must also deal with claims that arise during the administration of the case.[158] The trustee needs time not only to identify what the estate's assets and pre-petition debts are, but also to decide whether the bankruptcy trust should become liable on post-petition obligations. The provisions of the Code and the dictates of sound bankruptcy policy, not the simple reliance on the status of the estate or the debtor in possession or, for that matter, the bankruptcy trust as a legal entity, should determine the answers to these issues.[159]

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156. *See* 11 U.S.C. § 541(b) (1994) (providing for exceptions).

157. *See* Fried, *supra* note 146, at 518.

158. *See id.*

159. A good example of the analytical approach is the Supreme Court's decision in *NLRB v. Bildisco & Bildisco*. 465 U.S. 513, 530-32 (1984); *discussed supra* note 151. Another example is the debate by Michael Andrew and Professor Jay Westbrook about the liability that the bankruptcy trust should have on executory contracts before the trustee assumes or rejects them. Michael Andrew stated in his analysis of executory contracts that the bankruptcy estate is a new entity that is not obligated on an executory contract until the trustee assumes the contract. Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 59 U. COLO. L. REV. 845, 851-55 (1988) [hereinafter *Understanding Rejection*]; Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1, 24 (1991) [hereinafter *A Reply*]. Professor Westbrook, on the other hand, questioned the courts' use of the estate as a new entity to resolve issues arising in the rejection of executory

The following discussion shows how the existence of the bankruptcy trust either resolves specific issues[160] or clarifies the application of the Code and bankruptcy policies to resolve other issues. The discussion also shows how the failure to recognize the separate existence of the bankruptcy trust has caused faulty judicial analysis of the Code.

A. *Federal Bankruptcy Jurisdiction*

Most significantly, the existence of the bankruptcy trust as a legal person furnishes the essential element to the constitutional foundation for federal bankruptcy jurisdiction. Professor Ralph Brubaker has noted that neither the United States Supreme Court nor scholars have developed a satisfactory theory of the constitutional basis for conferring bankruptcy jurisdiction on federal courts.[161] He proposes a simple solution. The constitutional grant of jurisdiction to federal courts over "all Cases, in Law and Equity, arising under . . . the Laws of the United States"[162] includes jurisdiction over cases involving a juridical person created by federal law.[163] The United States Supreme Court so held in *Osborn v. Bank of United States*[164] when it sustained the jurisdiction of the federal cir-

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contracts. Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts,* 74 MINN. L. REV. 227, 235-36 (1989). Michael Andrew pointed out in response that Professor Westbrook had elsewhere characterized the estate as a separate entity. Andrew, *A Reply, supra,* at 24 n.116. Nevertheless, Professor Westbrook's purpose was not to address specifically the status of the estate as an entity. Instead, he decried courts' reliance on the status of the estate instead of a complete analysis of the specific issues that arise. *See* Westbrook, *supra,* at 235-36. In any event, despite their conceptual differences, both ground their arguments not on the status of the bankruptcy estate or bankruptcy trust but on a detailed analysis of the language of the Code and the policies behind the Code. *See* Andrew, *Understanding Rejection, supra,* at *passim*; Westbrook, *supra,* at *passim*; Andrew, *A Reply, supra,* at *passim.*

160. *See In re* SeaEscape Cruises, Ltd., 201 B.R. 321 (Bankr. S.D. Fla. 1996) (holding that, because the bankruptcy estate is a separate legal entity, the fee due the United States Trustee under 28 U.S.C. § 1930(a)(6) (1994) in Chapter 11 cases must be calculated only on disbursements of the estate under a confirmed plan and not from disbursements by the debtor reorganized pursuant to the plan). In addition, Korobkin's vision of bankruptcy depends on recognizing the bankruptcy trust as a legal person and not a collection of assets. Korobkin, *supra* note 145 at 721-22, 769-72.

161. Brubaker, *supra* note 7, at 800-13.

162. U.S. CONST. art. III, § 2, cl. 1 (stating that "[t]he judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority").

163. *See* Brubaker, *supra* note 7, at 813-16.

164. 22 U.S. 738, 824 (1824).

cuit court over litigation involving the Bank of the United States,[165] an entity chartered by the United States and owned substantially by private persons.[166]

The United States Supreme Court confirmed the extent of this federal jurisdiction when it ruled, in the *Pacific Railroad Removal Cases*,[167] that federal courts had jurisdiction over cases involving privately owned railroad corporations organized under federal law.[168] In Professor Brubaker's view, federal courts may have jurisdiction over bankruptcy matters because the bankruptcy estate is an entity created by federal law under *Osborn* and the *Pacific Railroad Removal Cases*.[169]

I find Professor Brubaker's constitutional analysis both elegant and persuasive. However, I believe it is more accurate to say that the bankruptcy trust is the federal entity for jurisdictional purposes. By definition, the estate is a collection of assets, and this definition undermines the logical grounds for making the bankruptcy estate a legal person for federal jurisdiction.[170] The bankruptcy trust is a legal person created specifically pursuant to federal law. In this context, it has all of the attributes of a privately owned railroad chartered under federal law[171] or a national banking association charted under the National Bank Act.[172] Under the Constitution, federal

165. *See id.* at 828.

166. *See* Act of April 10, 1816, ch. 44, § 1, 3 Stat. 266, 266 (authorizing the subscription of 350,000 shares of stock of the Bank of the United States, 70,000 shares to be held by the United States and 280,000 shares to be subscribed and paid by private persons); *id.* § 7, 3 Stat. at 269 (creating the bank as a corporation and body politic).

167. 115 U.S. 1, 13-14, 16-17 (1885) (holding that suits against corporations organized under federal law were suits arising under the laws of the United States within the meaning of U.S. CONST. art. III, § 2, cl. 1, noting that the federal law governed the existence, powers, functions, and duties of the corporations); *see id.* at 24 (Waite, C.J., dissenting) (stating that he does not doubt "the power of congress to authorize suits by or against federal corporations to be brought in the courts of the United States," but concluding that the particular statute did not do so); WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE, JURISDICTION AND RELATED MATTERS § 3571, at 176 (2d ed. 1984).

168. Congress later reduced this jurisdiction, and federal courts by statute now have jurisdiction over national banks and other federal entities "arising under" federal law in only limited circumstances. *See* WRIGHT ET AL., *supra* note 167, § 3571, at 176.

169. Brubaker, *supra* note 7, at 813-31. Professor Brubaker also explains why relying on the separate bankruptcy trustee as the federal entity is misleading and incomplete. *Id.*

170. *See supra* notes 69-71 and accompanying text.

171. *See, e.g.*, Act of July 1, 1862, ch. 120, 12 Stat. 489, 490 (1862) (authorizing the incorporation of the Union Pacific Railroad Co.).

172. *See* 12 U.S.C. § 21 (1994) (authorizing the formation of a national

courts could have jurisdiction to hear cases involving the bankruptcy trust because these cases arise under federal law.[173]

B. *Insurance Proceeds as Security Interest Proceeds*

Patton v. John Deere Co. (In re Durham)[174] illustrates how the existence of the bankruptcy trust as a legal person resolves a specific controversy—whether insurance payable to a debtor in possession constitutes proceeds of collateral subject to a pre-petition security interest. This case also illustrates how the bankruptcy trust clarifies the different status of the estate, the debtor, and the debtor in possession. In this case, the debtor had granted a secured party a security interest in equipment.[175] It then filed a Chapter 11 petition and used estate funds[176] to insure the equipment. After the equipment was destroyed by fire, the secured party claimed that the insurance payable to the debtor in possession was subject to its security interest.[177]

Under Section 9-306(a) of the Uniform Commercial Code, currently in effect in every state,[178] insurance payable on collateral subject to a security interest constitutes "proceeds" of the collateral subject to that security interest, with one important exception.[179] If the insurance is "payable to a person other than a party to the security agreement," the insurance does not constitute security interest

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banking association by more than four natural persons by entering into articles of incorporation).

173. Although I have used the term "bankruptcy courts" to include all courts deciding bankruptcy matters, there is an important distinction between United States bankruptcy courts and the other federal courts. Bankruptcy judges are not appointed by the President for life terms but instead are appointed by the judges of the courts of appeal for 14 year terms. *See* 28 U.S.C. § 152(a)(1) (1994). Therefore they are not "judges" within the meaning of Article III of the Constitution. U.S. CONST. art. III, § 1. Bankruptcy judges and their courts are created pursuant to the Bankruptcy Clause. *See generally* Thomas E. Plank, *Why Bankruptcy Judges Need Not and Should Not Be Article III Judges*, 72 AM. BANKR. L.J. 567, 569-75, 610-16 (1998) (discussing bankruptcy adjudication under the Constitution). Article III judges become involved only in specified circumstances, such as on appeal either to a United States District Court or to a United States Court of Appeals. *See id.* at 612-13, 616.

174. 87 B.R. 300 (Bankr. D. Del. 1988).

175. *See id.* at 301.

176. *See id.* The debtor in possession may use property of the estate in the ordinary course of business, and such use benefits not the debtor in possession but all the beneficiaries. *See* 11 U.S.C. § 363(b) (1994).

177. *See Patton*, 87 B.R. at 301.

178. *See* U.C.C. § 9-306(a) (1995) (the prior official text previously adopted in all 50 states); *see also* 3 U.L.A. 1-2 (1998).

179. *See* U.C.C. § 9-306(1).

"proceeds."[180] The secured party claimed that the debtor in possession—the payee—was a party to the security agreement because the debtor in possession is the same entity as the debtor.[181] Because the insurance was payable to the debtor, a party to the security agreement, the insurance did not satisfy the exclusion for insurance payable to a "person other than a party to the security agreement" and was subject to the secured party's security interest.[182]

The court disagreed. The court first stated that the bankruptcy estate was a new entity.[183] Further, asserting without explanation that *Bildisco*[184] was distinguishable, the court held that the insurance was payable to a different entity, the debtor in possession.[185] Because it was payable to "a person other than a party to the security agreement," the insurance did not constitute "proceeds" of the equipment subject to the secured party's security interest.[186]

Professor Stephen McJohn[187] cites this case as an example of confusion created by treating the estate as a separate entity. Be that as it may, the existence of the bankruptcy trust as a legal person explains why the result in this case is sound. That the debtor in possession was the same entity as the debtor is irrelevant. The insurance proceeds were payable to the debtor in possession as trustee for the bankruptcy trust. This is the same as if they were payable

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180. *See id.* This limitation on insurance as proceeds is continued in the 1999 revision of Article 9. *See* U.C.C. § 9-102(64)(E) (1999) (current official text, to be effective July 1, 2001, adopted in seven states as of January 2000) (stating insurance payable with respect to collateral constitutes proceeds "to the extent payable to the debtor [as defined in Article 9] or the secured party").

This limitation may seem peculiar. If D owns a property item subject to a security interest in favor of C and sells the property item to A, C's security interest in the property item continues. *See* U.C.C. § 9-306(2) (1995); U.C.C. § 9-315(a)(1) (1999). Similarly, if A sells the property, the proceeds from that sale will also be subject to C's security interest. *See* U.C.C. § 9-306(2) (1995); U.C.C. § 9-315(a)(2) (1999). Yet, if A insures the property item and does not name either C or D as an insured, C's security interest will not continue in any insurance payable on the property item. The provision on insurance proceeds was added in the 1972 revision to clarify that insurance payable on collateral subject to a security interest was proceeds, notwithstanding the general exclusion of insurance from the coverage of Article 9. *See* U.C.C. § 9-104(g) (1995). The purpose of limiting proceeds to insurance payable to a party to the security agreement was to ensure that the concept of proceeds does not interfere with the insurance contract. U.C.C. § 9-306(1), Official Reasons for 1972 Change, 3 U.L.A. 165 (1992).

181. *See Patton,* 87 B.R. at 302.

182. *See id.*

183. *See id.*

184. *See supra* note 153.

185. *See Patton,* 87 B.R. at 302.

186. *See id.*

187. McJohn, *supra* note 148, at 468 & n.16.

directly to the bankruptcy trust. The bankruptcy trust, a legal person, was not a party to the security agreement. The recognition of the bankruptcy trust as a legal person harmonizes (1) the fact that the estate is a collection of assets under the control of a trustee, the debtor in possession in this case; (2) the fact that the debtor in possession itself is the same entity as the debtor; and (3) the correct result that the beneficiaries of the bankruptcy trust and not the secured creditor should benefit from the insurance purchased with estate assets.[188]

C. *Setoff Against Post-Petition Contract Payments to Debtor in Possession*

The failure to recognize the separate existence of the bankruptcy trust has caused an unwarranted expansion of the setoff rights of creditors when a debtor in possession assumes an executory contract. A leading case committing this error is *United States v. Gerth*.[189] In that case, the debtor, Gerth, had entered into a contract with the Department of Agriculture by which the Department agreed to make payments for ten years to Gerth if he followed certain conservation practices on his farm.[190] The agreement also allowed the Department to set off against conservation payments due Gerth under the agreement any debts that Gerth owed the United States.[191] Two years after the agreement, Gerth filed a Chapter 12 petition and, as debtor in possession, assumed the agreement with the Department.[192] The Department filed a claim for amounts due for previous overpayments and asserted that it had the right under § 553 of the Code to set off against its claim the post-petition conser-

188. *Patton* does not represent the typical case. Usually, secured creditors insist that the debtor insure collateral subject to a security interest and require that the secured creditor be named as an insured. *See, e.g.*, WILLIAM C. HILLMAN, *Form 9.1 Commercial Security Agreement (Simple Printed Form)* § 3.(c), *in* COMMERCIAL LOAN DOCUMENTATION 179 (3d ed. 1990); WILLIAM C. HILLMAN, *Form 9.2 Security Agreement* § E.1, *in* COMMERCIAL LOAN DOCUMENTATION, *supra*, at 179. Further, the secured creditor of a debtor in bankruptcy is entitled to adequate protection of its security interest and, therefore, can require the debtor to procure insurance naming the creditor as an insured. *See* 11 U.S.C. § 363(e) (1994) (providing that the trustee may prohibit or condition the use of property in which an entity has an interest as necessary to provide adequate protection of that entity's interest). In *Patton*, none of these steps were taken because the secured party had purchased its own insurance that turned out to be inadequate. *Patton*, 87 B.R. at 301. It could have protected itself by insisting on adequate protection of its security and requiring the bankruptcy trust to name it as an insured party.

189. 991 F.2d 1428 (8th Cir. 1993).

190. *See id.* at 1430.

191. *See id.*

192. *See id.*

vation payments due under the agreement.[193] The debtor objected on the grounds (1) that the conservation payments due under the agreement were post-petition, not pre-petition, debts owed by the Department, and (2) that the conservation payments due under the agreement were owed to a different entity—the debtor in possession–and were not mutual debts owed to the debtor.[194] Accordingly, as the debtor argued, the setoff did not meet the requirements of § 553.[195]

The court of appeals sustained the position of the Department.[196] The court held that the Department's obligation to make post-petition conservation payments to the debtor in possession under the assumed agreement was a mutual pre-petition debt owed by the Department to the debtor.[197] This debt could be set off against the Department's pre-petition debt because the post-petition debtor in possession was the same entity as the pre-petition debtor.[198] This is wrong. The post-petition conservation payments due under the assumed contract are not owed to the debtor. They are owed to the bankruptcy trust. The bankruptcy trust earns the right to the conservation payments under the assumed contract by expending the estate's assets otherwise available to the beneficiaries, principally the unsecured creditors. The creditor should have no right to set off post-petition conservation payments due the bankruptcy trust[199]

193. *See id.*

194. *See id.* at 1430-31. Section 553(a) states that, with certain exceptions, Title 11 "does not affect any right of a creditor to offset a *mutual* debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case." 11 U.S.C. § 553(a) (1994) (emphasis added).

195. *See Gerth*, 991 F.2d at 1431.

196. *See id.* at 1431, 1436.

197. *See id* at 1436.

198. *See id.* The court also held that, because the agreement had been signed pre-petition, the Department's obligation to make post-petition conservation payments was a pre-petition claim, a somewhat questionable result. *See id.* at 1435. A difficult conceptual issue in bankruptcy that is beyond the scope of this Article is when a particular right to payment under a pre-existing contract that is contingent upon post-petition performance arises.

199. The conservation payments in contention are those due to the bankruptcy trust during the bankruptcy case. The reorganization plan would address how post-confirmation payments under the contract would be subject to setoff. The plan could provide that the contract would be assigned free of the setoff rights, or if the debtor retained the contract, the debt upon which the setoff rights would be based would be discharged. *See* 11 U.S.C. § 1123(b)(4), (5) (stating that a plan may provide for the sale of all or substantially all of the property of the estate and may modify the rights of holders of secured claims,

against the creditor's pre-petition claim. Recognition of the bankruptcy trust as a person, albeit under the control of the debtor as debtor in possession, avoids this misreading of § 553.

The conclusion of the court in this and other cases[200] contradicts both the letter[201] and spirit of the Code. Although the Code treats a creditor with a right of setoff as the holder of a secured claim to the same extent as a creditor with a lien,[202] these cases give a creditor with a right of setoff greater rights in property of the estate than a creditor with a lien would have. Under *Gerth*, the creditor with a right of setoff against the post-petition payments under the contract acquires a secured claim in property that becomes property of the estate after the commencement of the case. Those post-petition payments become property of the estate when the bankruptcy trust performs its obligations under the assumed contract. In contrast, the Code does not allow a creditor with a security interest in after-acquired property to acquire a comparable secured claim in property acquired by the bankruptcy trust, except property that constitutes

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including creditors with a right of setoff); § 1141(c), (d)(1) (stating that, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, and the confirmation of a plan discharges the debtor from any debt that arose before the date of confirmation).

200. *See* Farmers Home Admin. v. Buckner (In re Buckner), 218 B.R. 137, 146 (B.A.P. 9th Cir. 1998) (following Gerth and deeming Gerth the majority position); In re Mohar, 140 B.R. 273, 279 (Bankr. D. Mont. 1992); In re Allen, 135 B.R. 856, 868-69 (Bankr. N.D. Iowa 1992); In re Affiliated Food Stores, Inc., 123 B.R. 747, 749 (Bankr. N.D. Tex. 1991); In re Lundell Farms, 86 B.R. 582, 588 (Bankr. W.D. Wis. 1988); In re Ratliff, 79 B.R. 930, 933 (Bankr. D. Colo. 1987). But see In re Gore, 124 B.R. 75, 77-78 (Bankr. E.D. Ark. 1990) (stating that the debtor and the debtor in possession are not the same person for purposes of the mutuality requirement under § 553); In re Evatt, 112 B.R. 405, 414 (Bankr. W.D. Okla. 1989) (same), aff'd, 112 B.R. 417 (W.D. Okla. 1990); Walat Farms, Inc. v. United States (In re Walat Farms), 69 B.R. 529, 530 (Bankr. E.D. Mich. 1987) (same).

201. The debtor in possession may assume an executory contract because § 365 allows a "trustee" to assume an executory contract "of the debtor." 11 U.S.C. § 365(a). Moreover, the debtor in possession has the powers of a trustee. *See id.* § 1107(a). Thus, the statute contemplates that a person other than the debtor will use this power.

202. *See* 11 U.S.C. § 506(a). The provision reads:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim.

Id.

proceeds of property interests that the debtor owned before the petition.[203] There is no indication that Congress intended this disparate treatment.

An example will illustrate the disparate treatment. Assume that, under a contract assumed by the debtor in possession, the creditor owed the debtor $200 of pre-petition payments and would owe future payments of $100 per year for the next eight years. Assume also that the creditor had a claim against the debtor for $700. The elements of § 553 are met for the $200 pre-petition debt owed by the creditor, and the creditor has a right of setoff and a secured claim to the extent of the $200 in payments owed to the debtor against the creditor's claim of $700. If the debtor in possession assumes and performs the contract, it would be entitled to receive the $800 of future payments. However, with a right of setoff extending to post-petition payments, the creditor would acquire a secured claim at the rate of $100 a year for the remaining $500 of its claim to the extent that the debtor in possession continued to perform the contract, presumably using the assets of the estate.

Contrast this treatment with a creditor who has a claim of $700 secured by existing and after acquired-accounts of a debtor. As of the commencement of the case, assume that the debtor has accounts valued at $200. After the commencement of the case, the debtor in possession acquires accounts valued at $800 by selling property of the estate. Section 552 prevents the creditor from getting a security interest in those $800 of accounts.[204] There is no justification in bankruptcy policy for treating these two types of creditors with secured claims differently, and the Code does not create this disparate treatment.[205] Recognizing the existence of the bankruptcy trust and

203. *See, e.g., id.* § 552(a) ("Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case."). Subsection (b) provides that, with certain exceptions, if the debtor granted an entity a security interest in property of the debtor acquired before the commencement of the case and to proceeds, rents, product, offspring, or profits of such property, then the security interest extends to the proceeds, rents, product, offspring, or profits acquired by the estate after the commencement of the case. *See id.* § 552(b).

204. *See* 11 U.S.C. § 552, *quoted and discussed supra* note 203.

205. One might argue that this different treatment follows from the specific provisions of § 552(a) and that there is no comparable provision for setoffs. There are two answers to this argument. First, the situation covered by § 552(a) is much more common than that of a creditor with a right of setoff against post-petition payments under an assumed contract. Accordingly, that Congress addressed the more common situation does not imply that it intended to treat the less common situation differently. Second, the specific language of

the new role of the debtor in possession as the trustee of the bankruptcy trust would help courts see that a payment owed to a debtor in possession under an assumed contract performed by the debtor in possession is not a "mutual debt owing by such creditor to the debtor that arose before the commencement of the case"[206] under § 553.

D. The Strong Arm Power and the Knowledge of a Debtor in Possession

An isolated but prominent example of the error resulting from the failure to recognize the existence of the bankruptcy trust is *In re Hartman Paving*.[207] In this case, the United States Court of Appeals for the Fourth Circuit refused to apply § 544(a) as written. Section 544(a) gives the bankruptcy trustee the power to avoid a transfer that a hypothetical lien creditor or bona fide purchaser of real property could avoid, "without regard to any knowledge of the trustee."[208] In *Hartman*, however, the court held that a debtor in possession could not avoid a deed of trust that was ineffective against bona fide purchasers without actual knowledge, because the debtor had knowledge of the deed of trust and would not have qualified as a purchaser without knowledge.[209] The court was obviously uncomfortable allowing the debtor, as the debtor in possession, to avoid a security interest in real property that the debtor had created prepetition.[210] The majority—unlike the dissent[211]—failed to recognize that the debtor in possession was using the avoidance power not for its own benefit, but for the benefit of all of its creditors.[212] A recognition of the bankruptcy trust as a legal person, and an acknowledgment of the role of the debtor in possession as the trustee of the trust, should prevent these and other misapplications of the Code.[213]

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§§ 553 and 365—differentiating between debts owed to the debtor and assumption of contracts by the trustee does, analytically, produce the same result for a creditor asserting a right of setoff as § 552(a) does for a creditor with a lien.

206. 11 U.S.C. § 553, *quoted supra* note 194.

207. 745 F.2d 307 (4th Cir. 1984).

208. 11 U.S.C. § 544(a).

209. *Hartman*, 745 F.2d at 310.

210. *See id.*

211. *See id.* at 311 ("Hartman as debtor in possession does not avoid Pyne's lien as debtor; Hartman avoids it only in its role as trustee for all claimants against the debtor.").

212. Although avoiding the deed of trust would make the creditor unsecured, the debtor would not receive any benefit from recovering the transferred property unless all of the creditors were paid off. *See* 11 U.S.C. § 726.

213. Many courts, in fact, recognize the debtor in possession as a trustee operating for the benefit of creditors and interest holders. *See, e.g., In re* Osborn, 176 B.R. 217, 219 (Bankr. E.D. Okla. 1994).

E. Assumption of Non-Assignable Contracts

The attempted assumption by a debtor in possession of a non-assignable contract generates much of the confusion about the status of the estate and the debtor in possession. Section 365(c)(1)(A) provides that the trustee may not assume or assign any executory contract or unexpired lease of the debtor if applicable law excuses the other party to such contract or lease from accepting performance from or rendering performance to "an entity other than the debtor or the debtor in possession."[214] When a debtor who is a party to a non-assignable contract files for bankruptcy, the debtor as debtor in possession often tries to assume the contract. To prevent this assumption, some courts assert that the debtor in possession is a new legal entity[215] and for this reason may not assume the contract.

This result is right—but for the wrong reason. The debtor in possession is not a new entity. By definition, the term "debtor in possession" means the debtor unless a trustee is appointed.[216] Nevertheless, the debtor in possession has a new role as trustee of the bankruptcy trust. In such cases, the court is actually treating the bankruptcy trust as the new entity. Courts should rely less on the express characterization of the debtor in possession as a new entity and the implicit characterization of the bankruptcy trust as a legal entity and simply analyze the language of the Code. The status of the debtor in possession is irrelevant to the assumption of these non-

214. 11 U.S.C. § 365(c)(1)(A). The full text of § 365(c)(1)(A)-(B) reads:

> The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if— (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (B) such party does not consent to such assumption or assignment.

Id.

215. *See* Breeden v. Catron (*In re* Catron), 158 B.R. 624, 628 (Bankr. E.D. Va. 1992) (stating that a debtor in possession is a different legal entity than the debtor partner), *aff'd* 158 B.R. 629 (E.D. Va. 1992); *see also In re* West Elec., Inc., 852 F.2d 79, 83 (3d Cir. 1988) (applying the hypothetical test set forth in the statute but also stating that the use of the words "debtor or debtor in possession" in § 365(c)(1)(A) reflected Congress' "judgment that in the context of the assumption and assignment of executory contracts, a solvent contractor and an insolvent debtor in possession going through bankruptcy are materially distinct entities").

216. *See* 11 U.S.C. § 1101(1). The Supreme Court also rejected this claim in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527-35 (1984), *discussed supra* note 153 and accompanying text.

assignable contracts. The statute expressly establishes a hypothetical test for assumption: Could the other party to the contract refuse, under non-bankruptcy law, to accept performance from a third party?[217] If so, neither a separate trustee nor a debtor in possession may assume the contract.[218]

Some courts reject this "hypothetical" test.[219] They reason that Congress' insertion of the words "or the debtor in possession" in § 365(c)(1)(A) evidenced an intent to allow assumption by the debtor in possession of contracts that would not be assignable in or out of bankruptcy to a third party. These courts also rely heavily on the fact that the debtor in possession is not a new entity.[220] This reliance leads them to ignore the plain language of the statute and to conclude that the debtor in possession may assume the contract. It may well be that Congress intended to allow the debtor in possession to assume contracts during reorganization that it could not assign. This might help reorganization, but it also might prejudice the third party too much. In any event, Congress did not carry out this intention in the statute.[221] Courts should not rely on the identity of the debtor in possession to ignore the statute. They also should not ignore the fact that the debtor in possession, while the same person,

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217. *See* 11 U.S.C. § 365(c)(1)(A), *discussed supra* note 214.

218. *See, e.g.*, Perlman v. Catapult Entertainment, Inc. (*In re* Catapult Entertainment, Inc.), 165 F.3d 747, 750, 754 & n.9 (9th Cir. 1998) (applying the hypothetical test specified by the statute). In this case, the court specifically rejected reliance on the debtor in possession as a separate entity. *See id.* The court ascribed this reliance to *In re West Electronics, Inc.*, 852 F. 2d 89 (3d Cir. 1988), *discussed supra* note 215. *See Catapult Entertainment*, 165 F.3d at 754 n.8. The court also stated that this reliance was "subsequently discredited" in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527-29 (1984). *See id.*; *see also supra* note 153 and accompanying text. *Bildisco,* however, was decided four years before *West Electronics*.

219. *See* Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 493, 495 (1st Cir. 1997); Summit Inv. & Dev. Corp. v. Leroux, 69 F.3d 608, 613-14 (1st Cir. 1995); City of Jamestown v. James Cable Partners, L.P. (*In re* James Cable Partners, L.P.), 154 B.R. 813, 815 (M.D. Ga. 1993).

220. *See Institut Pasteur*, 104 F.3d at 493, 495 (stating that the debtor in possession is the same entity as the debtor and may assume a license agreement with licensor; approving plan in which the debtor in possession may sell its stock to licensor's prime competitor); *Summit*, 69 F.3d at 613-14 (rejecting the hypothetical test and noting that *Bildisco* diminishes "the legal 'fiction' that the pre-petition debtor and the post-petition debtor are to be treated as though they were *separate* legal entities"); *In re* Lil' Things, Inc., 220 B.R. 583, 587 (Bankr. N.D. Tex. 1998) (rejecting the "separate entity" theory of a debtor in possession and holding that a debtor in possession may assume a lease notwithstanding a state statute prohibiting assumption without the landlord's consent); *James Cable*, 154 B.R. at 815 (rejecting the hypothetical test for determining the applicability of § 365(c)).

221. *See also* 1 DAVID G. EPSTEIN ET AL., BANKRUPTCY § 5-15, at 475 (1992) (analyzing the assignability of executory contracts).

has a new role and owes new and different duties to the beneficiaries of the bankruptcy trust.[222]

F. Trustee Asserting Rights of Debtor's Management

A few circumstances seemingly invite the conclusion that the filing of the petition does not create a legal person. Professor McJohn, for example, has singled out the United States Supreme Court's holding in *Commodity Futures Trading Comm. v. Weintraub*[223] that a trustee for a corporation in a Chapter 7 case could waive the corporation's attorney-client privilege because the trustee represents successor management.[224] According to Professor McJohn, the trustee could do so only if the bankruptcy estate is not a separate entity from the pre-petition debtor.[225] Professor McJohn illustrates this point with the following example: if Corporation *A* (the pre-petition debtor) transferred all of its property to Corporation *B* (the putative estate as a separate entity), Corporation *B* could not waive Corporation *A*'s attorney-client privilege.[226]

As Professor McJohn acknowledges, however, the Court did not explicitly reject the separateness of the estate or the bankruptcy trust for its conclusion.[227] The Court's analysis was more subtle and is consistent with the status of the bankruptcy trust as a legal person. The Court analyzed all of the powers that the Code gives to the trustee over the debtor and noted that "the Bankruptcy Code gives the trustee wide-ranging management authority over the debtor. In contrast, the powers of the debtor's directors are severely limited."[228] To build on Professor McJohn's example, the Code does more than transfer the property from Corporation *A* to Business Trust *B*. The Code also requires Business Trust *B* to pay Corporation *A*'s pre-petition claims, allows Business Trust *B* to assume Corporation *A*'s ongoing business relationships, and empowers Business Trust *B*'s trustee to operate Corporation *A*'s business. The powers of the trus-

222. The court in *Summit Investment & Development Corp. v. Leroux* rejected the argument that a debtor in possession that remained a general partner in a partnership had inherently conflicting fiduciary duties to its co-partners and its creditors and, therefore, may not continue as a general partner by assuming a partnership agreement, but noted that the bankruptcy court could prohibit such assignment if it perceived an actual conflict of interest. *Summit*, 69 F.3d at 613-14.

223. 471 U.S. 343 (1985).

224. *See id.* at 353-55.

225. McJohn, *supra* note 148, at 499-500.

226. *Id.* at 499. The attorney-client privilege is not an interest in property, and the trustee does not acquire the right to exercise the attorney-client privilege as a successor in interest to Corporation *A*'s property.

227. *Id.*

228. *See Weintraub*, 471 U.S. at 353-55.

tee, the manager and operator of Business Trust *B*, to control Corporation *A* to the extent necessary to carry out the trust fully empower his waiving the attorney-client privilege for Corporation *A*.[229]

Other courts have also recognized the power of the trustee to perform specific acts of the debtor corporation in furtherance of the purposes of the bankruptcy trust.[230] This power creates some complexity. The filing of a bankruptcy petition by a corporation (or any legal person other than an individual) transforms the debtor into a person with a dual personality—a trustee and a non-trustee. In most instances, the trustee may use the powers of the corporation on behalf of the bankruptcy trust. Yet, the debtor corporation retains its own identity, and the officers and directors of the corporation may direct the debtor corporation to take actions on its own account. For example, when the bankruptcy trustee abandons property to the debtor, that property is no longer part of the property of the estate, and the debtor corporation is free to deal with the property as it pleases. Although the trustee retains control of the corporate debtor to use property of the estate, the management of the debtor may exercise control over the abandoned property. This complexity, however, is no greater than, and is analogous to, the normal complexity that arises when one legal person—an individual or an artificial entity like a corporation—assumes the role of a trustee and still retains the ability to do business for itself.[231] Accordingly, when a separate trustee for a debtor who is not an individual is appointed

229. One early decision relied on the separateness of the trustee from the pre-petition debtor and held that the trustee could not draw on a letter of credit issued to the debtor that required a certificate from the corporate secretary. *See* Farmer v. Crocker Nat'l Bank (*In re* Swift Aire Lines, Inc.), 30 B.R. 490, 495-96 (B.A.P. 9th Cir. 1983). This erroneous decision, no longer viable in light of *Weintraub*, results not from the conclusion that the bankruptcy trust is separate from the debtor in possession but from a failure to appreciate the role of the trustee in operating the debtor's business.

230. *See In re* Freedom Solar Ctr., Inc., 776 F.2d 14, 17 (1st Cir. 1985) (holding that a trustee is empowered to object, on behalf of debtor, to counsel's multiple representation of debtor, debtor's sole shareholder, and third party in bankruptcy case); United States v. Patrick, 916 F. Supp. 567, 571 (N.D.W. Va. 1996) (holding that a Chapter 11 trustee may consent to a police search of the property of the corporate debtor); Krystal Jeep Eagle, Inc., v. Bureau of Prof. & Occupational Affairs, 725 A.2d 846 (Pa. Commw. Ct. 1999) (holding that a Chapter 11 trustee may enter a plea of nolo contendere to violations of a criminal statute on behalf of a debtor corporation to preserve the assets of the estate instead of using the assets to litigate the criminal charges). *But see* JNC Companies v. Meehan, 797 P.2d 1, 3 (Ariz. 1990) (holding that a Chapter 11 trustee could not waive a corporate debtor's right to a jury trial or interfere with the corporate debtor's choice of counsel in a criminal matter).

231. *See, e.g.*, AMERICAN BAR FOUNDATION, MORTGAGE BOND INDENTURE FORM § 10.05, at 128 (1980) (authorizing trustee to become owner of bonds for which it serves as trustee and, subject to certain restrictions, to deal with the borrower as if it were not a trustee).

under the Code, the trustee may control that debtor to the extent necessary to carry out the trust.[232]

CONCLUSION

The bankruptcy trust resembles a business trust in many ways. The trustee (including the debtor in possession) operates the trust, either to liquidate the debtor's assets to pay the creditors' claims or to reorganize the debtor's affairs to repay those claims. The powers of the bankruptcy trust equal and surpass the powers of any business trust or other legal person created under non-bankruptcy law. The bankruptcy trust, like a business trust or other legal person, incurs liability for its activities. Because a business trust is recognized as a legal person, the bankruptcy trust should also be recognized as a legal person.

This recognition will provide the answers to some important bankruptcy issues. It provides an essential ingredient to a coherent theory for granting federal courts jurisdiction over bankruptcy. It answers other bankruptcy law questions that depend on understanding the status and identity of the estate or the debtor in possession. In other instances, it provides a framework in which bankruptcy courts can focus on and analyze the applicable wording of the Code and the policies behind it instead of manipulating vague notions of the estate or the debtor in possession as the same or different entities to reach their conclusions.

232. *See Weintraub*, 471 U.S. at 356-57 (noting that the trustee may not exercise the same control over a debtor who is an individual); *see also In re* McCourt, 12 B.R. 587 (Bankr. S.D.N.Y. 1981) (concluding a trustee may not exercise debtor's right to elect a statutory share of his deceased wife's estate).

The concept of the bankruptcy trust may also be helpful in analyzing issues that arise when an individual becomes a debtor in possession under Chapter 11. *See, e.g., In re* Durrett, 187 B.R. 413 (Bankr. D.N.H. 1995) (stating that an individual debtor in possession is a separate entity from the pre-petition individual debtor and, therefore, a Chapter 11 debtor's personal injury cause of action that arose after the filing of the petition was not property of the Chapter 11 estate). However, the role of the individual debtor in Chapter 11 implicates the prohibition of involuntary servitude under the Thirteenth Amendment. *See, e.g., In re* Cooley, 87 B.R. 432, 437-38 (Bankr. S.D. Tex. 1988) (giving a broad interpretation to the exclusion from property of the estate under 11 U.S.C. § 541(a)(6) (1994) of the earnings of a surgeon operating a sole proprietorship in Chapter 11 because of concerns about violating the Thirteenth Amendment's prohibition against involuntary servitude). Accordingly, an analysis of these issues must await another day.

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