The Cost of Realization by a Secured Creditor in Bankruptcy

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The Cost of Realization by a Secured Creditor in Bankruptcy

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I. INTRODUCTION

The creditor holding a valid encumbrance or a perfected security interest as of the date of bankruptcy in the property of the bankrupt debtor traditionally has been granted a true priority status in the distribution of the assets of the bankrupt. Under the general scheme of the Bankruptcy Act, liens of secured creditors are to be satisfied in full from encumbered assets or their proceeds, after which the trustee marshals the remaining assets of the estate for the benefit of the general, unsecured creditors and distributes the proceeds upon liquidation according to the provisions of the Act. Al-

1. Section 1(28) of the Bankruptcy Act, 11 U.S.C. § 1 (28) (1970), defines a secured creditor as follows: "Secured creditor shall include a creditor who has security for his debt upon the property of the bankrupt of a nature to be assign able under this title. . . ." The term "secured creditor" is used in this Note in a reference to all types of conventional, consensual security interests in property of a bankrupt debtor, including real estate mortgages, security interests in personal property under the Uniform Commercial Code, and pre-Code security interests in personal property such as chattel mortgages.

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though the language of former section 67d of the Bankruptcy Act, providing specific protection for the lien of the secured creditor was not carried forward by the 1938 amendments, the requirement remains the same—present section 70 in effect provides that the trustee takes title subject to valid, pre-existing liens.  

Because the secured creditor is given priority status in bankruptcy proceedings, it is in the best interest of the general creditors, and the bankruptcy trustee as their representative, to minimize the amount of secured debt of the bankrupt. This goal can be accomplished in two ways. First, the trustee can exercise a wide variety of powers bestowed upon him by the Bankruptcy Act which are designed to avoid entirely the lien status of claimants. For example, section 70c gives the trustee the status of a hypothetical lien creditor as of the date of bankruptcy to eliminate the secured status of creditors whose liens are perfected subsequently, section 60 allows the trustee to attack as preferential the transfer of a security interest within four months of bankruptcy for an antecedent indebtedness, and sections 67d and 70e give the trustee the power to attack certain transfers of security interests as fraudulent conveyances.  

Secondly, if the secured creditor must be allowed to realize on his security interest, the impact on the general estate can be minimized by charging as much of the cost of the bankruptcy proceeding as possible against the secured creditor’s fund, for these costs must be paid before any distributions are made to general creditors.  

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2. Section 67d of the Bankruptcy Act of 1898, ch. 541, 30 Stat. 564 provided: Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this Act. See In re Vulcan Foundry & Mach. Co., 180 F. 671, 672-73 (3d Cir. 1910): Lienholders are therefore the virtual owners of the property pro tanto, and (as a general proposition) this substantial ownership is not to be disturbed without their consent. 

Bankruptcy proceedings take place in a court of equity, and it should always be remembered that holders of valid liens have a statutory right to preferred treatment. [emphasis added].  

3. Section 70(a) of the Bankruptcy Act, 11 U.S.C. § 110(a) (1970) provides: The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this title. . . . See In re Beardsley, 38 F. Supp. 799, 803 (D. Md. 1941) (stating that although the specific language of § 67d of the Bankruptcy Act of 1898 was not carried forward by the 1948 amendments, the requirement of the law remains the same).  

4. For a general discussion of the trustee’s power to invalidate security interests under the Uniform Commercial Code, see J. White & R. Summers, Uniform Commercial Code 864-98 (1972) [hereinafter cited as White & Summers].  

5. After any valid liens have been paid, the priority claims of § 64 of the Bankruptcy Act, 11 U.S.C. § 104 (1970), are satisfied. See notes 29-30 infra and accompanying text. Dividend distributions then are made to general creditors under § 65, 11 U.S.C. § 105 (1970).
method of minimizing the amount of claims of secured creditors gives rise to an important issue in the bankruptcy proceeding: to what extent is the secured creditor responsible for the costs and expenses incurred during bankruptcy? The resolution of this issue involves the balancing of two conflicting principles. On one hand, the secured creditor is first in priority and primarily entitled to the proceeds from the sale of his security; thus the general creditors, for whose primary benefit the bankruptcy proceeding is carried out, should bear the expenses of administration. On the other hand, it is a general principle of equity that expenses paid or incurred in the protection and preservation of liened assets should be paid or reimbursed by the lienor from the fund before it is distributed. Accordingly, a lienholder should bear that portion of the expenses of preserving and liquidating the encumbered assets which redounds to his special benefit, or which was incurred with his consent or at his direction.6 Unfortunately, the attempt to reconcile these principles has resulted in utter confusion. As stated by one commentator:

[H]ardly any phase of the bankruptcy law has been plagued with so many inconsistent generalities, irreconcilable rules and principles, disagreements between circuits and even within circuits (apparently without any awareness thereof) and loose, indiscriminate statement of rules and citations of authority.7

The unacceptable nature of the rules that have developed in this area and the importance of the problem in the current economy is underscored by two factors. First, the foreclosure costs in bankruptcy, which have always been relatively high, have become increasingly so in relation to less expensive, modern procedures such as the default and repossession features of the Uniform Commercial Code.8 The recent Congressional Commission on the Bankruptcy Laws of the United States recognized the inordinate expense of liquidation in bankruptcy as a major impetus for reform:

The procedures required by the Act in the sale of property of a bankrupt estate have been much criticized for the inordinate administrative detail and expense. The trustee must ordinarily obtain court approval in the form of an order permitting the sale; creditors must ordinarily be notified of any proposed sale; the property must ordinarily be appraised; the sale must ordinarily be a public sale; and the trustee’s sale is subject to approval or disapproval by the court. Not only are such procedures not conducive to getting the best price,

8. See notes 65-73 infra and accompanying text.
but the expenses frequently consume a substantial part of the proceeds obtained from the sale.9

According to the Bankruptcy Commission Report, of the $13,136,826 net realization in asset cases during fiscal 1969, 33 1/3% was distributed to secured creditors and twenty-five percent was consumed by administrative expenses.10 The expenses charged against the secured creditor's fund after sale of the assets in bankruptcy free and clear of liens11 even may consume entirely the proceeds of the sale.12 Secondly, during the recent economic downturn, the number of consumers and businesses resorting to bankruptcy has increased greatly. In October 1974, business failures increased by eighteen percent, reaching the highest level in any month since March 1971. The number of business failures for that month was the highest in eighty years.13 As creditors seek to realize on their security interests, and encounter the problem of who should bear the expense incurred, they may discover that the term “secured” does not adequately describe the ability to recover advances made to the bankrupt debtor.

Despite the confusing state of the law in this area, the increasingly inordinate expense of foreclosure in bankruptcy, and the pressures of the current economy, the question of how much of the cost of liquidation should be borne by the secured creditors has gone

9. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, 93d Cong., 1st Sess., pt. I, at 16-17 (1973). [Hereinafter cited as 1973 REPORT OF THE BANKRUPTCY COMM’N]. The primary suggestion by the Commission to alleviate this problem was to allow the trustee to sell the property of the estate without the necessity of compliance with excessive formalities. Thus § 5-203 of the act proposed in the Commission’s 1973 report would provide:

5-203 Sale of Property of the Estate.
(a) Sale of Property. The trustee may sell property of the estate in such manner as he determines to be appropriate without hearing or order of the court but subject to the giving of notice as provided in section 4-307(c)(3).

The Note to this § states:
Subdivision (a) is a sharp departure from the requirements of appraisal and court approval in § 70f of the present Act and Proposed Rule 606(a) and (b). The trustee is given discretion concerning method of disposition of the estate in order to maximize the return to creditors. 1973 REPORT OF THE BANKRUPTCY COMM’N, pt. II, at 190-91.

10. 1973 REPORT OF THE BANKRUPTCY COMM’N, pt. I, at 145. In terms of percentage satisfaction for secured creditors, statistics by the Administrative Office of the United States Courts show that in 1969 secured creditors had allowed claims of $49,082,828, but realized 76.4% of that amount. ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, TABLES OF BANKRUPTCY STATISTICS, table F6 (1969). Although a substantial portion of the remaining 23.6% may be attributed to costs assessed against secured creditors, the insufficiency of the secured assets to satisfy the asserted liens probably is also a factor.

11. See notes 23-25 infra and accompanying text.

12. See, e.g., In re Prindible, 115 F.2d 21 (3d Cir. 1940); In re Williams’ Estate, 156 F. 834 (9th Cir. 1907).

virtually unnoticed by commentators and reformers of the bankruptcy laws. This Note will attempt to analyze the various theories recognized by the courts—benefit to the secured creditor, consent, existence of a surplus or general fund, and cost of analogous proceedings in state court—in the determination of whether the cost of the bankruptcy proceeding should be assessed against the secured creditor, and, if so, how much of the cost should be assessed. The policy considerations underlying these theories, an expression of which is largely forgotten or ignored by the cases, will receive particular focus. Finally, a proposal for legislative action in this area will be set forth.

II. THE SECURED CREDITOR IN BANKRUPTCY: AN OVERVIEW OF THE PROCEEDING

Under Rule 601(a) of the Bankruptcy Rules the filing of a petition in bankruptcy operates “as a stay of any act or the commencement or continuation of any court proceeding to enforce . . . a lien against property in the custody of the bankruptcy court. . . .” Subdivision (b) of Rule 601 states that the stay will continue in effect until the bankruptcy case is closed, the property is abandoned or transferred, or the bankruptcy court allows termination or annulment of the stay. These provisions protect against interference with the bankruptcy court’s summary jurisdiction over property in the actual or constructive possession of the bankrupt as of the date of bankruptcy. The term “lien” as used in the Rule includes a consensual security interest in personal or real property, and the stay operates to prevent further judicial proceedings and nonjudi-

14. The 1973 REPORT OF THE BANKRUPTCY COMM’N does no more than mention the fact that the costs and expenses of bankruptcy are criticized as inordinate. See note 9 supra.
15. BANKRUPTCY R. 601(a).
16. BANKRUPTCY R. 601(b).
17. The Advisory Committee’s Note to Bankruptcy Rule 601 discusses the stay provision and bankruptcy court jurisdiction:

The first branch of subdivision (a) protects the custody of the bankruptcy court against interference by an attempt to enforce a lien, whether the attempt is by a judicial proceeding or by a nonjudicial mode of enforcement. Property is in the custody of the bankruptcy court if it is in the actual or constructive possession of the bankrupt at the date of bankruptcy. [citations omitted]. Insofar as such property is concerned, the rule is a substantially restricted statement of the much quoted and applied dictum of Mueller v. Nugent, 184 U.S. 1, 14 (1901), that “the petition is a caveat to all the world, and in effect an attachment and injunction.” Once the jurisdiction of the court has attached, any act or proceeding brought in another court to enforce a lien against such property cannot disturb the custody of the bankruptcy court without its consent. [citations omitted]. The automatic stay is thus a logical corollary of the bankruptcy court’s exclusive jurisdiction to deal with the property of the bankrupt within its custody from the date of bankruptcy.
18. Id.
cial modes of enforcement. Finally, Rule 11-44 provides for a similar stay against enforcement of liens after the filing of a petition under Chapter XI of the Bankruptcy Act.

Thus the secured creditor who has a lien on property of the bankrupt debtor when the petition is filed for straight bankruptcy or an arrangement under Chapter XI has four options:

1. If the collateral is already solely and properly in the secured creditor’s possession, he may disregard the bankruptcy proceeding, decline to file a claim, and rely solely on his security.

2. If the security was in the debtor’s possession when the petition was filed, and thus within the bankruptcy court’s jurisdiction, the secured creditor may file a proof of secured claim and request reclamation or permission to foreclose.

3. The secured creditor may surrender or waive his security and prove his claim as an unsecured one.

4. If the debt exceeds the value of the security, the secured creditor may avail himself of his security as indicated above and share in the general assets of the estate as to the unsecured balance.

Of course, in the majority of cases the secured creditor will be concerned primarily with recovery of his security since the debtor usually retains possession of the security. Resort to general assets of the estate normally results in little or no recovery.

Although the secured creditor’s claim to encumbered assets may be prima facie valid, the bankruptcy trustee may refuse to release the security and, instead, sell the assets free and clear of liens if: (1) there is an equity for the general estate over and above the amount of valid liens, or (2) the trustee believes that the lien may be proved invalid under local law or voidable under the Act.

19. Id.
20. Chapter XI R. 11-44.
23. According to the Advisory Committee’s Note to Bankruptcy Rule 606, the authority of the bankruptcy court to sell free of liens rests in case law. See Van Huffel v. Harkelrode, 284 U.S. 225 (1931). The bankruptcy court’s power is generally restricted, however, to the two grounds listed. See 4A Collier ¶ 70.89(1); A. Paskay, Handbook for Trustees and Receivers in Bankruptcy, in 11 Collier ¶ 14.014, at P-447 [hereinafter referred to as Handbook for Trustees]. The act proposed by the Commission on Bankruptcy in its 1973 Report would continue to allow the trustee to exercise this power:
24. 5-203 Sale of Property of the Estate
(b) Sale Free of Interests of Third Persons. The trustee may sell nonexempt property
The secured creditor is given notice and a hearing at which he can object to the sale free and clear of liens, but the bankruptcy trustee can exercise discretion over the secured creditor's objection. Refusal to release the security may constitute abuse of discretion, however, if there is no apparent basis for challenging the validity of the lien or the secured claim exceeds the value of the collateral. Upon sale of the encumbered assets free and clear of liens, the priority of the lienholders in the assets is transferred to the proceeds of the sale. Since the Bankruptcy Act was designed to leave intact the lien of the secured creditor, he is theoretically entitled to payment in full from the proceeds of the sale, as well as payment for attorney fees and interest on the principal in proper situations. A provision for attorney fees as a part of the lien is generally accorded the same validity and scope allowed by local law, unless allowance would contravene some positive provision of the Bankruptcy Act. The secured creditor also is entitled to payment of interest on the debt; interest usually is allowed to the date of bankruptcy, although there are certain exceptions: interest is allowed on a secured claim to the date of payment if the estate is solvent; if security held by the bankruptcy court produces income during administration of the estate, that income is used to pay post-bankruptcy interest on the secured claim; and when the value of security is more than sufficient to pay both principal and interest, interest is allowed to date of payment.

After full payment of the lien, and before any distribution is made to general creditors, the claims under section 64, which establishes various classes of priority claims, must be satisfied. Included in the first class are actual and necessary costs of preserving the estate subsequent to the filing of the petition, the fees for the Referee's Salary and Expense Fund, and costs and expenses of administration. After all of these priority payments are made, pro rata of the estate although subject to an encumbrance if (1) there is an apparent equity or (2) the validity of the lien . . . is in dispute.


25. See Standard Brass Corp. v. Farmers Nat'l Bank, 388 F.2d 86 (7th Cir. 1967).

26. See notes 2 & 3 supra and accompanying text.

27. See generally 6 Remington § 2605.1. In Rubenstein v. Nourse, 70 F.2d 482 (8th Cir. 1934), the holder of two promissory notes secured by the assets of the bankrupt sought enforcement of identical attorney fee provisions. The Eighth Circuit disallowed attorney fees as a part of the lien on the first note since the provision was void in Kansas, where the note was executed. The lien for attorney fees was allowed on the second note because the provision was valid under Missouri law.


30. See generally 3A Collier ¶ 64.101; D. Epstein, Debtor-Creditor Relations 256-61 (1973) [hereinafter cited as Epstein].
shares in the remainder of the estate are distributed to general creditors under section 65.

Despite this general scheme of distribution under the Act, equitable principles were developed early in the bankruptcy case law that require the secured creditor to pay certain costs and expenses associated with realization on his lien. In practical terms, this equitable exception reduces the amount of the proceeds payable to the secured creditor. The right of the trustee to assess such costs is asserted even when the security is released pursuant to an order granting a reclamation petition or a petition to foreclose. This equitable principle of assessment, however, has varied in statement as well as application, so that a secured creditor today is faced with a maze of theories which seek to explain the diminution of his preferred status.

III. THEORIES IN ASSESSING COSTS

In developing the case law around the equitable exception to the lienholder's preferred status, the courts have suggested various theories in the determination of whether to assess any costs at all, and, if so, which costs and to what extent. The primary theories considered are benefit to the secured creditor, consent to the sale free of liens, the existence of a surplus in the proceeds, and the analogous cost of foreclosing outside bankruptcy. These factors can be applied alone or in combination, but they do not necessarily produce consistent results. It is submitted that the major inadequacy of this area of bankruptcy law is the failure of the courts to examine or articulate any policy underlying the various rules which currently govern the outcome of cost assessment cases. The major emphasis in the remainder of this Note, therefore, will be on a critical evaluation of these rules in light of the policy underlying the treatment accorded the secured creditor by the Bankruptcy Act rather than concentrating on a synopsis of the case law.

A. Benefit to the Secured Creditor

The courts often state that, as a general rule, the secured creditor should not be charged with the expenses of bankruptcy administration. When costs have been incurred to protect or preserve the secured assets or to assist the secured creditor in realization on his security by a sale under the direction of the bankruptcy court, however, the courts also state that the secured creditor should bear that

31. See Oppenheimer v. Oldham, 178 F.2d 386 (5th Cir. 1949); In re Beardsley, 38 F. Supp. 799 (D. Md. 1941).
32. HANDBOOK FOR TRUSTEES § 14.107, at P-2514.
portion of the expenses which were of direct benefit to him.\textsuperscript{33} The Seventh Circuit Court of Appeals in \textit{Dreyfuss v. Klein}\textsuperscript{34} espoused this view as follows:

A lienholder normally should not be charged with administrative expenses. However, where expenses are incurred that primarily benefit the lienholder such expenses should be allocated to him in the proportion to the benefit he derives therefrom. When a lienholder alone derives the benefit then he alone should bear the expense. [Citation omitted.] To hold otherwise would be to compel general creditors to pay costs and expenses not incurred for their benefit but solely for the benefit of a third person.

This view is grounded on the equitable principle that provides that charges be levied only against those who have derived primary benefit.\textsuperscript{35} In addition, according to the equitable doctrine of unjust enrichment, the secured creditor should not be allowed to profit from expenditures by the bankruptcy court which led to realization on his lien when he would have had to foreclose anyway in another forum.\textsuperscript{36} One commentator has stated:

Certainly Congress had the right to change the forum in which lienholders might realize upon their securities, even to the extent of excluding all other courts, if the bankruptcy court has possession, and no sound reason exists for making out of the bankruptcy court a charity court in which lienholders can realize on their securities without the costs and expenses they would ordinarily be charged with in the state courts. . . .\textsuperscript{37}

Although the equitable rationale of unjust enrichment has strong appeal, the benefit approach has several drawbacks. The first problem is the difficulty in determining what is of actual benefit to the secured creditor. The potential costs which can be assessed are almost endless. Courts utilizing this theory have charged the secured creditor with his proportionate share\textsuperscript{38} of sale costs, such as advertising and printing fees and auctioneer’s fees,\textsuperscript{39} costs of preserving the assets, such as pumping water out of a ship,\textsuperscript{40} fees and commissions of the referee and trustee,\textsuperscript{41} and attorney fees of the

\begin{itemize}
  \item \textsuperscript{33} \textit{Dreyfuss v. Klein}, 257 F.2d 310 (7th Cir. 1958);
  \textit{In re Cheyenne Wells Elevator Corp.}, 266 F. Supp. 927 (D. Colo. 1967);
  \item \textsuperscript{34} 257 F.2d 310, at 312 (1958).
  \item \textsuperscript{35} \textit{In re Louisville Storage Co.}, 21 F. Supp. 897 (W.D. Ky. 1936).
  \item \textsuperscript{36} \textit{Note, Allocation of Expenses Incurred in a Bankruptcy Sale Free of Liens}, 53 \textit{COLUM. L. REV.} 845, 856-58 (1953).
  \item \textsuperscript{37} 6 \textit{REMINGTON} § 2610, at 144.
  \item \textsuperscript{38} When courts have referred to the proportionate share of expenses to be borne by the secured creditor they apparently assume that the benefit derived by the secured creditor from the sale is equivalent to the amount of secured credit over the value of the security. Thus, if the secured debt is 9/10 of the value of the secured asset, the creditor would realize 9/10 of the benefit of the sale and should pay 9/10 of the attendant costs.
  \item \textsuperscript{39} \textit{In re Beardsley}, 38 F. Supp. 799 (D. Md. 1941).
  \item \textsuperscript{40} \textit{In re Alaska Fishing & Dev. Co.}, 167 F. 875 (W.D. Wash. 1909).
  \item \textsuperscript{41} \textit{In re Beardsley}, 38 F. Supp. 799 (D. Md. 1941).
\end{itemize}
bankrupt debtor and trustee. Some courts have sought to limit this approach to costs exclusively for the benefit of secured creditors, but others have assessed costs according to the proportion of benefit derived.

The difficulty of determining what is for the benefit of the secured creditor gives rise to a second point: who bears the burden of showing which costs, and what portions thereof, are for the benefit of the lienholders? The courts are strangely silent on this point. This determination is likely to be of significance since a secured creditor who is required to disprove the benefit of any alleged costs will not have immediate access to the records he needs. Moreover, the records of a bankruptcy proceeding usually are not kept with this problem in mind. For example, when the attorney for the debtor keeps time slips, he rarely indicates what portion of his time was spent "for the good of the secured creditor." When the debtor's attorney has spent a considerable amount of time trying to prove the invalidity of the secured claim, a secured creditor who must bear the burden of limiting assessed costs may find that this inaccuracy in bookkeeping has resulted in payments for his own demise. Logically, it would seem that the bankruptcy trustee or debtor in possession must bear the strict burden of proving the benefit to the secured creditor of any charges assessed because the authority to assess such costs is based on an equitable exception to the time priority status.

Although certain expenses may have been admittedly beneficial in the preservation or sale of the collateral, a third problem arises when the reason for the delay in foreclosure or the reason for the continued possession of the bankruptcy trustee, and hence, the necessity of incurring these expenses, is considered. If the trustee has refused reclamation because he hopes to defeat the secured claim or hopes to obtain the equity for general creditors, the secured creditor might well contend that the expenses incurred were for the benefit of the general creditors. This rationale was adopted by the Third Circuit in In re Street, in which the trustee sold assets free and clear of liens in order to obtain an anticipated surplus for the benefit of general creditors. The court reasoned that it was only fair for the general creditors to bear the expense of this proceeding since the sale was requested by the trustee for their benefit. It must be remembered that the secured creditor is an unwilling participant in bankruptcy proceedings, especially when the trustee has asserted

43. See, e.g., Reconstruction Fin. Corp. v. Cohen, 179 F.2d 773 (10th Cir. 1950).
44. In re Street, 184 F.2d 710 (3d Cir. 1950).
the right to sell assets free and clear of liens. The secured creditor is in the bankruptcy court out of necessity; he must protect his security interest and the concomitant right to realize thereon. Another aspect of the necessity of the allegedly beneficial expenses is the ability of the secured creditor to foreclose elsewhere at significantly lower costs. This point is discussed in detail below, but suffice it to say that modern default and foreclosure provisions of the Uniform Commercial Code allow realization by the secured creditor with little or no expense at all. The secured creditor may well contend that the foreclosure in bankruptcy has benefited him only to the extent that resort to these relatively inexpensive procedures has been rendered unnecessary. Finally, the reason for delay is particularly important to the validity of the benefit theory in reorganization proceedings or continuation of the bankrupt's business. Here the trustee or debtor in possession is holding and utilizing the assets to generate cash for the payment of general unsecured claims. For example, the debtor in possession may retain manufacturing equipment secured by a lien to produce goods for sale. The equipment will require, among other expenses, insurance, maintenance, and protection by night watchmen. These interim expenses certainly are primarily, if not totally, for the benefit of the general creditors. The Third Circuit in In re Pioneer Sample Book Co. stated that it was "elementary" that the costs and expenses of a reorganization proceeding could not be assessed against a secured creditor. Yet, the same Circuit, some twenty-eight years earlier stated:

Where, as here, the business of the debtor was carried on . . . in the hope of reorganization the lienholder's forebearance in not foreclosing its lien, which enabled the business to be thus carried on in the mortgaged property, was obviously for the benefit of the debtor and its general creditors. The fact that the mortgagee did not press for foreclosure but consented to permit the business to be carried on in the mortgaged property should not be held to penalize it by postponing its lien to the expenses of operating the business, since to so hold would be to place a penalty upon a lien creditor for its forebearance and

45. For a discussion of the consent of the secured creditor as a factor in assessment, see notes 74-98 infra and accompanying text.
46. See notes 85-73 infra and accompanying text.
47. In re Pioneer Sample Book Co., 374 F.2d 953 (3d Cir. 1967).
48. The reluctance of courts to assess costs against secured creditors in a Chapter XI proceeding is in part due to the Act's definition of an arrangement, which seemingly precludes the authority to alter the status or rights of a secured creditor during the course of reorganization. Section 306(1), 11 U.S.C. § 706 (1970), provides: "'[a]rrangement' shall mean any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts. . . ." [emphasis added]. It is doubtful, however, that this provision would pose any more of a deterrent to the assessment of costs against secured creditors than the true priority principle embodied in former § 67d and present § 70 of the straight bankruptcy provisions. See note 2 supra.
for the consideration it has shown for general creditors. This of course is not
to say that the lienholder should not bear the reasonable expenses of preserving
the property, which expenses were clearly for its benefit. 49

In summary, requiring the secured creditor to bear expenses
incurred for his benefit is well grounded in the theory of unjust
enrichment since the secured creditor at least has been spared the
cost of foreclosure elsewhere. From the secured creditor's viewpoint,
however, a further inquiry into the necessity of expenses incurred
may be appropriate, especially when the assets are being held dur-
ing reorganization or continuation of the bankrupt's business, the
assets are being sold for the peculiar benefit of general creditors, or
the cost of foreclosure elsewhere is much lower. In addition, the
difficulty of proof in determining what portion of costs was for the
benefit of secured creditors makes this factor an expensive element
in the liability of the secured creditor. The potential inequity of this
approach has led some courts to rely on the limiting factor of the
state foreclosure theory.

B. State Foreclosure Theory

Some courts and commentators have suggested that the real
benefit received by the secured creditor is the amount he would have
expended if he had pursued his alternative remedy of foreclosure in
state court, all other expenses being incurred solely because the
federal remedy of bankruptcy is necessary to the unsecured credi-
tors. 50 Although this proposition is actually part of the basic ration-
ale of the benefit theory, 51 several courts, particularly those in the
Fourth and Fifth Circuits, 52 have adopted the "state foreclosure
theory" as a limit 53 on the amount of costs and expenses which can
be charged to the secured creditor. The leading case adopting this
view is In re Williams' Estate, 54 in which the court stated:

By coming into the bankruptcy court, therefore, the holder of a valid lien upon
the estate of a bankrupt comes into an appropriate place and into a court

49. Miners Sav. Bank v. Joyce, 97 F.2d 973, 977 (3d Cir. 1938) [emphasis added].
50. See Note, supra note 36, at 856-58.
51. Id.
52. Textile Banking Co. v. Widener, 265 F.2d 446 (4th Cir. 1959); Reconstruction Fin.
Corporation v. Rhodes, 214 F.2d 606 (5th Cir. 1954); L. Maxcy, Inc. v. Walker, 119 F.2d 535 (5th
Cir. 1941).
53. The court in Textile Banking Co. v. Widener, 265 F.2d 446 (4th Cir. 1959), empha-
sized that the state foreclosure test was to be a limit on the amount of costs assessed rather
than a measure. It reasoned that the secured creditor could be assessed the cost of foreclosure
in state court or the actual cost of the sale by the trustees, whichever is smaller. Charging
the secured creditor more than was actually expended would be unjust since the general
creditor would profit at the expense of the secured creditors. Id. Since the cost of foreclosing
in bankruptcy is almost always the greater cost, this point is of little practical value.
54. 155 F. 934, 939 (9th Cir. 1907).
amply able to enforce and protect his rights. The enforcement of his lien in another court would entail upon the proceeds of the property upon which the lien exists the payment of the appropriate court costs; and so, in the enforcement of such lien in a court of bankruptcy, the proceeds of the property of the bankrupt upon which such lien exists is properly chargeable with the costs of such court appropriate to such enforcement, but with no other or further costs. They are not chargeable with the general costs of the administration of the bankrupt's estate. If so, the valid lien upon the estate of the bankrupt, which the bankruptcy act expressly declares should be unaffected by any of its provisions, might very readily be destroyed, as it would unquestionably be, should costs equal or exceed the proceeds in cases like the present.

Thus, the rationale of the state foreclosure theory is that the secured creditor is an unwilling participant in bankruptcy proceedings and it is unfair to charge him with expenses greater than those he would have incurred in the forum of his own choice. Although some courts have applied the state foreclosure theory as the sole factor in the assessment of costs, it is most frequently applied in conjunction with other theories such as the consent theory or the surplus theory. For example, in *L. Maxcy, Inc. v. Walker*, the Fifth Circuit stated that when the property sold free and clear of liens did not produce enough income to satisfy the lien in full, the lienholder could not be compelled to contribute more than the reasonable cost of selling the encumbered property, to be measured by the actual cost of foreclosing the lien in a state court. Yet, in another Fifth Circuit case, *Reconstruction Finance Corp. v. Rhodes*, the court applied the state foreclosure theory because the secured creditor had not consented to the sale free of liens. In *Gugel v. New Orleans National Bank*, however, the state foreclosure theory was applied even though the secured creditor had consented to the sale. The court reasoned that imposition of general administrative expenses such as the trustee's commission would "have the effect of imposing on the lienholder the expense of the general administration of the bankrupt estate, in which he has no interest and from which he derives no benefit."

The rationale of this test is persuasive when the assets are being retained for the benefit of general creditors—sale by the bankruptcy court to obtain an anticipated equity, or continuation of the business to generate funds for the general estate. When the secured creditor has elected to foreclose in bankruptcy court, however, the

55. Textile Banking Co. v. Widener, 265 F.2d 446 (4th Cir. 1959).
56. Gugel v. New Orleans Nat'l Bank, 239 F. 676 (5th Cir. 1917).
57. These theories are discussed in detail *infra* at notes 74-96 and accompanying text (consent theory) and notes 97-116 and accompanying text (surplus theory).
58. 119 F.2d 535 (5th Cir. 1941).
59. 214 F.2d 606 (5th Cir. 1954).
60. 239 F. at 678.
reason for limiting his expenses is less defensible. This consideration has led some courts to consider the willingness of the secured creditor to foreclose in bankruptcy. If the secured creditor thrusts the burden of foreclosure on the bankruptcy court, he should pay the expenses normally incurred there. If the secured creditor desires to pay only the cost of foreclosure in state courts, he should refuse to consent to the sale free of liens.61

Another criticism of the state foreclosure theory is that it is too uncertain. Reliance on approximate or similar expenses of foreclosure elsewhere prevents the creditor from knowing in advance what his costs will be and imposes an unnecessary burden on the bankruptcy court. It has been suggested that because state courts frequently change the charges and fees for foreclosure of liens in civil suits, no bankruptcy court can know with any degree of certainty what the rule for assessment would be.62

When the state court in which alternative foreclosure proceedings would be instituted allows or enforces provisions for attorney fees in a note or mortgage as part of the lien,63 the secured creditor may be able to foreclose there without impairing the recovery of principal or interest. This factor has been applied as part of the state foreclosure theory in at least two cases where the sale produced a surplus over the amount of the lien.64 If the state foreclosure theory is to be applied consistently with its rationale, the expenses charged should be reduced accordingly when a secured creditor who could have enforced an attorney fee provision as part of his lien in state court is forced to foreclose in bankruptcy. The only benefit the secured creditor receives from foreclosure in bankruptcy in this situation is that portion of the expenses in state court that would have exceeded the amount of the attorney fee provisions.

The primary criticism of the state foreclosure theory, however, is that it fails to take into account the modern default and foreclosure provisions of the Uniform Commercial Code (UCC). Since the state foreclosure theory was developed early in this century,65 when real estate and chattel mortgages were the standard security devices, it is natural that the doctrine is geared to the more expensive and cumbersome method of judicial foreclosure in state courts. This

62. Oldham, Sale of Property Free and Clear of Liens and the Right of the Bankruptcy Court to Tax the Costs Against the Mortgagee, 28 Ref. J. 88, 89 (1954); Note, supra note 36, at 857.
63. See notes 27-28 supra and accompanying text.
64. In re Street, 184 F.2d 710 (3d Cir. 1950); Oppenheimer v. Oldham, 178 F.2d 386 (5th Cir. 1949).
65. See, e.g., In re Williams' Estate, 156 F. 934 (9th Cir. 1907).
equation probably remains accurate as applied to real estate mortgages unless the mortgage is coupled with a power of sale. The UCC, however, purposely provides remedies for quick and inexpensive realization on security interests in personal property. The basic policies of the resale provisions in part five of Article Nine of the UCC are the following: (1) to allow realization on the collateral with minimum resort to judicial proceedings, and (2) to encourage higher yields upon disposition by allowing private as well as public sale of the collateral.\textsuperscript{66} To implement these goals section 9-503 of the UCC, the self-help provision, allows the secured party to take possession upon default without judicial process if this can be done without a breach of the peace, and it permits the secured party to dispose of the collateral on the debtor's premises under section 9-504.\textsuperscript{67} The provisions of 9-504 allow the secured creditor to dispose of the collateral by public or private proceedings\textsuperscript{68} in a commercially reasonable manner and to apply the proceeds of the sale as follows:

(1) . . . The proceeds of disposition shall be applied in the order following to

(a) The reasonable expense of retaking, holding, preparing for sale, selling and the like and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorneys' fees and legal expenses incurred by the secured party;
(b) The satisfaction of indebtedness secured by the security interest under which disposition is made;
(c) The satisfaction of any indebtedness secured by any subordinate security interest. . . .\textsuperscript{69}

Finally, a secured creditor can avoid altogether the need to sell the security, and thereby avoid almost all costs, by resorting to the strict foreclosure remedy of 9-505:\textsuperscript{70}

9-505. Compulsory Disposition of Collateral; Acceptance of the Collateral as Discharge of Obligation.

. . . .

(2) In any other case involving consumer goods or any other collateral a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. . . .

Use of these provisions may be of great importance to a lender such as a finance company that is already "set up" for repossession and thus uniquely able to take advantage of the extra-judicial remedies. Also, the strict foreclosure provision may be particularly attractive to the secured creditor who can make some use of the collateral in

\textsuperscript{66} \textsc{White & Summers} § 26-4, at 962.
\textsuperscript{67} \textsc{Uniform Commercial Code} § 9-503 (1982 Official Text).
\textsuperscript{68} \textit{Id.} § 9-504(3).
\textsuperscript{69} \textit{Id.} § 9-504(1).
\textsuperscript{70} \textit{Id.} § 9-505(2).
his business or occupation and who fears that a depressed sale of the collateral will bring far less than its actual value.

The real importance of the UCC remedies, however, in relation to the state foreclosure theory, is that 9-504 allows the secured creditor to deduct from the proceeds of the collateral, before even the amount of the secured indebtedness is subtracted, the very costs which the state foreclosure test assumes he will have to pay out of his own pocket. The secured creditor who is forced by the bankruptcy trustee to realize on his security by a sale free of liens in bankruptcy court might well point to these provisions and contend that under the state foreclosure theory, strictly applied, he is liable for no costs and expenses because outside the bankruptcy court he could have deducted such expenses from the proceeds without impairing the amount of his lien. The accuracy of this argument, however, is subject to two important "ifs." First, if the secured creditor cannot take possession under 9-503 without a breach of the peace, use of the follow-up extra-judicial resale provisions is effectively precluded. Breach of the peace in repossession by a creditor may expose him to tort liability or liability under 9-507, and it may deprive him of the right to a deficiency judgment. Therefore, the bankruptcy trustee might claim on behalf of the bankrupt debtor that extra-judicial repossession would have been stringently resisted so that the secured creditor could not have taken advantage of these "cost free" remedies. Whether the bankruptcy trustee should be allowed to so assert is apparently an open question. It would seem, however, that the bankruptcy trustee has no right to allege hypothetical or potential resistance to the secured creditor's extra-judicial repossession, unless the secured creditor's claim to the assets is invalid. Thus, this use of the breach of peace provision was probably not within the contemplation of the drafters of the UCC. The trustee in bankruptcy does not need this protection against invalid claims by creditors of the bankrupt because he can challenge those claims directly in the bankruptcy court. Secondly, the ability to deduct costs and attorney fees from sale proceeds before payments toward the full amount of the indebtedness assumes the sufficiency of the collateral to satisfy all of these claims. Of course, the secured creditor can sue for a deficiency judgment when the lien is not satisfied in full, but, in bankruptcy terms, this means that the secured creditor becomes unsecured to that extent and thus competes with the general unsecured creditors for the amount of the deficiency.

71. For a discussion of the "breach of peace" standard, see White & Summers, § 25-6.
73. See note 22 supra and accompanying text.
Nevertheless, the secured creditor has a strong argument that the measure of state foreclosure of a security interest under the UCC should be geared to the remedies under part five of Article Nine. If the bankruptcy court strictly adheres to the underlying rationale of the state foreclosure theory—the secured creditor should pay the amount of costs he would have incurred elsewhere—it may conclude that the secured creditor has been spared no costs and therefore should be assessed no costs, particularly when it is the trustee who has insisted on a sale free of liens.

C. Consent of the Secured Creditor

Many courts have viewed the consent of the secured creditor as the paramount consideration in determining whether, and to what extent, the costs of bankruptcy should be assessed against the secured creditor. These courts generally hold that when a secured creditor has expressly or impliedly consented to the sale free and clear of liens, he is liable for the costs of the sale, preservation and protection of the assets, and a proportional share of the general administrative expenses of bankruptcy. The basic rationale underlying the consent theory is that if a secured creditor wishes to avoid the expenses of bankruptcy, he need only object to the proceeding and effect his foreclosure elsewhere; if he willingly resorts to the bankruptcy court, he cannot be heard to complain of any costs that are subsequently incurred:

[A] secured creditor . . . is still only a secured creditor. He has a lien. He has neither title nor the actual money represented by his lien. Before he either acquires title or converts the lien covered assets into cash someone is going to have to devote the time and effort necessary to produce those results. Generally that means that some one is going to have to take charge of the property, protect and preserve it, appraise it or have it appraised, prepare and file pleadings in some court or prepare and give such other notice as may be necessary, fix the time and place of the sale, advertise the sale, conduct the sale, collect and be responsible for the proceeds, keep the necessary books and records and do the various other acts necessary . . . before the desired end is attained.

If the secured creditor so desires then generally he may, at least with leave of the Bankruptcy Court, assume all this responsibility and expense himself and the Receiver or Trustee may promptly disclaim all right, title and interest in and to such assets. But, on the other hand, if such creditor wishes to shift this burden to the Bankruptcy Court then under what reason or theory of law

74. Byrer v. Bushong, 108 F.2d 594 (4th Cir. 1940); Miners Sav. Bank v. Joyce, 97 F.2d 973 (3d Cir. 1938); Tawney v. Clemson, 81 F.2d 300 (4th Cir. 1936); In re Orbitronics, Inc., 254 F. Supp. 400 (E.D. Wis. 1966); In re Karolovitz, 130 F. Supp. 24 (D. Minn. 1955); 4A COLLIER ¶ 70.99[6] at 1227-30 (stating that this is the preferable view).

should he be relieved from the payment of the necessary costs and expenses incurred by and in the Bankruptcy Court?

Although the rationale of the consent theory is well founded in equitable principles, application of the rule itself has resulted in virtual chaos. The history of the consent theory in the Fourth Circuit is instructive. In 1904 the Fourth Circuit in *Mills v. Virginia-Carolina Lumber Co.* held that a secured creditor could not be held liable for costs of the general administration of the bankrupt estate even though he consented to a sale free of liens. In 1936 and 1940 the Fourth Circuit apparently reversed this position, stating:

When the sale is made . . . with the lienholder's consent, it may fairly be inferred that it is made at least in part for his benefit; and there is nothing in the Bankruptcy Act and no equitable consideration which excuses a lienor, who seeks the aid of the bankruptcy court, from paying such part of the costs of the sale and expenses of administration as is attributable to the sale of the mortgaged property.

In 1959, however, in *Textile Banking Co. v. Widener* the same court held that a secured creditor could not be assessed any of the general expenses of administration, such as commissions and other costs, when the trustee had elected to sell the assets over the objections of the lienor. Although the *Widener* court stated that this was "unquestionably the rule where, as here, the sale by the Trustee has been had over the objection of the lienholder," it appeared to be the rule "whether the sale by the trustee was consented to by the lienholder or not." Finally, in 1973 a Fourth Circuit district court concluded that the Fourth Circuit had recognized and permitted the assessment of administrative expenses against a lien creditor when his lien has been dealt with in bankruptcy proceedings, with or without his consent.

Equally confusing is the effect given by courts to the refusal to consent. For example, in *Reconstruction Finance Corp. v. Rhodes* the court held that failure of the secured creditor to consent meant that the contribution of the secured creditor to the bankrupt estate must be limited according to the state foreclosure test. Another

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77. 164 F. 188 (4th Cir. 1908); accord, Varney v. Harlow, 210 F. 824 (4th Cir. 1913).
78. Tawney v. Clemson, 81 F.2d 300 (4th Cir. 1938).
80. Tawney v. Clemson, 81 F.2d 300, 304 (4th Cir. 1938).
81. 265 F.2d 446 (4th Cir. 1959).
82. Id. at 453.
84. 214 F.2d 606 (5th Cir. 1954); accord, In re Orbitronics, Inc., 254 F. Supp. 400 (E.D. Wis. 1966).
court has held that a secured creditor could not be charged even with the expenses of the sale if he had not consented.\footnote{85. In re Baskind, 43 F. Supp. 602 (S.D.N.Y. 1942).}

The consent theory has been applied in conjunction with the surplus theory,\footnote{86. See notes 97-116 infra and accompanying text.} but, again, the area is confused. Two district courts in the Third Circuit have reached seemingly opposite results regarding the relevance of a surplus over the amount of the lien realized from a sale free of liens. The Delaware District Court held, "[w]here a lienholder consents to a sale free of liens, and irrespective of whether the sale brings less than enough to discharge the lien, the proceeds are chargeable with the costs of the sale and other administrative expenses."\footnote{87. See notes 97-116 infra and accompanying text.} The District Court of New Jersey, on the other hand, has held the existence of a surplus decisive when the secured creditor had not consented to the sale.\footnote{88. See notes 97-116 infra and accompanying text.}

Aside from the need for consistency in application, the consent theory presents several practical problems. First, the secured creditor's consent to a sale free of liens is meaningless in the face of the trustee's power to order such a sale. When the bankruptcy court is conducting the sale at the request of the secured creditor his consent is quite relevant. Having imposed on the bankruptcy court the burden of foreclosing his lien, it seems only equitable that the secured creditor should bear the expenses normally or necessarily incurred in the course of the proceedings. However, when the bankruptcy trustee has decided in his discretion to sell the assets free of liens in order to realize an equity for general creditors or to retain the proceeds pending possible invalidation of the lien, the consent of the secured creditor becomes irrelevant because the trustee can proceed without consent.\footnote{89. See note 117 infra.} Since the secured creditor's objection to the sale would be meaningless under these circumstances, a requirement that the secured creditor object to the sale in order to minimize the costs assessed seems illogical and unnecessary:

This is to put a premium on opposition and obstruction by the secured creditor. Every lienor, regardless of his honest opinion as to the wisdom of the court's projected actions, would object; for he could then obtain benefits at the expense of the unsecured creditors.\footnote{90. See note 117 infra.}

Secondly, if consent is to be the crucial factor, the secured creditor must know what actions or statements on his part will

\footnotesize{\textsuperscript{85. In re Baskind, 43 F. Supp. 602 (S.D.N.Y. 1942).} \textsuperscript{86. See notes 97-116 infra and accompanying text.} \textsuperscript{87. See notes 97-116 infra and accompanying text.} \textsuperscript{88. See notes 97-116 infra and accompanying text.} \textsuperscript{89. See note 117 infra.} \textsuperscript{90. See note 117 infra.} \textsuperscript{91. See note 23 supra and accompanying text.} \textsuperscript{92. Note, supra note 36, at 852.}}
constitute consent, and predictably, the courts have varied in this determination. Acquiescence in, or failure to object to, the sale free of liens has been held sufficient to show consent. On the other hand, the fact that the secured creditor did not “ask for” the services of the bankruptcy court in foreclosing has been held the equivalent of refusal to consent. A rather surprising result was reached by the Third Circuit in *In re Pioneer Sample Book Co.*, in which the court found that failure to file a reclamation petition and have it subsequently denied constituted consent, even though the secured creditor had apparently objected orally to the sale and indicated an intention to file a reclamation petition at a hearing before the referee. The referee had dissuaded the secured creditor by stating that he would deny any such petition.

Finally, a distinction must be drawn between consent to sale by the bankruptcy court and consent to whatever expenses may be subsequently incurred. If consent once given to the sale relates to all expenses that are subsequently incurred, without any objective limitation, the secured creditor may be at the mercy of the trustee, who has an admitted inclination to assess costs liberally in order to maximize the general estate. Thus the lienholders should at least have some guarantee in the form of a standard of reasonableness, necessity, or benefit regarding costs subsequently incurred. Otherwise, the decision whether to consent to a sale free of liens may be a precarious one indeed. Conversely, if consent must be determined for each item of cost incurred, the bankruptcy court will be faced with difficult problems of proof and constant friction between its trustee and the secured creditor. There are certain costs, such as costs normally incurred in the sale of assets under accepted bankruptcy procedures, which a secured creditor should not be allowed to dispute once he has acquiesced in the sale free of liens; but certain other costs, such as preservation or protection expenses or extraordinary attorney fees for the debtor, which may have been unanticipated at the time of the original “consent,” may require in fairness some showing of continuing approval.

D. Surplus Theory

According to a fourth theory relied upon by the courts, if sale

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93. *In re Torchia*, 188 F. 207 (3d Cir. 1911).
95. 374 F.2d 953 (3d Cir. 1967).
96. For an example of a dispute over expenses assessed even after the secured creditor had consented in advance to “reasonable” expenses incurred in the sale, see *In re Orbitronics*, 254 F. Supp. 400 (E.D. Wis. 1966). The district court upheld the assessment of a $8,566.17 fee for the trustee (proceeds of the sale were $428,308.42) as “not unreasonable.” *Id.*
of the assets free and clear of liens produces a surplus for the general estate in excess of the amount of secured indebtedness, then the general estate, rather than the secured creditor, should bear the expenses incurred. The rationale of this approach is founded in the recognition that when a trustee elects to sell the assets free of liens to obtain an apparent equity for the general estate, it is the general creditors who will benefit primarily from the proceeding. Also, courts adopting this approach have emphasized the requirement that a secured creditor submit to the jurisdiction of the bankruptcy court respecting disposition of the property under these circumstances.

In Reconstruction Finance Corp. v. Cohen the court would not allow assessment of general administrative expenses against a secured creditor, even though he had consented to the sale free of liens, because the sale produced a substantial surplus. The court reasoned that since there was a surplus, the bankruptcy court should have denied any motion to foreclose elsewhere; there was no course open to the secured creditors except to foreclose in bankruptcy, and it was therefore irrelevant that the secured creditor used facilities of the bankruptcy court and the services of the trustee and his attorney to foreclose. Other courts have reached the same result when the secured creditor did not consent to the sale.

A variation of the surplus theory has been applied when the sale of the secured assets did not produce a surplus, but a general estate otherwise existed sufficient to defray the costs incurred. The rationale underlying the surplus theory would appear wholly inapplicable to the presence of a general estate. The existence of funds other than those produced by the sale of the secured assets in question

97. Reconstruction Fin. Corp. v. Cohen, 179 F.2d 773 (10th Cir. 1950); Rubenstein v. Nourse, 70 F.2d 482 (8th Cir. 1934).
98. In re Street, 184 F.2d 710 (3d Cir. 1950).
100. 179 F.2d 773 (10th Cir. 1950).
101. The actual cost in dispute was a 3% charge for the Referee's Salary and Expense Fund. Id. See notes 148-59 infra and accompanying text.
102. The property was worth $130,000 and the secured creditor had a lien for $80,525.
179 F.2d 773.
103. Id. at 777.
105. Reconstruction Fin. Corp. v. Cohen, 179 F.2d 773, 776 (10th Cir. 1950):
But where an equity exists in mortgaged property over and above the mortgage debt thus creating a general estate, or where a general estate exists otherwise, and the mortgaged property is sold free and clear of debts, general administrative expenses of the bankruptcy court are to be paid out of the general estate rather than from the fund due the secured creditor. [emphasis added].

 Accord, Standard Brass Corp. v. Farmers Nat'l Bank, 388 F.2d 86 (7th Cir. 1967); In re Baskind, 43 F. Supp. 602 (S.D.N.Y. 1942).
bears no relation whatever to the necessity of the secured creditor’s submission to the bankruptcy court’s jurisdiction or the determination of who is to receive the primary benefit of the sale.

Another variation of the surplus theory is that when the sale free of liens has failed to produce a surplus, the secured creditor cannot be compelled to contribute to the general fund of the estate more than the reasonable cost of selling the property, usually to be measured by the actual cost of foreclosure in state court. This result apparently is premised on the belief that the trustee has abused his discretion in retaining the assets because there was no equity in the property after all. Had the trustee allowed reclamation by the secured creditor, the creditor would have incurred only the cost of foreclosure elsewhere. This approach has been criticized as an exercise in hindsight rather than discretion. As stated by Collier:

Where courts have emphasized the result of the sale as a determining factor, they would seem to have placed an unwarranted burden on the trustee or receiver, except in the case of the most improvident action. The time to decide whether or not there is any probability of an equity for the estate is before the order of sale, not afterwards upon distribution of the proceeds; and where the sale is ordered by the court and confirmed, there is no real reason why the consenting lienor should not bear his pro rata share of the costs and expenses attributable to the sale. If the court’s exercise of discretion in ordering the sale was improvident or constituted an abuse of discretion it should have been subject to review at the proper time.

Even when courts have accepted the validity of the surplus theory, they have disagreed about the types of cost that can be charged to a secured creditor. The Tenth Circuit, in Reconstruction Finance Corp. v. Cohen, held that when a surplus was derived from the sale of the secured assets, the secured creditor could not be held liable for any general administrative expenses, but he could be charged with costs of the sale, or preservation or protection of the secured assets incurred for his exclusive benefit. Other courts, however, particularly in the Eighth Circuit, have held that when secured assets produce a surplus over the amount of the lien, the proceeds due the secured creditor could not be reduced by costs of administration, the costs of preservation of the assets, or even the cost of the sale.

106. See note 23 supra and accompanying text.
107. See notes 44 & 45 supra and accompanying text.
108. L. Maxcy, Inc. v. Walker, 119 F.2d 535 (5th Cir. 1941).
109. 4A COLLIER ¶ 70.99[6].
110. 4A COLLIER ¶ 70.99[6], at 1238-39.
111. 179 F.2d 773 (10th Cir. 1950).
112. Rubenstein v. Nourse, 70 F.2d 482 (8th Cir. 1934); In re La Rowe, 91 F. Supp. 52 (D. Minn. 1950).
When the existence of a surplus over the amount of the secured indebtedness is used to exonerate the secured creditor from all costs, however, it would seem that the secured creditor receives a windfall. He is unjustly enriched because the sale by the bankruptcy court has obviated the necessity for foreclosure in state court. There is no reason why the bankruptcy court should constitute a “charitable organization” for the benefit of secured creditors. Since the bankruptcy proceeding is governed by equitable principles, considerations of fairness would seemingly require that a secured creditor contribute at least the amount he has been spared by foreclosure in bankruptcy. This type of reasoning has led several courts to disregard completely the surplus theory.

E. Causation by the Secured Creditor

When the secured creditor requests or demands that certain extraordinary procedures be followed in the foreclosure proceeding, then the bankruptcy court may charge the costs incurred from following these procedures against the secured creditor’s portion of the proceeds. This approach assumes that the expenses incurred at the insistence of the secured creditor are for his benefit. Causation by the secured creditor seems to be a just consideration in the assessments of costs, especially when the requested procedures are not ordinarily followed in standard bankruptcy practice.

F. Proportion of Secured Assets to Total Assets

A novel approach was applied by the Third Circuit in In re Pioneer Sample Book Co., in which the amount of costs charged to the secured creditor, who had assented to the sale free of liens, was determined by comparing the amount of secured assets to the amount of total assets of the estate and assessing that same proportion of costs against the secured creditor. Although this approach offers certainty and predictability, it is a “rough rule of thumb” which fails to take into account the underlying policies involved, such as benefit to the secured creditor.

114. Murphy, supra note 76, at 99.
115. Oppenheimer v. Oldham, 178 F.2d 386 (5th Cir. 1949).
118. Id.
119. Id. (secured creditor demanded a bond for the trustee in the full amount of value of secured assets).
120. 374 F.2d 953 (3d Cir. 1967).
121. The operation of this “proportion test” should be distinguished from the requirement that a secured creditor pay expenses in proportion to his interest in the assets. For
Some commentators have suggested that the determination whether certain costs will be assessed against the secured creditor can be made by classifying the type of costs involved. Thus, it is stated that the secured creditor is ordinarily liable for costs of the sale and preservation or protection of the property, but he is not liable for general administrative expenses or the cost of continuing the debtor's business. Accord 22 This analysis, the court classifies the expense according to the benefit derived by the secured creditor. The classification of the expense as a general administrative expense rather than part of the cost of preservation thus is viewed as a legal conclusion. Accord 23 It is submitted, however, that the proper classification of costs has little to do with the final determination; rather, it is the particular court's view of the theories discussed above that is decisive. For example, courts relying on the consent test have been willing to assess almost every type of cost conceivable, but courts following the surplus theory have refused to assess any costs at all, including even the cost of the sale. Accord 24

The purpose of this section of the Note is simply to identify the types of costs that may be involved in the charge against the proceeds due to a secured creditor after a sale free of liens. Also, some particular considerations for certain costs will be discussed as they relate to the theories discussed above.

A. Costs of the Sale

The actual costs of the sale that may be assessed against the secured creditor include: advertising and printing costs; auctioneer's fees; appraiser's fees; court costs; postage; costs of an abstract; sale clerk's fee; fees of the receiver's or trustee's attorney insofar as attributable to the sale, such as those charged for preparing papers, examining the abstract, or searching the title; and cost of "conditioning" the property. These costs are usually directly

123. Note, supra note 36, at 848; see, e.g., In re Cheyenne Wells Elevator Corp., 266 F. Supp. 927 (D. Colo. 1967); In re Beardsley, 38 F. Supp. 799 (D. Md. 1941) (both cases holding that general administrative expenses were beneficial to the secured creditor).
124. See, e.g., In re Torchia, 188 F. 207 (3d Cir. 1911).
126. See 4A COLIER ¶ 70.56(5), at 1229-30 n.37; 6 REMINGTON § 2607.
beneficial to the secured creditor because he would have incurred them in foreclosure proceedings elsewhere; courts therefore have been quite willing to assess these costs against him, especially when the secured creditor has consented to the sale. The amount of sale costs may be limited, however, by application of the state foreclosure theory. Further, some courts have refused to assess them at all when the secured creditor objected to the sale or the sale produced a surplus.

B. Cost of Preserving and Protecting Secured Assets

At least two Supreme Court cases have recognized the general principle that the cost of preserving or protecting a fund is a dominant charge against the fund. On the basis of such authority many courts have held that when a sale of encumbered property is made free and clear of liens, the costs of preserving the property are deductible from the proceeds of the sale before the benefits of the security accrue to the lienor. Examples of the costs of preservation include: insurance premiums on the property; watchman's fees; rent; lights and power; repairs; storage; pumping water out of a ship or mine; keeping an orchard in cultivation; or feeding horses. Since these expenditures enhance the lienor's ultimate realization from the sale, it seems only fair that the secured creditor should bear his proportionate share of the expenses. Nevertheless, some courts refuse to assess these costs, because the secured creditor did not consent to the sale, or because the property sold produced a surplus sufficient to defray the preservation costs.

Although preservation or protection expenses generally are beneficial to the secured creditor, such expenses may not be necessary, at least from the secured creditor's point of view. Where the secured assets are held by the trustee in order to obtain an equity for the benefit of general creditors, it may be of little consolation to the secured creditor that interim expenses required by the delay in foreclosure were beneficial for the property. On the other

128. See notes 50-75 supra and accompanying text.
132. E.g., In re Prindible, 115 F.2d 21 (3d Cir. 1940); In re Cheyenne Wells Elevator Corp., 265 F. Supp. 927 (D. Colo. 1967).
133. See 4A COLIER ¶ 70.99(6), at 1230 n.38; 6 REMINGTON ¶ 2608; Note, supra note 36, at 849.
135. See, e.g., In re La Rowe, 91 F. Supp. 52 (D. Minn. 1950).
136. See notes 44 & 45 supra and accompanying text.
hand, when the secured creditor has elected to foreclose in bankruptcy, he should not be allowed to escape any reasonable expenses incurred in the preservation of his security.

A special problem exists when the trustee elects to continue the business of the bankrupt in hopes of generating cash for the payment of general claims, or when the debtor's business is carried on pursuant to a Chapter XI arrangement. The expenses incurred in preserving or protecting the property under these circumstances are obviously for the benefit of general creditors. Therefore, the majority of courts have refused to charge them against the secured creditor.137

C. Increasing or Augmenting the Value of Liened Assets

When the bankruptcy trustee, under the direction of the court, has increased the value of secured assets by actions such as the completion of unfinished goods, the benefit to the secured creditor is obvious, and he will seldom object to the deduction of such expenses from the proceeds of the sale. For example, in Meinhard, Greeff & Co. v. Edens,138 in which the bankruptcy trustee completed the process of manufacture on yarn, the court held that the secured creditor with a factor's lien against the yarn was entitled to the proceeds from their sale minus the cost of putting them in salable condition.

D. General Administrative Expenses

The initial problem with a discussion of general administrative expenses is definitional. The courts have referred loosely to administrative expenses without designating the specific costs involved, but an examination of the cases indicates that all of the following items may be administrative expenses: fees or commissions for the trustee or receiver;139 the trustee's bond;140 costs of receivership;141 fees for the Referee's Salary and Expense Fund;142 attorney fees for the

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137. 6 REMINGTON §§ 2608, 2661. Contra, Miners Sav. Bank v. Joyce, 97 F.2d 973 (3d Cir. 1938).
138. The secured creditor will seldom object if, in fact, the efforts of the trustee were beneficial to the sale value of the property. To avoid any assumption of the risk of failure the trustee should always obtain a court order to continue the business.
139. 189 F.2d 792 (4th Cir. 1951).
141. Id.; In re Beardsley, 38 F. Supp. 799 (D. Md. 1941).
142. In re Torchia, 188 F. 207 (3d Cir. 1911).
The determination whether to assess such costs against the secured creditor is the most controversial issue in the disposition of proceeds after a sale free of liens, for the equitable argument regarding benefit to the secured creditor becomes more tenuous when it appears that he is being asked to contribute to the general estate. The determination is further complicated by conflicting interpretations of certain statutory provisions which bear on the issue.

Section 40 of the Bankruptcy Act establishes the Referees' Salary and Expense Fund (RSEF), designed to provide a fixed yearly compensation for referees. The source of the funds for the referee's salary and expenses is to be derived from a filing fee, which is charged at the time the petition in bankruptcy is filed, and a percentage fee charged "against each estate wholly or partially liquidated in a bankruptcy proceeding, and . . . computed upon the net proceeds realized. . . ." The Judicial Conference of Senior Circuit Judges is given the power to fix the schedule of fees charged. Pursuant to this authority the Judicial Conference in 1947 declared that a three percent charge on net proceeds realized would be assessed in all straight bankruptcy cases, defining "net proceeds realized" as follows:

1. Determination of net proceeds realized.

In determining the amount of net proceeds realized in asset cases for the purpose of Section 40c(2) of the Bankruptcy Act as amended, the term "net proceeds realized in asset cases" shall mean, in the case of sale or liquidation, the amount of money coming into the estate of a bankrupt as assets of such estate, which shall include the entire sale price of encumbered property when sold free and clear of all liens or, if not sold or liquidated, the fair cash market value of all property coming into the estate as assets of such estate. . . .

The application of this regulation to the proceeds due a secured creditor after a sale free of liens produced inconsistent results. The
District of Delaware, in *In re Stephen R. Jackson & Co.*, held that when a mortgagee of real estate had consented to a sale free of liens, the entire proceeds of the sale, including the portion due to the mortgagee, were subject to the percentage charges of the RSEF. In *Reconstruction Finance Corp. v. Cohen*, however, the Tenth Circuit refused to assess the percentage charges against a secured creditor, even though he had consented to the sale. The *Cohen* court reasoned that section 40c(2) was not concerned with the source of payment, but was satisfied when the full amount was assessed against the assets of the estate, whether or not paid from funds belonging to the secured creditor. The Judicial Conference promulgated a clarifying amendment in 1966, providing that where property is sold by the trustee free and clear of liens, the *entire proceeds* of the sale are subject to the percentage charge for the RSEF, without deduction for the amount of the lien.

The validity of the 1947 Judicial Conference regulations was attacked in *Mesa Farm Co. v. United States*, in which a secured creditor objected to the rule that payment to the RSEF was to be based on the fair market value of all assets coming into the hands of the trustee, whether or not the trustee liquidated or sold the assets. The secured creditor contended that the Judicial Conference had exceeded its authority because the phrase "net proceeds realized" in section 40c(2) necessarily implied the result of sale or liquidation efforts. The Ninth Circuit rejected this argument, however, and stated that the rule was consistent with the intent of Congress that the fee should be assessed according to the size of the estate in support of the self-sustaining system. If the Ninth Circuit is correct in its assessment of the validity of the Judicial Conference rule regarding assets abandoned or released to the secured creditor, then the validity of the rule as applied to proceeds from the sale free of liens would follow a fortiori. Thus, the propriety of charges against the secured creditor for the RSEF would appear to be well settled.

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154. 179 F.2d 773 (10th Cir. 1950).
155. *Id.* at 776. The court relied upon the existence of a surplus upon sale of the secured assets in its determination.
156. *Handbook for Trustees* §14.017, at P-455. For example, if a building incumbered by a $10,000 mortgage is sold by the trustee for $15,000, the entire $15,000 is part of the net proceeds and is therefore subject to the charges to be made for the RSEF. The charge is also made if the proceeds of the sale are insufficient to satisfy all liens. *Id.*
157. 475 F.2d 1004 (9th Cir. 1973).
158. *Id.* at 1008.
159. This conclusion follows from the specific mention of "net proceeds realized" in the Act, § 40c(2), 11 U.S.C. § 68c(2) (1970), and the fact that the Referee expends far more time and effort in relation to the secured assets when they are sold under the bankruptcy trustee's direction.
under section 40c(2) and the regulations pursuant thereto.

Imposition of a fee for the trustee also has statutory authority. Section 48c of the Bankruptcy Act allows a percentage fee for the trustee's services, to be assessed "upon all moneys disbursed or turned over by them to any persons, including lienholders..."163

As might be expected, however, courts reluctant to assess secured creditors with general administrative expenses have interpreted the language of section 48c as applying to the computation of the fee, rather than the source of payment. This interpretation was adopted by the court in Gugel v. New Orleans National Bank:141

[T]here seem to be two possible constructions that may be given the language [of 48c]—one, that it relates to the basis of computation of the commission, and has no reference to the source from which payment is to be made; and the other, that it has reference to the source of payment as well. There is nothing in the language of the amendment that would force the latter construction. It is necessary, therefore, to look beyond the language to the purpose to be subserved and the results that follow from the respective constructions, in order to reach a conclusion.

The purpose of Congress was evidently to increase the compensation of the trustee, but not necessarily at the expense of lienholders and with the effect of displacing their liens. Section 67d forbids such a construction. The purpose to increase is worked out by enlarging the basis of computation... To give it this broader construction would have the effect of imposing on the lienholder the burden of the expense of the general administration of the bankrupt estate, in which he has no interest and from which he derives no benefit. We cannot think that Congress intended any such inequitable result... Imposing upon the lienholder the burden of the cost of the general administration of an insolvent estate, when he has ample security for his debt, is a denial of an adequate remedy for the collection of the debt secured by the lien.

As indicated above, the imposition of costs for general administration is the most controversial aspect of this problem. In addition to the conflicting statutory interpretations already discussed, the factors or theories of assessment are applied in chaotic fashion. Although many courts charge the consenting secured creditor with administrative expenses,162 others refuse to do so despite his consent.163 General administrative expenses have been denied because

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160. Section 48c(1), 11 U.S.C. § 76c(1) (1970), provides in part:
   (1) Normal Administration.
   When the trustee does not conduct the business of the bankrupt, such sum as the court may allow, but in no event to exceed 10 per centum on the first $500 or less, 6 per centum on moneys in excess of $500 and not more than $1,500, 3 per centum on moneys in excess of $1,500 and not more than $10,000, 2 per centum on moneys in excess of $10,000 and not more than $25,000, 1 per centum on moneys in excess of $25,000, upon all moneys disbursed or turned over by them to any persons, including lienholders...  

161. 239 F. 676, 678 (5th Cir. 1917).
163. Gugel v. New Orleans Nat'l Bank, 239 F. 676 (5th Cir. 1917); In re La Rowe, 91 F. Supp. 52 (D. Minn. 1950).
the secured creditor failed to consent, but they have also been denied because a surplus was realized, even though the secured creditor consented. General administration expenses have been charged to the secured creditor because they were deemed beneficial, but denied because of the state foreclosure test.

V. LEGISLATIVE PROPOSAL

Despite the confusion in this area of the bankruptcy law, each of the theories discussed above has an element of fairness, and each type of cost is properly charged against the secured creditor under certain circumstances. It is submitted that the two overriding principles in conflict—(1) the priority of the secured creditor in bankruptcy, and (2) the equitable principle that expenses incurred in the protection, preservation, or liquidation of a fund should be reimbursed by the secured creditor before distribution—can be reconciled if the equity of the second principle is constantly pursued in forging an exception to the first. The problem with the cases in this area is that they have not logically and consistently followed the benefit principle. The theories of consent, surplus, and state foreclosure are all founded on the idea of benefit to the secured creditor; the confusion developed when those theories were applied independently, without an analysis of the benefit actually derived by the secured creditor under the particular circumstances. The following three principles are suggested as a workable set of rules for the assessment of costs against a secured creditor.

First, the bankruptcy court must determine why the secured assets are being held for a sale free of liens. If the trustee is holding the assets to obtain an anticipated equity for general creditors or in hopes of invalidating the asserted lien, the general creditors will derive the primary benefit of the sale; the secured creditor has no option other than submission to the bankruptcy court’s jurisdiction. On the other hand, if the trustee has no desire to retain and liquidate the secured assets, because he believes that the asserted lien is valid and would consume the entire value of the assets, then he should make this known to the secured creditor. If the secured creditor requests foreclosure in bankruptcy anyway, and the trustee accepts the task, then the sale seemingly would be for the sole benefit of the secured creditor.

164. Textile Banking Co. v. Widener, 265 F.2d 446 (4th Cir. 1959); Oppenheimer v. Oldham, 178 F.2d 386 (5th Cir. 1949).
165. Reconstruction Fin. Corp. v. Cohen, 179 F.2d 773 (10th Cir. 1950).
Secondly, when the trustee has decided in his discretion to retain the property, the consent of the secured creditor, or the existence of a surplus derived from the sale, should be irrelevant; the secured creditor should be assessed the amount it would have cost him to foreclose elsewhere. If the trustee has made a proper discretionary determination of the existence of an equity or the possibility of invalidating the lien, he can order a sale over the objection of the secured creditor. Therefore, a requirement that the secured creditor object to the sale in order to minimize his costs would serve no useful purpose. The fact that a surplus was or was not obtained should likewise be irrelevant, being little more than an indication that the trustee properly exercised his discretion. The secured creditor, however, has derived some benefit from the sale—he has been spared the cost of foreclosing elsewhere—and he should not receive a windfall by walking away without paying at least a portion of the expenses. The fact that a surplus was not realized should also be irrelevant168 because the secured creditor still benefits from the foreclosure. An occasional mistake in valuation by the trustee is probably unavoidable. It must be remembered, however, that the only real benefit accruing to the secured creditor is that he has been spared the cost of foreclosure elsewhere, and the costs charged against him should be limited accordingly. Furthermore, a distinction should be made between the cost of realization on a UCC security interest and the cost of foreclosing a traditional real estate mortgage. The latter is readily calculable by reference to standard state foreclosure costs.169 While reference to the UCC default and foreclosure remedies may result in an assessment of minimal costs against the secured creditor, it seems undeniable that the secured creditor could have pursued that course had he been permitted,170 and he is only benefited to the extent that the bankruptcy court accomplishes the task for him.

Thirdly, when the trustee would otherwise abandon the secured assets but the secured creditor has requested or consented to foreclosure in bankruptcy court or a sale free of liens,171 the benefit

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168. The failure to obtain a surplus is irrelevant unless the trustee has abused his discretion. The trustee should not be judged, however, strictly by hindsight; only those factors known or reasonably ascertainable at the time the trustee decided to sell the property free of liens should be considered. And even if the trustee has abused his discretion, the remedy should not be realization by the secured creditor on his security without paying costs, because the general creditors will be the ones who actually suffer.

169. This assumes that state foreclosure costs can be reasonably ascertained. But see note 62 supra and accompanying text.

170. See note 71 supra and accompanying text.

171. See BANKRUPTCY R. 608.

172. It is difficult to understand why the trustee would desire or consent to a sale free
to be derived is entirely that of the secured creditor. Consequently, he should be required to bear the expenses normally incurred\textsuperscript{173} or necessitated\textsuperscript{174} by the foreclosure. If he wishes to avoid these expenses then presumably he can take his chances on foreclosure by other means, because the trustee will not resist reclamation. Fairness requires, however, that the expenses chargeable should be governed by some objective, external standard so that the secured creditor is not at the mercy of the trustee. This does not mean that he should have the advantage of the state foreclosure theory because he has voluntarily rejected this alternative. Rather, a standard similar to the following should be applied: the secured creditor will be liable for his proportional share\textsuperscript{175} of the expenses normally incurred in the liquidation of assets in bankruptcy,\textsuperscript{176} plus any other expenses reasonably necessary and beneficial\textsuperscript{177} to the liquidation of the lien.

Of course, the key to this scheme is the early determination by the bankruptcy trustee whether he wishes to retain and liquidate the secured assets. This determination, however, can be made relatively early in the proceeding. These issues must be resolved eventually, and the factual data underlying such a decision will not vary significantly during the course of the proceeding. Most issues regarding the validity of secured claims are determined as of the date of the petition in bankruptcy, so there is no reason to prolong the decision. Also, this determination need not be a final hearing on the validity of the claim; the trustee need decide only whether the possibility of invalidating the lien is sufficiently significant to retain the assets. Extensions of time could be granted where necessary for the trustee to gather additional information. Since the assets are not likely to increase significantly in value during the course of administration, nothing is gained by a delay in the appraisal of the value of the assets. Moreover, if the assets are the type that depreciate rapidly, a delay may mean that the secured creditor will end up com-

\textsuperscript{173} The assessment of expenses “normally incurred” contemplates a sale under accepted bankruptcy procedure. Whatever costs are normally incurred—sales costs, percentage charges for the trustee and the RSEF, and other general administrative expenses attributed to a sale of assets—are presumably known by the secured creditor when he elects this means of foreclosure.

\textsuperscript{174} Necessary expenses would include costs necessary to preserve or protect the assets pending the sale. See notes 131-37 supra and accompanying text.

\textsuperscript{175} “Proportional share” as used here means that if the secured creditor has a lien for $900 in assets worth $1,000, he should pay $9/10 of the costs attributable to those assets.

\textsuperscript{176} See note 173 supra.

\textsuperscript{177} See note 174 supra.
peting with the general creditors for other assets of the estate.\textsuperscript{178}

Adherence to a simple set of notice requirements can facilitate the process. After the secured creditor is notified of the filing of a petition in bankruptcy by his debtor, he can file a reclamation petition and proof of secured claim.\textsuperscript{179} If the trustee must respond within a fixed period of time by indicating his intentions with respect to the secured assets, the goal is achieved with a minimal departure from existing bankruptcy procedure. A question may arise regarding any necessary expenses, such as emergency preservation costs, which are incurred between the notice to the secured creditor of his debtor's petitions and the secured creditor's response. Secured creditors are notoriously slow in reacting to the bankruptcy of their debtors.\textsuperscript{180} The answer to this question should be that the secured creditor delays at his own peril: a secured creditor should be liable for reasonable, necessary, and beneficial expenses incurred between the notice of bankruptcy and the time of his response by filing a reclamation petition.\textsuperscript{181} The foregoing suggestions can be summarized in proposed statutory form:

\textit{Assessment of Costs Against a Secured Creditor Upon Sale of Assets Free and Clear of Liens}

(1) Not more than fifteen days after the secured creditor files a reclamation petition with the bankruptcy court, the trustee shall indicate whether he intends to retain the secured assets pursuant to section \textit{___} and sell them free and clear of liens, applying the priority of any valid liens to the proceeds:

(a) if the trustee desires to sell the assets, costs in an amount not to exceed the cost of foreclosure outside the

\textsuperscript{178} Alexander Paskay, a Bankruptcy Judge for the Middle District of Florida, indicates in his handbook for trustees that a speedy disposition would be beneficial to the bankrupt estate:

A speedy determination of the validity and the extent of all security interest [sic] encumbering the properties in the possession of the trustee is absolutely essential to an efficient administration and is in the best interest of all parties concerned. If the properties are validly encumbered to the full extent of their value, the estate should not be burdened with the cost of preserving and safekeeping the property. The trustee should not waste his time with the preparation of the inventory and offer the properties for sale only to be faced with the valid demand of a secured creditor to turn over to him the entire proceeds of the sale.

\textit{HANDBOOK FOR TRUSTEES § 14.014, at P-446.}

\textsuperscript{179} This scheme of notice provisions is not a significant departure from current bankruptcy procedure. See, e.g., \textit{BANKRUPTCY R. 203.}

\textsuperscript{180} \textit{HANDBOOK FOR TRUSTEES § 14.014, at P-446.}

\textsuperscript{181} The secured creditor should be required to protect his own interest. If he has not responded to the notice of sale free of liens, he should bear his proportional costs of the sale as well.
bankruptcy court, plus any additional expenses under subsection (2), shall be assessed against the proceeds due the secured creditor;

(b) if the trustee indicates a willingness to abandon the assets, but the secured creditor requests foreclosure by the bankruptcy court or consents to any proposed sale by the trustee or receiver, then the secured creditor shall be liable for his proportional share of the expenses normally incurred in the liquidation of assets in bankruptcy, plus any other expenses reasonably necessary and beneficial to the liquidation of the lien, plus any additional expenses under subsection (2).

(2) The secured creditor shall also be liable for any expenses reasonably necessary and beneficial to the preservation of the assets which were incurred by the bankrupt estate up to the time of the filing of a reclamation petition.182

VI. CONCLUSION

There is a definite need for clarity and consistency in this area of the bankruptcy law in order to afford predictable and just results. The overwhelming number of cases on the question is indicative of the inadequacy of the present state of the law. One result of the confusion is that parties to a bankruptcy proceeding are likely to resort to litigation whenever the costs assessed are unsatisfactory. At a time when the high cost of realization in bankruptcy proceedings is an important concern to reformers of the Act,183 it is ironic that the additional expenses of litigation and appeal should be encouraged by the state of the law. Another possible result of the confusion about permissible charges against secured creditors is that the bankruptcy trustee may be given an inordinate amount of leverage in the negotiation of settlements with secured creditors. Since the trustee can support the most extreme position on assessment of costs by reference to portions of the existing case law, the secured creditor may agree to a larger portion of the expenses than he considers justified in order to avoid the cost of appeal.

Any attempt to regulate this area of bankruptcy administration must be carried out with an awareness of the potential effect on the cost and availability of secured credit. One commentator has suggested that unfair or unwarranted interference with the enforceability of security interests in bankruptcy can have an adverse impact

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182. See note 181 supra.
183. See note 9 supra and accompanying text.
on the commercial needs of a credit society. To the extent that the legal system facilitates secured transactions, it is contended, the cost of credit is restrained and its availability is improved; conversely, to the extent that the legal system hinders or restrains the enforcement of security interests, the cost of credit is increased and its availability is restricted. Since the availability of credit is related to the need for the bankruptcy court’s services, the economic impact of cost assessment against secured creditors should not be ignored.

Finally, the method by which reform of this area of bankruptcy administration is attempted is significant. The useless classification of cases according to the various theories discussed or types of costs involved should be discarded in favor of a comprehensive set of guidelines that take into account the underlying policies and equities mentioned above. Although a series of definitive cases might alleviate the confusion, the task would have to be undertaken by the Supreme Court because there is disagreement among circuits as well as within circuits. This would be a slow and tedious process at best. The preferable solution is an amendment to the Bankruptcy Act or Rules, for Congress has the authority to impose the definitive regulation that is sorely needed.

J. Hobson Presley, Jr.
