

Uncertainty Continues Over Debtor's Right to Abandon Property

BY LORENZO MARINUZZI

The U.S. Bankruptcy Code (the Code) affords debtors and trustees many powerful tools intended to promote the key goals of bankruptcy—providing a debtor with a “fresh start” and recovering value for creditors. One of the tools is the power of a debtor or a trustee to abandon property of the estate under §554(a) of the Code. This section provides that “[a]fter notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.” This sensible power to effectively walk away from burdensome property is analogous to the power to reject economically burdensome contracts. It is completely appropriate and consistent with the goals of the Code.

But what happens, according to §554, after a trustee or Chapter 11 debtor in possession abandons property is unclear. We as practitioners are left with an undeveloped body of case authority that fails to answer the obvious question: now what? Whether one represents a municipality wondering who will be responsible for maintaining land that was abandoned by a debtor, or a secured creditor with a secured interest in abandoned real estate, practitioners are often left struggling with how to address the post-abandonment rights and obligations of their clients.

LORENZO MARINUZZI is global co-chair of the firm-wide business restructuring and insolvency group at Morrison & Foerster.



This confusion arises from a combination of factors. First, like many of the powers found in Chapters 3 and 5 of the Bankruptcy Code, they are equally available to debtors in Chapters 7 and 11. Like many of these special provisions, §554 does not distinguish between abandonment by a Chapter 7 trustee and a Chapter 11 debtor in possession. It does, however, say that “[u]nless the court orders otherwise, any property scheduled under section 521(a)(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title.” In the context of a Chapter 7 case, it would make sense that a trustee can abandon an asset to the debtor. A trustee is appointed in every case under Chapter 7 to administer the estate of a Chapter 7 debtor and acts distinct from the

debtor. In most Chapter 11 cases, however, the debtor continues to operate its business and maintain control over its assets as a debtor in possession.

This blanket granting of trustee powers to a Chapter 11 debtor in possession raises another source of the confusion. Many important provisions of the Bankruptcy Code reference a “trustee” as the entity that has the authority to perform certain acts. For example, §547(b) sets forth the trustee’s ability to recover preferential payments to the debtor’s creditors made within 90 days of the commencement of the debtor’s bankruptcy case—“[e]xcept as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property ...” The same is true of §365(a) which reads, “the trustee, subject to the court’s approval, may assume or reject

any executory contract or unexpired lease of the debtor.” The Bankruptcy Code contains many provisions that authorize acts by the “trustee”.

The drafters of the Bankruptcy Code clearly did not intend to make these broad trustee powers only available in a Chapter 7 case or in the rare instances where a trustee has been appointed in a Chapter 11 case under §1104. Instead, the powers of a trustee are vested in the debtor in possession by virtue of §1107(a), which provides that “a debtor in possession shall have all the rights ... and powers, and shall perform all the functions and duties, except the duties specified in §1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.”

In most instances, vesting a Chapter 11 debtor in possession with the powers of a trustee works seamlessly. Abandonment, unfortunately, is a rare exception. That is principally because §554(a) references both a “trustee” and the “debtor”. It is the trustee—as the administrator of the debtor’s estate—that can determine that an asset is of little use to the estate and abandon the asset “to the debtor ...”

But abandoning property “to the debtor” is confusing where the debtor in possession is doing the abandoning. Blanket application of the concept of abandonment to “the debtor” by courts does not quite work in Chapter 11 cases as it does in the case of an individual Chapter 7 debtor. Indeed, even in business Chapter 7 bankruptcy cases, where the debtor ceases to exist, practitioners are left to wonder about the ownership of the abandoned asset.

Some courts deem abandonment by a Chapter 11 debtor as surrendering property to the party with a “possessory interest” in the property. See *In re Jandous Elec. Constr.*, 96 B.R. 462, 466 (Bankr. S.D.N.Y. 1989). See also *In re First Magnus Fin.*, No. 4:07-BK-01578-JMM, 2008 WL 5101347, at *5 (Bankr. D. Ariz. Nov. 25, 2008) (confirming power to abandon personal property to secured creditor or lessor because “the legislative history and weight of authority holds that abandonment to a third party with a possessory interest is entirely proper,” vacated in part on other grounds, No. 4:07-bk-01578-JMM, 2009 WL 248020 (Bankr. D. Ariz. Jan. 30, 2009)).

But other courts in Chapter 7 cases have expressly rejected interpreting §554 in this manner or balked at directing abandonment to a third party. *In re Pilz Compact Disc.*, 229 B.R. 630, 638-39 (Bankr. E.D. Pa. 1999) (“Abandonment under Code §554 removes property from the bankruptcy estate and returns the property to the debtor as though no bankruptcy occurred... Although the legislative history indicates that property of the estate may be abandoned to any party with a possessory interest in the property, as well as to the debtor, such abandonment of the estate’s interest to a specific nondebtor entity is inconsistent with the concept of abandonment under the Code ... The determination

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of competing claims to the abandoned property must be made either by the state courts after abandonment, or by adversary proceeding procedure under Bankruptcy Rule 7001.” (3 Norton Bankruptcy Law and Practice 2d, § 53.1, at 53-2 to 53-4; 1997)).

Given the state of confusion, parties seeking to take ownership or control of abandoned assets are well advised to take additional steps as advised by the court in *Pilz Compact Disc*. In this way, a creditor or party in possession of assets can protect itself from future claims by creditors of the debtor.

But what happens to parties that wish to avoid any liability associated with the abandoned property? Does abandonment saddle a party with liability because they were “in possession” of the property at the time of abandonment? In *In re Contemporary Industries*, No. BK 98-80382 A, 1998 Bankr. LEXIS 2013 (Bankr. Neb. 1998), the debtor rejected a real estate lease for property on which it operated a retail gasoline station and sought to

abandon the underground gasoline storage tanks located beneath the premises. The landlord opposed the abandonment motion, arguing that the tanks can only be abandoned to an entity that has an interest in the property. The court refused to interpret §554 in such a manner and authorized the debtor to abandon the tanks. The court then suggested that the landlord’s remedy was to file a claim for the cost of removal of the tanks and for the cost of any environmental clean-up.

The court’s decision in *In re Contemporary Industries* leaves open the important question of whether the landlord is now deemed to be the owner of the abandoned property—and saddled with the liability of an owner—by virtue of the court’s order. The same question applies to equipment that may be housed in a warehouse at the time of abandonment and subject to the lien of a creditor. Typically, if the property had any value (but not enough for the debtor to utilize it), one might anticipate a fight over the property between the warehouseman (to enforce its lien) and the secured creditor, who may want to sell the equipment as scrap to obtain some value. But if the equipment has any risk of environmental liability, there may not be a rush to claim ownership. Then, to whom does the equipment belong? Is it the “debtor” to whom the “trustee” abandoned the equipment under §554(c)? Is it the warehouseman who was “in possession” of the property when the abandonment order was entered? Or is it the secured creditor that maintains “an interest” in the property? Might it even be the party that sold the equipment to the debtor? It is this uncertainty that presents the most glaring impact of the lack of developed authority on abandonment. As a practitioner, one can hope that courts take a closer look at the impact of abandonment on the rights and obligations of third parties and help clarify this uncertainty.