What Power Does and Should the Chapter 13 Debtor Have to Avoid Liens and Transfers?

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I. INTRODUCTION

Chapter 5 of the United States Bankruptcy Act1 grants powers to a trustee
(or a debtor in possession in a reorganization). The powers are to avoid certain
transfers of property, or preferential payments made or involuntarily suffered
by the bankrupt (or debtor) during specified times preceding and following the
filing of a bankruptcy petition.2 Chapter 5 applies to a Chapter 7, 11, 12 and
13 bankruptcy under the Act.3 Relief ranges from straight bankruptcies under
Chapter 7,4 to reorganization plans used primarily by business debtors under

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2. 1 COLLIER ON BANKRUPTCY ¶ 1.03[7] (Lawrence P. King et al. eds., 15th ed. 2002) [hereinafter COLLIER].
3. 2 id. ¶ 103.02.
4. 6 id. ¶ 700.01.
Chapter 11,\(^5\) to wage earner plans under Chapter 13.\(^6\)

Chapter 5 of the Bankruptcy Act grants the trustee power to avoid offending transfers and preferences.\(^7\) However, an anomaly appears in the Chapter 13 context in that there appears to be little, if any, incentive for the trustee to exercise the power. Distinct from straight bankruptcies and reorganizations under Chapter 11, the Chapter 13 trustee has no interest in maximizing the debtor’s estate; it benefits neither the creditors’ recovery, nor the trustee’s compensation to do so. This is the necessary implication of reliance on the debtor’s future earnings as the source of repayment of old debts. Further influencing the Chapter 13 trustee is the fact that trustee’s compensation is not based, directly or indirectly, on the size of the estate.\(^8\) As a result, Chapter 13 trustees may be somewhat apathetic. This trustee apathy has prompted some courts to permit the Chapter 13 debtor, as the party really representative of the estate and motivated to maximize it, to maintain avoidance proceedings.\(^9\)

A question arises as to whether the statute confers avoidance powers on the Chapter 13 debtor. In one context, it clearly does when the property to be recaptured is exempt from execution.\(^10\) However, this may be small consolation to a debtor struggling to continue to support a family while clearing up old debts. What if the debtor would merely use the recovered property or money to pay off the creditor body sooner or to emerge from the proceeding with a stake for the future? Here, lower courts disagree on whether the debtor can maintain the proceeding. Most courts of appeal have not yet spoken and the Supreme Court of the United States has not addressed the issue. Consequently, the more relevant question is whether the statute effectively and practically confers avoidance power on the Chapter 13 debtor.

This Comment argues that Congress should resolve the division among the lower courts by amending 11 U.S.C. \(\$\) 1303 to grant explicit standing to the

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5. 1 id. \(\$\) 1.03[4]. Often, there is not a trustee appointed in Chapter 11; instead, the debtor remains in control of its assets and business, though usually answerable to a committee of its creditors. Id.

6. Id. \(\$\) 1.03[6]. Wage earners’ plans contemplate that a debtor with a regular, though limited, source of income may work their way out of insolvency through disciplined application of future earnings. See id. The debtor's earnings are applied in part toward current living expenses and in part toward the retirement of the old debt. Id.

7. Id. \(\$\) 1.03[7].

8. See 3 id. \(\$\) 326.02[3][a].


10. Section 522 of the Code expressly provides the debtor with avoidance powers with respect to certain liens and transfers that impair exemptions. 11 U.S.C. \(\$\) 522 (2000); see infra Part IV.A.
Chapter 13 debtor to exercise the same powers of avoidance now given to the trustee. This standing could be exercised in instances when the trustee fails or declines to act on the debtor’s request to pursue avoidance of a transfer or preference. Although some courts construe such debtor standing into the present law, others do not. The arguments that have persuaded the latter (e.g., that the grant of express standing to recover exempt property implies denial of standing to pursue non-exempt property) are forceful. Yet, the conclusion derived from those arguments seems inconsistent with the objectives of the Bankruptcy Act in general and Chapter 13 in particular. The objectives of the Act are to provide relief to honest and worthy debtors while ensuring equitable treatment for creditors. By leaving the avoidance power confined in the hands of a trustee who is not likely to use it, creditors are effectively given a license to squeeze pre-bankruptcy wage earners unconscionably.

In making the argument that Congress should amend 11 U.S.C. § 1303, this Comment begins by analyzing the history and policy behind the statute. Second, it examines the avoidance powers in the Code and the differences between Chapter 7, Chapter 11, and Chapter 13. Finally, this Comment analyzes the Chapter 13 debtor’s avoidance powers and the defects in the Code that produce anomalous results in this area.

II. CHAPTER 13: HISTORY & POLICY

In 1978, Congress enacted the Bankruptcy Reform Act. Chapter 13, subtitled “Adjustment of Debts of an Individual With Regular Income,” was created as a part of this Act. Congress created Chapter 13 in reaction to information indicating that most debtors with a stable income would prefer to keep their assets and repay their debts rather than liquidate their assets and discharge the remaining debts. Though derived primarily from Chapter XIII of the former Bankruptcy Act, the reform was designed to relax the...
restrictions and formal nature of Chapter XIII in order to encourage debtors with regular income to "make greater . . . use of [this] repayment plan[]." The goal of Chapter 13 is to optimize the debtor's relief by allowing the debtor to retain existing assets, thereby employing its going-concern value while completing a trustee supervised repayment plan. In other words, Congress's intent in creating Chapter 13 was to improve "creditor recover[y], by enacting a simplified, expanded and more flexible chapter 13," thereby providing greater relief and a fresh start for the debtor.

III. AVOIDANCE POWERS

Two main objectives of bankruptcy law are: (1) debtor relief, commonly referred to as the "fresh start," and (2) the maximization of value and equitable treatment among similarly situated creditors. The primary means to achieve the first objective is the discharge of unsecured debt. An additional method for achieving debt relief is through the avoidance powers specifically provided to the debtor under § 522. One of the means provided to achieve the second objective is the "trustee's avoidance powers," provided for in Chapter 5 and expressly granted to the bankruptcy trustee or Chapter 11 debtor in possession. The trustee's avoidance powers allow for recovery or avoidance of, property that was previously transferred, to the extent that the transfer conflicts with what would have been fair and equal treatment of creditors from the same class.

"rehabilitate" rather than "liquidate." Id. at xxv.

18. 8 COLLIER, supra note 2, ¶ 1300.02.

19. Id.


24. 11 U.S.C. § 522(b) (2000); see infra Part IV.A.


These avoidance powers include: (1) the "'strong arm' power," enabling the trustee "to avoid security interests and mortgages that were not properly perfected [by] the date . . . the bankruptcy petition was filed,"27 (2) statutory lien avoidance;28 (3) avoidance of preferences, whereby payments made by debtors to unsecured creditors within 90 days of filing of the bankruptcy petition are avoidable because it is considered "'preferential;'"29 (4) avoidance of fraudulent transfers, such as those made with the intent to hinder, delay, or defraud any creditor, or those where the debtor received less than the equivalent value and was or became insolvent on the date that the transfer took place;30 and (5) post-petition transactions, whereby the trustee may avoid any

27. 7 COLLIER, supra note 2, ¶ 1100.08[1]; see 11 U.S.C. § 544 (2000). Perfecting a security interest in personal property by filing, taking possession, or other methods available in non-bankruptcy forum, insures the lien creditor priority status over subsequent lien creditors. 7 COLLIER, supra note 2, ¶ 1100.08[1]. Perfecting a mortgage interest in real property by recording insures the mortgagee priority status over a bona fide purchaser of the property. Id. "The filing of the bankruptcy petition gives the trustee the status of lien creditor and [that] of a bona fide purchaser of real property," thereby the ability to avoid the interests of the so-called predecessor lien or mortgage holder, subject to state perfection laws. Id.; see Little v. Duncombe (In re Duncombe), 143 B.R. 243, 245 (Bankr. C.D. Cal. 1992) superseded by statute as stated in Davisson v. Engles (In re Engles), 193 B.R. 23, 27-28 (Bankr. S.D. Cal. 1996) (finding state statute promulgated a fifteen day window by which bona fide purchaser may record purchase and not lose status to bankruptcy trustee who assumes status as hypothetical bona fide purchaser upon filing of a bankruptcy petition); Aikens v. City of Philadelphia, 100 B.R. 729, 732-33 (Bankr. E.D. Pa. 1989) (stating strict compliance with state indexing law regarding liens must be adhered to in order to avoid losing status to bankruptcy trustee as hypothetical bona fide purchaser).

28. See 11 U.S.C. § 545 (2000). The list of statutory liens that may be avoided include: those where the lien was not effective against the debtor before the commencing of a bankruptcy case; where the lien was not effective against the debtor before the debtor became insolvent; and those that are for failure to pay rent. Id.

29. See 11 U.S.C. § 547(b) (2000); Gordon v. Siems Rental & Sales Co. (In re M.P. Indus., Inc.), 215 F.3d 1320, 2000 WL 727772, *2 (4th Cir. 2000) (unpublished table decision). The time frame is extended to any payments made to an insider from 90 days to one year prior to the filing of the bankruptcy. 11 U.S.C. § 547(b)(4)(B). The trustee may avoid preferential transfers under § 547(b) of the Code, if it can be proven that the payment was (1) made "to or for the benefit of a creditor," (2) on an antecedent debt, (3) the debtor was insolvent at the time the payment was made, and (4) the payment provided more to said creditor than would have been provided under a Chapter 7 liquidation. 11 U.S.C. § 547(b); Arrow Elecs., Inc. v. Jootus (In re Kaypro), 218 F.3d 1070, 1073 (9th Cir. 2000); Jones Truck Lines, Inc. v. Cen. States, S.E. & S.W. Areas Pension Fund (In re Jones Truck Lines, Inc.), 130 F.3d 323, 326 (8th Cir. 1997).

transfers of the debtor's property made after the filing of a bankruptcy petition.\footnote{31}

Important to the exercise of the trustee's avoidance powers is that the trustee possesses the proper combination of the power, duty, and incentive to do so. The Chapter 7 trustee possesses all three. As to power, the Act expressly grants the Chapter 5 avoidance powers to the Chapter 7 trustee.\footnote{32} As to duty, the Chapter 7 trustee is charged with those duties necessary to achieve liquidation and distribution of the debtor's estate to the various creditors.\footnote{33} The trustee oversees all aspects of collecting the property of the estate, reducing it to money, and distributing it to the creditors in accordance with the Act.\footnote{34} Accordingly, the trustee, as a representative of the estate, has an affirmative fiduciary duty to maximize the estate's assets; failure to do so places the trustee at risk of personal liability.\footnote{35} “In a Chapter 7 case, the appointed trustee steps into the debtor’s shoes, taking control of the debtor’s assets and seeing that every effort is made to enhance the estate for full distribution to the creditors.”\footnote{36} Finally, as to incentive, trustees in Chapter 7 are compensated based on the value of the pre-petition estate distributed to claimants;\footnote{37} accordingly, the more assets the trustee recovers and disburses to creditors, the more the trustee is paid.

\footnote{31}{11 U.S.C. § 549(a) (2000). Subject to the limitations in subsections 549(b) and (c), section 549(a) grants the trustee the power to avoid any transfers of the debtor's property made after the filing of a petition for bankruptcy. 11 U.S.C. § 549(a)-(c) (2000). See generally Commonwealth Mortgage Co. of Am. v. Konowitz (In re Konowitz), 905 F.2d 55, 56 (4th Cir. 1990) (involving a § 549(c) exception—purchaser's interest must have been perfected prior to judicial ratification of a post-petition foreclosure sale to enjoy use of exception to fraudulent transfer avoidance).}

\footnote{32}{Section 103(a) of the Code, subtitled “Applicability of Chapters,” reads in pertinent part: “chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title.” 11 U.S.C. § 103(a) (2000).}

\footnote{33}{See 11 U.S.C. § 704(1) (2000); 6 COLLIER, supra note 2, § 704.02.}

\footnote{34}{See 6 COLLIER, supra note 2, § 704.01-.13 (providing a detailed analysis of the duties and responsibilities of a Chapter 7 trustee as prescribed by the Code).}


\footnote{36}{Ciavarella v. Russo (In re Ciavarella), 28 B.R. 823, 825 (Bankr. S.D.N.Y. 1983).}

\footnote{37}{The Chapter 7 trustee is paid 15 percent of the first $1,000 distributed, 6 percent of the distributions between $1,000 to $3,000, and 3 percent on amounts exceeding $3,000. See WEINTRAUB & RESNICK, supra note 17, § 6.08[5].}
In light of the foregoing, it is clear that the Chapter 7 trustee has the power, duty, and incentive to exercise the avoidance powers. Consequently, there is no anomalous result based on the distribution of these duties and powers.

Chapter 11 is a reorganization chapter designed primarily for business debtors in order to provide them an opportunity to continue business operations under a reorganization plan. It provides the debtor with unique features, including the ability to operate the business as a "debtor in possession." Under Chapter 11, a debtor in possession has most of the rights, duties, and powers of the Chapter 11 trustee. The duty to maximize the estate, however, is not specifically placed on the debtor in possession. The Chapter 11 debtor in possession, although not faced with the fiduciary duty to maximize the estate, nonetheless, may at times have the incentive to exercise the trustee avoidance powers. When such a situation arises, the debtor in possession possesses the power to do so. Thus, no anomaly exists as to the allocation of duties, powers, and incentives in the Chapter 11 context.

Under a Chapter 13 rehabilitation plan, the trustee’s function is primarily administrative: "evaluating proposed plans to ensure their compliance with the statutory provisions prior to recommending any plans for confirmation." Because the plan is not a liquidation plan as in Chapter 7, the trustee is not

38. 7 COLIER, supra note 2, ¶ 1100.01 (citing Toibb v. Radloff, 501 U.S. 157, 165 (1991)).

39. See id. ¶¶ 1104.02, 1107.01 ("Normally in Chapter 11 cases, the debtor remains in possession of its assets and continues to operate its business as it restructures and attempts to formulate a reorganization plan."). See generally 11 U.S.C. § 1104 (2000).

40. See 11 U.S.C. § 1107(a) (2000). See generally 7 COLIER, supra note 2, ¶ 1107.02 (providing a detailed analysis of the duties of the "debtor in possession"). The Chapter 11 debtor in possession is required to carry out most of the duties and responsibilities of what a Chapter 11 trustee would perform, if assigned. Id. at ¶ 1107.02[4].

41. The duties of the Chapter 11 debtor in possession mandated by § 1107 and enumerated in § 1106(a) do not include the duty under § 704(1) to "collect and reduce to money the property of the estate," which the Supreme Court has determined amounts to the fiduciary duty to maximize the estate. See supra note 35.


44. In enumerating the duties of the Chapter 13 trustee, § 1302(b) does not include the duty as required under § 704(1) to "collect and reduce to money the property of the estate." See 11 U.S.C. § 1302(b) (2000); 11 U.S.C. § 704(1) (2000). Furthermore, § 1306(b) reads "[e]xcept as provided in a confirmed plan or order confirming a plan, the debtor shall remain
charged with the duty to collect the assets of the estate, reduce them to money, and distribute the money to the claimants. In other words, there is no fiduciary duty imposed on the trustee to maximize the estate. Rather, the Chapter 13 debtor is allowed to retain all exempt and non-exempt assets in order to take advantage of their ongoing value.

There is little incentive for a Chapter 13 trustee to avoid liens and transfers. The Chapter 13 trustee is compensated based on the payments the trustee makes to creditors under the plan, but the funds to pay creditors may be derived from the debtor’s future earnings, not solely from pre-petition assets, or from property recovered through an avoidance action. Only if the assets recoverable through avoidance actions were such that the debtor’s disposable income was not adequate to fund the plan would distributions of the reconveyed assets be made, thereby enhancing the trustee’s compensation. In light of the foregoing, it seems clear that the Chapter 13 trustee, while possessing the powers to avoid liens and transfers, lacks the duty and, in most instances, incentive to exercise them.

This raises the question discussed below: whether the Chapter 13 trustee’s lack of duty and incentive to exercise the avoidance powers warrants the transfer of those powers to the Chapter 13 debtor, who does possess the incentive to exercise them.

IV. THE CHAPTER 13 DEBTOR’S ABILITY TO EXERCISE AVOIDANCE POWERS

The Code unequivocally provides limited powers to the Chapter 13 debtor to avoid liens and transfers through the use of § 522 exemptions. However,
there is no consensus in the courts as to whether the Chapter 13 debtor should possess the full grant of avoidance powers or the limited power to avoid liens and transfers that are exempt under § 522.

A. The Protection of Otherwise Exempt Property Through the Use of § 522

No real controversy exists in terms of whether the Chapter 13 debtor may make limited use of some avoidance powers through § 522 of the Code. Most courts, even when applying the plain meaning of § 1303,\(^{51}\) are willing to grant the Chapter 13 debtor the use of the trustee’s avoidance powers to the extent they are used in conjunction with the power given the debtor in §522(h). To the extent property would otherwise be exempt, § 522(h) permits the debtor to recover involuntary transfers of property that the trustee could have avoided, but failed to do so.\(^{52}\)

Additionally, § 522(f) provides explicit powers to the debtor to avoid judicial liens on personal property and non-possessory, non-purchase money security interests in certain consumer goods or tools of trade that would have otherwise been exempt.\(^{53}\) Unlike the power granted in § 522(h), this power is not specifically tied to whether the trustee could have avoided the lien or transfer but failed to do so.\(^{54}\)

The policy behind these provisions seems to track with the fresh start policy behind bankruptcy exemptions.\(^{55}\) If a creditor is able to beat the debtor to the courthouse and encumber otherwise exempt property, the purpose of the bankruptcy exemptions—to provide the debtor with a fresh start—would be obliterated.\(^{56}\) The effect of allowing Chapter 13 debtors to utilize these

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51. See Barclays Am. Mortgage Corp. v. Wilkinson (In re Wilkinson), 186 B.R. 186, 191 (Bankr. D. Md. 1995) (reasoning that § 544 “strong arm” power is not part of the list in § 1303, “[t]herefore, a plain reading of section 1303 indicates that a Chapter 13 debtor does not have the authority to exercise the ‘strong arm’ powers.”).


54. Section 522(f) reads in pertinent part: “the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled [to].” 11 U.S.C. § 522(f)(1). No where does the provision tie this power to whether the trustee acts or fails to act as in § 522(h). 11 U.S.C. § 522(h).

55. See supra note 21, and accompanying text.

provisions is to give them the benefit of avoiding judicial liens and transfers as if they had claimed exemptions under Chapter 7. This seems fair because the Chapter 13 debtor must pay the creditors what they would have received under Chapter 7 before the debtor can qualify under Chapter 13. Therefore, the debtor should not be deprived of the exemptions available under a Chapter 7 plan.

A distinction worth noting specific to Chapter 13, is that the avoidance is not accomplished until the creditor receives what it is entitled to under a confirmed plan and the debtor has received a discharge. This prevents the creditor from being deprived of the asset in the event the debtor's bankruptcy is dismissed and the creditor's lien is then reinstated. If the debtor sold the property between avoidance and dismissal of the case, the creditor would have nothing to show for the reinstated lien.

These powers, while valuable, obviously fail to provide the Chapter 13 debtor with the ability to fully avoid certain transfers or liens, irrespective of whether the property is exempt. Unfortunately for the debtor, full avoidance powers rest with the trustee by explicit statutory grant and most courts are unwilling to find an implied grant of avoidance powers for the debtor.

58. See supra note 50. This is termed the "best interests test," wherein the trustee in a Chapter 7 is required to maximize the estate by means that include avoiding liens and transfers that are in the "best interests" of the unsecured creditors. See 8 COLLIER, supra note 2, ¶ 1325.05[1]-[2]. This means that the Chapter 13 debtor must pay any given creditor the amount that would have been received under this test in a Chapter 7 liquidation plan.
61. In re Stroud, 219 B.R. at 390; see 11 U.S.C. § 1328(a) ("As soon as practicable after completion by the debtor of all payments under the plan . . . the court shall grant the debtor a discharge of all debts provided for by the plan . . . ."). But see 11 U.S.C. § 349(b)(1)(B) (2000) (stating that "any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) . . . is reinstated"). In re Stroud determined that this reinstatement would be worthless to the creditor if the debtor had received an avoidance of the lien, sold the property, and had his case dismissed. 219 B.R. at 389.
63. A somewhat novel approach could be argued: the basic nature of the Chapter 13 plan, in allowing the debtor to retain non-exempt assets, essentially provides that all the debtor's assets are, therefore, exempt, and the debtor needs the full compliment of available avoidance powers in order to protect them.
B. The Negative Approach: The Code Lacks an Express Grant to the Chapter 13 Debtor to Exercise the Trustee’s Avoidance Powers on Non-Exempt Property

The general rule stems from a strict reading of the Code: the Chapter 13 debtor lacks a statutory grant of authority to exercise the Chapter 5 avoidance powers. The exception to this general rule is the narrow grant of avoidance powers to the Chapter 13 debtor via the use of § 522(h). A strong argument...
for the negative approach lies in Congress’s express grant of powers to the Chapter 11 debtor in possession. Statutory interpretation is persuasive when one considers that Congress was obviously cognizant of the need to expressly grant trustee avoidance powers to the debtor in Chapter 11; thus, the lack of such a grant to the Chapter 13 debtor speaks for itself.

Beyond the obvious lack of any statutory grant to the Chapter 13 debtor previously discussed, there are other plausible arguments for denying the debtor these powers. One is that they were never meant to benefit the debtor; rather, they are preserved for the estate’s sake. Another, and building upon the first, is that the funding source to pay creditors is, for the most part, not derived from voidable liens and transfers. Therefore, the debtor should not be granted the authority to do so. A third argument is that any avoidance powers afforded to the debtor are specifically granted in § 522. This section provides the necessary powers to protect otherwise exempt property, thereby meeting the goals of the Code’s fresh start policy.

Unfortunately, these rules and rationales fail to provide an explanation for the anomaly presented by the Code in granting the Chapter 13 trustee the power to avoid liens and transfers without the concomitant duty, or at least the incentive, to exercise them. Furthermore, it is confusing how these rationales comport with the goals and policies of bankruptcy and, more specifically,
Chapter 13. This will be examined further after first exploring the affirmative approach in granting these trustee avoidance powers in full to the Chapter 13 debtor.72

C. The Affirmative Approach: The Protection of Property Without Regard to its Exempt or Non-Exempt Status—Allowing for the Independent Exercise of Avoidance Powers by the Chapter 13 Debtor

Notwithstanding that 11 U.S.C. § 1303 expressly grants the Chapter 13 debtor powers also conferred on the trustee, it does not grant the trustee avoidance powers.73 Nevertheless, some courts have deemed the debtor to have such powers74 on rationales ranging from: (a) inference caused by the absence of express withholding of such powers from the debtor;75 (b) suggestions in the legislative history of § 1303 that it was not intended to be exhaustive in its enumeration of the debtor’s powers;76 and (c) recognition that, in the singular approach taken by Chapter 13, the debtor’s ability to exercise such powers is intrinsic to the design and purpose of the Bankruptcy Act.77 One court states:

Since the Chapter 13 debtor remains in control of the assets of the estate and offers a plan for the payment of allowed claims out of future earnings or other future income and since the trustee’s functions are limited under Code § 1302 to administrative functions, in sharp contrast to the wide array of powers and duties available to Chapter 7 and 11 trustees, it is apparent that Congress intended an active role for the Chapter 13 debtor at the functional expense of the Chapter 13 trustee. A Chapter 13 trustee

72. The affirmative approach seeks out reasons to go beyond the literal reading of the text to provide an equitable solution in terms of whether the Chapter 13 debtor should be granted full use of the avoidance powers in Chapter 5.
75. See In re Einoder, 55 B.R. at 322.
76. See In re Ottaviano, 68 B.R. at 240-41 (quoting 124 CONG. REC. H11106 (daily ed. Sept. 8, 1978)) (stating that just because the Chapter 13 debtor is granted certain enumerated powers, this “‘does not imply that the debtor does not also possess other powers concurrently with the trustee’”).
77. See In re Einoder, 55 B.R. at 322-23.
would have little, if any, interest in avoiding a fraudulent transfer of a Chapter 13 debtor's residence. The debtor's interest in that result, however, is obvious. It is unlikely that Congress intending to permit a Chapter 13 debtor to preserve his home by curing defaults and reinstating mortgages on residential property also intended to limit the authority to avoid the fraudulent transfer of that residence to a trustee who, as noted, has minimal interest in the transfer.\textsuperscript{78}

In addition, a considerable number of decisions have granted full use of the trustee avoidance powers to the Chapter 13 debtor without articulating the basis for doing so.\textsuperscript{79}

\textsuperscript{78} In re Carr, 34 B.R. at 655 (citations omitted); see also Ciavarella v. Russo (In re Ciavarella), 28 B.R. 823, 828 (Bankr. S.D.N.Y. 1983) (stating Chapter 13 debtor most appropriate party to determine what, if any, avoidance actions will "further the . . . rehabilitative interests under the Chapter 13 plan").

\textsuperscript{79} See Thacker v. United States Lending Corp., 256 B.R. 724, 728 (Bankr. W.D. Ky. 2000) (acknowledging the fact that the courts are divided on the issue of Chapter 13 debtors possessing avoidance powers and adopting reasoning of the bankruptcy court that debtors may avail themselves of the use of the trustee's § 544 strong arm powers); In re Bonner, 206 B.R. 387, 388 (Bankr. E.D. Va. 1997) (holding that either trustee or debtor may exercise hypothetical lien creditor's rights and render a secured creditor unsecured); In re Reese, 194 B.R. 782, 787 (Bankr. D. Md. 1996) (indicating that inaction by trustee was held by same court in prior opinion to be "limited situations [where] courts have allowed Chapter 13 debtors to exercise avoidance rights'') (quoting Barclays Am. Mortgage Corp. v. Wilkinson (In re Wilkinson), 186 B.R. 186, 191 (Bankr. D. Md. 1995)); Rich v. Q.T.S. Corp. (In re Rich), No. 92 B23792, 93 A976, 1994 WL 527161, *2 (Bankr. N.D. Ill. 1994) (stating that inaction by the Chapter 13 trustee paves road to allowance of standing on part of debtor to seek avoidance action); Hernandez v. Cantu (In re Hernandez), 150 B.R. 29, 30 (Bankr. S.D. Tex. 1993) ("Chapter 13 debtor has standing to assert the trustee's avoidance powers in their entirety") (quoting McKeever v. McClandon (In re McKeever), 132 B.R. 996, 1004 (Bankr. N.D. Ill. 1991) and citing Robinson v. Taylor (In re Robinson), 80 B.R.455 (Bankr. N.D. Ill. 1987)) (note that McKeever is a Chapter 7 case that references the holdings in In re Einoder and In re Robinson to illustrate that the Chapter 13 reasoning in these cases, though valid, are distinguishable from analysis in a Chapter 7 case); Little v. Duncombe (In re Duncombe), 143 B.R. 243, 245 (Bankr. C.D. Cal. 1992) (stating that the court follows the majority view to allow Chapter 13 debtors § 544 avoidance powers); Reece v. Scharf (In re Reece), 117 B.R. 480, 482 (Bankr. E.D. Mo. 1990) (finding that the absence of any action by the trustee confers power on the debtor to exercise § 548 avoidance power); Aikens v. City of Philadelphia (In re Aikens), 100 B.R. 729, 732 (Bankr. E.D. Pa. 1989) (agreeing with the bankruptcy court that unperfected lien "is vulnerable to attack by the debtor, standing in the shoes of the trustee under § 545(2)"); Annis v. First State Bank of Joplin, 96 B.R. 917, 919 (Bankr. W.D. Mo. 1988) (analyzing the elements of avoiding a particular transfer at issue—debtor standing to bring the action is not even discussed—by inference, debtor has avoidance power). Freeman v. Eli Lilly Fed. Credit Union (In re Freeman), 72 B.R. 850, 854 (Bankr. E.D. Va. 1987) (holding chapter 13 debtor may exercise trustee avoidance powers where trustee fails to act).

It should be noted that while In re Hernandez and Annis have not been overruled, they are from the Fifth and Eighth Circuits, respectively, and both circuits have determined that the Chapter 13 debtor may only access the trustee avoidance powers via use of § 522. See
Although the affirmative approach has considerable merit, it remains vulnerable to the powerful negative arguments based primarily on the language of the text. \(^{80}\) Notwithstanding this roadblock, it would appear that Chapter 13 debtors are more appropriately stationed to ascertain whether avoidance of a lien or transfer will further the goals or their Chapter 13 plans. \(^{81}\) Some may argue, however, that the debtor’s best interests should not work to the detriment of the other participants in the bankruptcy process, such as the unsecured creditor. That, however, is not the argument being made; instead, the goal here is simply to encourage debtors to file Chapter 13 bankruptcies rather than Chapter 7 bankruptcies. This will not happen if the debtor cannot get a confirmable plan. Obviously the debtor, being the one in possession of the assets, is more aware of the importance of carrying out a successful plan. \(^{82}\) The Chapter 13 trustee, on the other hand, is not in a position to monitor the individual needs of any one particular plan. A Chapter 13 trustee is appointed by the United States Trustee and handles several hundred, even thousands, of plans at any given time. \(^{83}\) Based on the sheer number of plans, without any regard to the lack of financial incentive to seek avoidance actions, it is clear the trustee simply cannot stay abreast of the individual needs of the debtors. \(^{84}\)

At the risk of being overly simplistic, one illustration of the need for the debtor to have full avoidance powers, would be a situation where the debtor’s home equity lender has fixed a non-consensual lien on the primary residence and the trustee has failed to seek an avoidance action that, if undertaken, would be successful. For purposes of illustration, the debt is $40,000 and there is a homestead exemption available to the debtor of $15,000. \(^{85}\) Of course, under § 522, the debtor would be able to avoid the lien up to the $15,000 exemption amount. \(^{86}\) The remaining $25,000 of the lien, however, would survive. Therefore, if the debtor is unable to cure the default, the lender could still foreclose. If the debtor is subjected to a forced sale and receives only the $15,000 exemption, the debtor may be unable to secure alternative housing and

\(^{80}\) See supra Part IV.B.

\(^{81}\) See supra notes 78-79 and accompanying text.

\(^{82}\) See supra notes 16-19 and accompanying text.

\(^{83}\) For instance, in November of 1985 the Northern District of Illinois, in the Eastern Division alone, had 18,000 Chapter 13 cases pending that were being handled by only two trustees. In re Einoder, 55 B.R. at 323.

\(^{84}\) See supra notes 48-50 and accompanying text.

\(^{85}\) A discussion of homestead exemptions and whether a particular state follows the federal exemptions under the bankruptcy law or has opted out and follows its own state non-bankruptcy exemption laws in a bankruptcy situation, is beyond the scope of this article. It is sufficient to say that these options exist and the choices vary among the states.

\(^{86}\) See supra Part IV.A.
some of the future income that was originally slotted for payments to unsecured creditors may have to be diverted to housing needs. This could jeopardize the debtor's ability to obtain a confirmable plan. If, however, the debtor is able to avoid the entire lien and is not forced to sell, this by itself may save the plan. If not, the option to sell the property is always available. Furthermore, with the entire $40,000 now available, the debtor may still be able to secure a place to live and amply fund the estate in order to get the plan confirmed.

If the debtor is able to avoid the lien only up to the amount of the $15,000 exemption, then the Chapter 13 debtor is placed in a more compromising position due to the lack of a full avoidance action being undertaken. This could force the debtor to convert to a Chapter 7, which has several implications: (a) the avoidance action not sought by the Chapter 13 trustee and not available to the debtor under Chapter 13 will now be sought by the Chapter 7 trustee (at least, under this option, the debtor will receive the $15,000 exemption, plus the discharge of unsecured debt that under the Chapter 13 plan would otherwise have devoted to three, or possibly up to five years\(^87\) of future earnings toward paying off the debt);\(^88\) (b) the unsecured creditors, which includes those parties that had their liens avoided, will receive nothing more than what they would have received under the Chapter 13 plan had the avoidance been successful there;\(^89\) (c) the goal of bankruptcy law to promote Chapter 13 plans is undermined;\(^90\) and (d) the freshest start possible for the debtor has not been achieved.\(^91\) Any of these implications presents the problem associated with a literal reading of the text, causing some results to be anomalous, and in some cases absurd.

Using the hypothetical from above, imagine that the debtor is able to secure a confirmable plan—but only because the lien is avoided in full and the debtor is not subjected to a forced sale with the need to secure alternative housing. In this situation, whether it was the debtor or the trustee who initiated the avoidance action, what happens to the additional $25,000 beyond the exemption saved in the process? If the debtor can fund the plan with future earnings alone, the debtor emerges from the proceeding with a stake in the future. The additional $25,000 goes to the debtor, either in the form of

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87. Section 1322(d) limits the repayment plan to three years, except for good cause, it may be extended to five. 11 U.S.C. § 1322(d) (2000).
88. See supra notes 14-20 and accompanying text.
89. As to the unsecured creditors, the plan will provide what is required under a Chapter 7. See supra note 50. As to the secured creditors, this statement speaks for itself.
90. See supra notes 16-20 and accompanying text.
91. A debtor able to remain in possession of all assets, including non-exempt, which may include the ability to maintain equity, certainly has a fresher start than one stripped of all or some assets, and forced to start the equity building process over. Just the moving process alone, regardless of where, is considerably costly in the best of circumstances.
additional equity in the home or cash if the debtor decides to sell. Either way, it does not matter who avoided the lien—the trustee or the debtor—because the unsecured creditors would not benefit from the avoidance. Again, providing only the trustee with such power, while the net result when exercised by the debtor is exactly the same, is anomalous.

A strict reading of the Code results in anomalies and absurdities. Finding for the debtor in a situation similar to that described above is not only logical, but intellectually consistent with the policies and goals of the bankruptcy code. Admittedly, such a result does not comport with the wording of the statute, which strongly suggests Congress did not intend for the debtor to have standing to fully avoid liens and transfers irrespective of the exemptions involved.

Another serious anomaly in the strict reading of the Code lies in how the Chapter 13 debtor determines what the unsecured creditors would receive under a Chapter 7 liquidation plan. This amount, once determined, must then be factored into the Chapter 13 repayment schedule in order to get the plan confirmed. In confirming the plan, the court must take into consideration that the amounts to be received by unsecured creditors under Chapter 7 will include recovery of avoidance actions undertaken by the Chapter 7 trustee as required by the "best interest" test. This enhances the recovery percentage. These avoidances are critical to the calculation of what a creditor would receive under Chapter 7 and factored into what the Chapter 13 debtor must repay. Therefore, they should be available to the Chapter 13 debtor in the absence of any trustee action. In other words, if recovery under a liquidation plan is based on the value of property with full avoidance of transfers, preferences, and liens, and if the analysis of what the creditors should be paid under Chapter 13 is based

92. Furthermore, to touch on another puzzling aspect of a strict reading of the Code, there is an issue as to the obvious separation of powers and duties in the Chapter 13 context. The bankruptcy laws are fashioned around the conjunction of duties of a trustee and the powers granted to carry out those duties. This is evident in Chapter 7. There, the duties and powers are aligned. In contrast, the Chapter 13 trustee has the powers, but lacks the duty to employ them. See supra note 72 and accompanying text. It seems evident that Congress made a conscious effort to marry the trustee's powers with the duties to carry them out in Chapters 7. Yet, this duty/power relationship is lacking in the Chapter 13 arena. Consequently, the issue of avoidance powers with respect to the Chapter 13 debtor has been addressed on an ad-hoc basis for nearly a quarter of a century, unnecessarily leaving the country in a state of flux without the proper guidance from Congress or most of the higher courts.


94. See supra Part IV.B.

95. See In re Einoder, 55 B.R. at 323.

96. Id.

97. Id.; see supra notes 49, 57 and accompanying text.

98. In re Einoder, 55 B.R. at 323.
on full avoidance under Chapter 7, then full avoidance should be an option given to the debtor under Chapter 13. A holding to the contrary results in an absurdity created by the current construction of the Code.

In light of the foregoing discussion, there are excellent policy reasons for granting full use of the avoidance powers to the Chapter 13 debtor. Asset retention—exempt and non-exempt alike—is an obvious perk in filing a Chapter 13 repayment plan rather than a Chapter 7 liquidation plan. This perk provides incentive to file under Chapter 13, thus furthering the goals of bankruptcy law. The ability to protect these assets through the full use of avoidance powers ensures that this perk will remain an incentive to file under Chapter 13. Furthermore, the unsecured creditors' interests are protected in that these creditors are to receive no less than that which would be provided to them under Chapter 7; the secured creditors retain their liens, and, over the life of the plan, will receive the present value of their collateral (unless of course they are avoided, in which case they would have been in Chapter 7 as well). Just as important, providing the unambiguous statutory ability to protect assets through full use of the avoidance powers by the debtor in Chapter 13 will correct the anomalies and absurdities that the current literal construction of the Code presents and provide the proper guidance needed to resolve the division among the lower courts.

V. CONCLUSION

Literal adherence to the language of the Act offers results that are anomalous, sometimes absurd, and almost always inconsistent with the goals of the Bankruptcy Act. Yet, the cases that have carried out the objectives of the Act are subject to serious contradiction by reference to statutory language.

Congress should amend 11 U.S.C. § 1303 to confer explicit standing upon the Chapter 13 debtor to exercise the trustee avoidance power in the event the Chapter 13 trustee fails to act. Such an amendment will correct the ambiguous

99. *Id.* at 323.
100. See 8 COLLIER, supra note 2, ¶ 1300.02.
101. The goal of the legislature in 1978 was to relax the Code such that debtors had more incentive to file a rehabilitation plan under Chapter 13, rather than file a liquidation plan under Chapter 7. See supra notes 14-18 and accompanying text. Preserving the assets of the estate by avoiding liens and preferences will provide the incentive for a debtor to file for Chapter 13.
104. See supra notes 64-72 and accompanying text.
105. See supra notes 77-79 and accompanying text.
reading and anomalous results based on current construction of the text, resolve the division among the lower courts, and further provide a mechanism by which the objectives of the Bankruptcy Act can be met.