WHEN DOES SOME FEDERAL INTEREST REQUIRE A DIFFERENT RESULT?: AN ESSAY ON THE USE AND MISUSE OF *BUTNER V. UNITED STATES*

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Thousands of judges and scholars have relied on the statement in the 1979 Supreme Court opinion in Butner v. United States *that "property interests are created and defined by state law . . . unless some federal interest requires a different result." Often, they cite to the statement as a policy constraint that elevates state property law over federal bankruptcy law. This Article posits that the* Butner *rule is not as broadly applicable as commonly believed. To do so, the Article surveys some notable uses and misuses of the* Butner *rule in the thirty-five years since the case was decided and concludes that so long as Congress clearly states a federal purpose for modifying a party's state law property rights at the moment a bankruptcy case is filed, such a modification is permissible.*

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I. INTRODUCTION

"Property interests are created and defined by state law."[1] This statement forms half of the "principle"[2] set forth in the Supreme Court's opinion in *Butner v. United States*. Repeated over and over again by courts, commentators, and others, the statement is noncontroversial in a vacuum. After all, what other set of laws would define property rights?

Property rights are never defined in a vacuum, however. To lawyers, the word "property" does not refer to the asset; it refers to the relationships among persons with respect to that asset. Those relationships play a critical role in bankruptcy, because the bankruptcy estate, which forms the basis for payments to creditors, consists of "all the interests of the debtor . . . in . . . property as of the commencement of the [bankruptcy] case."[3] Before a debtor files for bankruptcy, the half of the *Butner* rule stated above is incontestable. Once the debtor has filed for bankruptcy, the debtor has chosen to resolve its financial problems in a federal collection system. Therefore, the other half of the rule, "unless some federal interest requires a different result,"[4] should also be noncontroversial. Many provisions of the Bankruptcy Code (the "Code") alter property rights in the bankruptcy process.[5]

If both halves of the *Butner* rule seem obvious, why is the opinion cited so often and why has its rule earned such an exalted status? As I will demonstrate in this Article, courts have so overused *Butner* that its limited scope has been buried. The rule should apply only to the determination of property rights at the moment of the bankruptcy petition, not to the distribution of those rights in the bankruptcy process.

In its proper limited role, the *Butner* rule can inform the work of the American Bankruptcy Institute Commission to Study the Reform of Chapter 11. Motivating the Commission is the concern that by giving secured creditors excessive control over business reorganizations, Chapter 11 no longer effectively balances its two primary goals, the effective reorganization of businesses and the maximization of asset values for all

1. Butner v. United States, 440 U.S. 48, 55 (1979).

2. Some have questioned the inclusion of the Court's statement in *Butner* in bankruptcy law's pantheon of principles. *See, e.g.*, Barry E. Adler, *The Questionable Axiom of* Butner v. United States, *in* BANKRUPTCY LAW STORIES 11 (Robert K. Rasmussen, ed. 2007); David Gray Carlson, *Rents in Bankruptcy*, 46 S.C. L. REV. 1075, 1088 (1995) (explaining that the Supreme Court in *Butner* deprived the mortgagee of its interest in postpetition rents not because of a state law rule, but for failure to follow a bankruptcy rule).

3. 11 U.S.C. § 541(a)(2) (2012).

4. *Butner*, 440 U.S. at 55.

5. *See, e.g.*, 11 U.S.C. § 362(a)(4)–(5) (2012) (imposing a stay against all acts to enforce a lien against property of the estate or property of the debtor).

creditors.[6] Other participants in this symposium have discussed the increased use by businesses of loans secured by blanket liens on entity assets.[7] These blanket liens, coupled with the expanded definition of proceeds as a result of the 2001 amendments to Article 9 of the Uniform Commercial Code ("UCC"),[8] leave no unencumbered assets for unsecured creditors. Some have argued that, by expanding the reach of a secured creditor's lien in ways that operate primarily in bankruptcy, the 2001 amendments to Article 9 impermissibly amend bankruptcy law.[9] This view is accurate if bankruptcy law must both defer to and incorporate state law rights.

In another article, I argued that the *Butner* principle is not as broad as is commonly believed.[10] *Butner* is less a policy constraint than a warning. Its caveat "unless some federal interest requires otherwise" swallows the rule as far as the treatment of property rights inside of bankruptcy is concerned.[11] The *Butner* rule is relevant only the moment at which property of the estate is determined. At that point in time, all property rights must possess their state law attributes unless some federal interest requires otherwise. Because Congress has legislated in the field of debtor-creditor relations by enacting bankruptcy laws, it may modify property rights so long as such modification furthers a clearly stated bankruptcy policy. State law does not prevail in bankruptcy, rather, it is displaced unless Congress has permitted it to govern for specific bankruptcy purposes.[12]

In this Article, I will survey some notable uses and misuses over the past thirty-five years of the Court's statement about property in *Butner* to illustrate that courts applying the case have obscured its proper role. To do so, I will survey the property rights of secured creditors in bankruptcy and how they are altered by bankruptcy law in Part II. In Part III, I will discuss *Butner* and some notable misuses of its rule. Part IV will review some cases in which courts appropriately balanced state and federal

6. *Purpose of the Commission*, ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11 (June 2011), http://commission.abi.org/purpose-commission.

7. *See*, *e.g.*, Michelle M. Harner, *The Value of Soft Variables in Corporate Reorganizations*, 2015 U. ILL. L. REV. 509.

8. U.C.C. § 9-102 (a)(64)(C) (2014) (including "rights arising out of collateral" in the definition of proceeds).

9. *See, e.g.*, G. Ray Warner, *The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy*, 9 AM. BANKR. INST. L. REV. 3, 5 (2001) (explaining that the "major bankruptcy-related changes in revised Article 9 have little significance outside of bankruptcy").

10. *See* Juliet M. Moringiello, *(Mis)use of State Law in Bankruptcy: The Hanging Paragraph Story*, 2012 WIS. L. REV. 963, 982–83 (explaining that courts applying *Butner* both underemphasize its caveat regarding overriding federal purposes and fail to distinguish between property interests and contract rights).

11. In another article, I argue that although state law deserves deference in determining the in-bankruptcy treatment of property rights, courts and Congress should determine the extent of that deference using the analysis in *United States v. Kimbell Foods,* 440 U.S. 715 (1979), rather than a *Butner* analysis. *Id.*, at 990–93.

12. Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 196 (1819); *see also In re* Pruitt, 401 B.R. 546, 554 (Bankr. D. Conn. 2009) ("[O]nce a bankruptcy case is commenced, there is allowance for the operation of State Law *only to the extent that Congress provides for its viability*.").

law in determining a secured creditor's bankruptcy rights. In Part V, I will conclude by offering a brief suggestion for modifying the rights of secured creditors in bankruptcy.

II. THE PROPERTY RIGHTS OF SECURED CREDITORS IN BANKRUPTCY

Although people often use the words property and asset interchangeably, they are not synonyms in law. Law school property casebooks describe property as "rights or relationships among people with respect to things."[13] To most legal scholars, the word "property" means a package of rights, or "bundle of sticks," rather than the asset itself.[14] To recognize property rights in an asset is to establish certainty; the early property commentators acknowledged this by justifying the institution of property as a method of avoiding conflict and of promoting productivity.[15] If an individual had exclusive rights to an asset, his ability to exclude others would give him the incentive to maximize the value of that asset.[16] Modern theorists extend this property justification to secured credit—if a person has stable and verifiable property rights in an asset, that person can use the asset as collateral for a loan.[17]

One of these sticks is the right to transfer, and secured transactions law today generally respects this important property principle of free transferability of property rights by enabling a debtor to encumber as many of its assets as it would like with liens.[18] Thus, outside of bankruptcy, a debtor can grant a security interest in any asset it chooses and thus endow a creditor with the status of "secured creditor" with all of its attendant property attributes.[19]

The textbook definition of property illustrates the point that bankruptcy law modifies the property rights of secured creditors in important

13. *See, e.g.*, JESSE DUKEMINIER ET AL., PROPERTY 83 (Vicki Been et al. eds., 7th ed., 2010).

14. *See, e.g.*, Joseph William Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 611, 637 (1988) (explaining that the law divides control over resources among several interested parties); Kenneth J. Vandevelde, *The New Property of the Nineteenth Century: The Development of the Modern Concept of Property*, 29 BUFF. L. REV. 325, 357–60 (1980) (explaining the evolution of property theory from Blackstone's definition of property as "absolute dominion over things" to Hohfeld's conception of property as a set of legal relationships among persons).

15. *See, e.g.*, Vandevelde, *supra* note 15, at 360.

16. *See* Carol M. Rose, *Canons of Property Talk, or, Blackstone's Anxiety*, 108 YALE L.J. 601, 606–07 (1998) (explaining the property theories of John Locke and William Blackstone).

17. *See* HERNANDO DE SOTO, THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE 6 (1st ed. 2000); Clifford G. Holderness, *A Legal Foundation for Exchange*, 14 J. LEGAL STUD. 321, 339 (1985) (noting that property rights are not fully transferable unless potential purchasers can identify the owners of the rights).

18. *See* U.C.C. § 9-109 (2014) (providing limited exceptions to the scope of Article 9); *id.* at § 9-504 (allowing a financing statement to indicate that it covers all of the debtor's personal property); Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021, 2024–25 (1994).

19. State and federal law narrow this rule for consumer debtors. *See, e.g.*, U.C.C. § 9-204(b)(1) (2014) (stating that an after-acquired property clause in a security agreement will not extend to consumer goods); *see* 11 U.S.C. § 522(f)(1)(B) (2012) (allowing an individual in bankruptcy to set aside nonpossessory, nonpurchase money security interests in listed types of assets to the extent that the security interest impairs an exemption).

ways. Once a debtor files for bankruptcy, the creditor who received secured creditor status before bankruptcy will not enjoy all of the sticks in its prebankruptcy bundle. Under state law, a secured party has the right to possession of its personal property collateral upon default.[20] But by imposing a stay against collection actions at the moment of a bankruptcy filing, the Code deprives secured creditors of that right in order to further its goal of debtor rehabilitation.[21] At the moment the debtor files its bankruptcy petition, the creditor's status as a secured creditor is the same as it is under state law; but, as soon as the bankruptcy process begins, federal law modifies the property rights that define that status.[22]

Bankruptcy law sometimes strips the property attributes of secured creditors at the bankruptcy entry point. When bankruptcy law does so, the creditor who had the full panoply of secured creditor rights finds itself without any of them for the purpose of bankruptcy distribution. The trustee's power to avoid preferential transfers is an example of this kind of modification.[23] Preferential transfer law effects the type of modification to which a *Butner* analysis properly applies. A creditor that takes an interest in property to secure a preexisting debt has all of the rights of a secured creditor under state law.[24] Bankruptcy law, however, permits the trustee to avoid that interest, if the creditor takes it too close to the moment of bankruptcy.[25] If the trustee does so, bankruptcy law strips that creditor of secured status for bankruptcy purposes.[26] The federal policy, as expressed in the legislative history to the Code, could not be clearer: preference law exists to discourage creditors from "racing to the courthouse," and to "facilitate the prime bankruptcy policy of equality of distribution."[27]

The foregoing examples illustrate that bankruptcy law modifies the property rights of secured creditors, primarily by depriving them of one or more of the property attributes defined by state law. One concern motivating this symposium—that of the undue influence of a blanket lien creditor who uses a § 363 sale to realize on its collateral[28]—raises a related question. That question is whether bankruptcy law can redefine one or more of those property attributes. The Code recognizes the secured

20. *See* U.C.C. § 9-609(a)(1).

21. *See* 11 U.S.C. §§ 362, 542; *see also* United States v. Whiting Pools, Inc., 462 U.S. 198, 208 (1983).

22. *See Whiting Pools*, 462 U.S. at 211.

23. *See* 11 U.S.C. § 547. Although the secured creditor's rights are not stripped on the date of the bankruptcy filing because the trustee must bring an avoidance action, the secured party whose interest is avoided is treated like an unsecured creditor for the purpose of distribution.

24. In order for a security interest to attach and therefore be enforceable, the secured party must give value. U.C.C. § 9-203 (b). Under the UCC, a creditor gives value if it takes security in satisfaction of a preexisting claim. U.C.C. § 1-204 (b).

25. Title 11 of the United States Code allows the trustee to avoid certain transfers made by the debtor within 90 days before the date of filing for bankruptcy. 11 U.S.C. § 547 (b).

26. *Id.* at § 547(i).

27. H.R. REP. NO. 95-595, at 177–79 (1977).

28. *See* Charles J. Tabb, *The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, 2015 U. ILL. L. REV. 765, 770.

creditor's entitlement to the value of its collateral[29] and also recognizes that the creditor's security interest extends to proceeds of its collateral, even if those proceeds are realized after the debtor has filed for bankruptcy.[30] The 2001 Amendments to Article 9 of the UCC expanded the definition of proceeds to include "rights arising out of the collateral,"[31] a definition that could so expand the idea of proceeds as to deprive unsecured claimants of any recovery at all.[32] Today, it is common for an entity to grant a security interest in all of its assets.[33] As a result, when a secured creditor forecloses on the assets of that entity, the creditor is selling the business, not discrete assets of the business.[34] Such a sale generates proceeds that can be attributed to the entity's going concern value. Entity sales in bankruptcy are designed to maximize this going concern value, because they eliminate the first-to-grab structure of state foreclosure law and enable transfers free and clear of claims to the assets involved.[35] Because of the unique nature of bankruptcy sales and the expansive view of proceeds embodied in the UCC and often shared by courts, some argue that "bankruptcy enhanced" going concern value should not be allocated to secured creditors but should instead be shared by the debtor's unsecured creditors.[36]

The other contributors to this symposium have addressed the complicated question of how to allocate going concern value.[37] The goal of this Article is more modest. In this Article, I argue that whether a secured creditor is entitled to going concern value in bankruptcy depends on the property rights that the secured creditor holds at the moment a bankruptcy petition is filed. Here is where *Butner* plays its proper role. Bankruptcy law need not incorporate the UCC Article 9 definition of "proceeds," but should only vary it if such variation is justified by a federal interest. Other authors have argued convincingly that such a federal interest exists.[38] Unfortunately, *Butner* and the myriad cases that cite to it give little guidance.

Several experts who have testified before the Commission have warned that any bankruptcy rule that would impair the rights of secured

29. 11 U.S.C. § 506.

30. *Id.* at § 552(b)(1).

31. U.C.C. § 9-102 (a)(64) (2014).

32. Some have criticized the UCC's expanded definition of proceeds as an expression of bankruptcy policy disguised in state law. *See, e.g.*, Warner, *supra* note 9, at 5.

33. The 2001 amendments to Article 9 of the UCC simplified the process for doing so. This policy choice codifies the idea of free alienability of property. *See* Harris & Mooney, *supra* note 19, at 2052.

34. *See* Harner, *supra* note 7, at 515.

35. *See* Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 892–93 (2014) (explaining the advantages to secured creditors of a going-concern sale in bankruptcy).

36. Edward J. Janger, *The Logic and Limits of Liens*, 2015 U. ILL. L. REV. 598, 606.

37. *See, e.g.*, *id.* at 594.

38. *See, e.g.*, Warner, *supra* note 9, at 21.

creditors would throw the capital markets into disarray.[39] This is where the federal interest comes into play. Whether *Butner* applies or not, Congress and the courts should be careful about upsetting certain creditor expectations. The certainty that secured creditors and the market desire is the certainty that the holder's security interest has the expected priority over the claims of others with an interest in the property. That point should not be ignored; most commercial relationships will be governed from beginning to end by state law, so, in fashioning federal rules to govern security interests, policymakers should be cognizant of the extent to which such rules might disrupt commercial relationships.[40] *Butner* and its progeny do not provide any guidance on this point, because all the case says is that state-created property rights should be respected unless a federal interest requires otherwise. The cases that cite *Butner* tend to, at worst, misapply it, and, at best, apply it correctly without elaborating on the types of federal policy that justify modification. Perhaps the latter goes without saying; bankruptcy is, after all, an expression of federal policy.

Part of the *Butner* confusion may be due to the fact that many bankruptcy distributional rules mirror their state law counterparts. For example, the Code states that a claim is a secured claim in the amount of the collateral value.[41] This is a bankruptcy rule, not a state law rule, but it mirrors a creditor's rights on state law foreclosure.[42] Whether or not this rule can be changed, by redefining "value," for instance,[43] is not a *Butner* question, because it relates to bankruptcy distribution. In the next Part, I will discuss *Butner* and then explain how its meaning has been obscured by overuse.

III. *BUTNER* AND ITS PROGENY

A. Butner*: Why the Fuss?*

Although *Butner* has gained iconic status as a statement of bankruptcy law's deference to state property law, the dispute in the case arose as a result of the plaintiff creditor's failure to follow bankruptcy proce-

39. *See, e.g.*, Testimony of A.J. Murphy, Co-Head, Global Leveraged Finance, Bank of America Merrill Lynch, Field Hearing in N.Y.C., N.Y., (Oct. 17, 2012), *available at* http://commission.abi.org/sites/default/files/statements/17oct2012/Murphy_testimony_final.DOC; Testimony of Lee Shaiman, Managing Director, GSO Capital Partners, Blackstone, Field Hearing, in N.Y.C., N.Y. (Oct. 17, 2012), New York, NY, *available at* http://commission.abi.org/sites/default/files/statements/17oct2012/Final_Shaiman_Written_Testimony.pdf.

40. *See* United States v. Kimbell Foods, Inc., 440 U.S. 715, 728–29 (1979); Theodore Eisenberg, *Bankruptcy Law in Perspective*, 28 UCLA L. REV. 953, 957 (1981) (arguing that bankruptcy rules should track nonbankruptcy rules because the "commercial world will work more smoothly if planning for commercial transactions may be limited to one set of legal rules"); Alfred Hill, *The Erie Doctrine in Bankruptcy*, 66 HARV. L. REV. 1013, 1035 (1953) (observing that the purpose of bankruptcy law is to "provide a system for the effectuation of what are for the most part state-created rights").

41. 11 U.S.C. § 506(a)(1) (2012).

42. *See generally United States Foreclosure Laws*, FORECLOSURELAW.ORG, http://foreclosurelaw.org/ (last visited Nov. 10, 2014) (providing access to state specific foreclosure laws).

43. Which Congress has already done for the purpose of consumer cases. 11 U.S.C. § 506(a)(2).

dure. The plaintiff, Butner, was a mortgage creditor who claimed an interest in postpetition rents from the debtor's real property.[44] Because the mortgage did not include an express assignment of rents, North Carolina's default rule on a mortgagee's right to rents applied outside of bankruptcy.[45] Under that law, a mortgagee could perfect its right to rents only if the mortgagee took possession of the real property.[46] Butner could not take possession because of the debtor's bankruptcy filing, and therefore, under state law, had no right to the postbankruptcy rents from the encumbered property.[47] Although the bankruptcy filing prevented him from taking possession of the real estate, Butner could have asked the court to appoint a receiver to sequester the rents. The debtor had first filed for an arrangement under Chapter IX of the Bankruptcy Act of 1898 and during that proceeding, the court appointed an agent to collect the rents.[48] That agent's appointment terminated when the court converted the case to a liquidation bankruptcy.[49] Butner's problem, therefore, was a result of his failure to follow a federal procedure to take steps that would have been analogous to the possession required by state law to grant him secured status in the rents in bankruptcy.[50]

Because Butner had failed to take any steps either before or after the bankruptcy filing to assert possessory rights over the real estate as required by state law, he argued that a federal rule of equity should govern a mortgagee's right to rents in bankruptcy. [51]

At the time, the circuits were split on the question of whether state or federal law governed a mortgagee's right to postpetition rents in bankruptcy. A majority of courts had held that if state law required a mortgagee to take possession of property in order to collect rents, then a mortgagee could be entitled to postpetition rents only if it had taken actual or constructive possession of the real estate.[52] A minority of circuits had decided otherwise, applying a federal rule of equity to recognize the fact that a bankruptcy filing would prevent a mortgagor from taking the affirmative acts necessary to perfect its interest in rents.[53]

44. Butner v. United States, 440 U.S. 48, 49 (1979).

45. *Id.* at 51–52.

46. *Id.* at 51.

47. *Id.*

48. Golden Enterprises, Inc. v. United States, 566 F.2d 1207, 1209 (4th Cir. 1977), *aff'd sub nom.* Butner v. United States, 440 U.S. 48 (1979).

49. *Id.* at 1210.

50. *Id.*

51. *Id.* at 1210.

52. *See, e.g.*, Tower Grove Bank & Trust Co. v. Weinstein (*In re* Hallenberg-Wagner Motor Co.), 119 F. 2d 120, 122 (8th Cir. 1941) (holding that "the construction of mortgages is governed by local state law").

53. *See, e.g.*, Cent. Hanover Bank & Trust Co. v. Philadelphia & Reading Coal & Iron Co., 99 F. 2d 642, 645 (3d Cir. 1938) (applying a federal rule of equity because "the bankruptcy proceeding has taken from the Debtor the possession of his property and in so doing has deprived the mortgage creditor of his ordinary remedy to reach the property mortgaged and its income").

The *Butner* court sided with the majority of circuits, setting forth its now famous rule regarding property rights.[54] The Court gave three reasons for uniform treatment by both state and federal courts within a state: such treatment reduces uncertainty, discourages forum shopping, and "prevent[s] a party from receiving a windfall merely by reason of the happenstance of bankruptcy."[55] Only the first two reasons, however, justify the holding. *Butner* involved a dispute about bankruptcy entry status, not about the treatment of that creditor in bankruptcy. Although status drives distributions, the issue in *Butner* was whether the creditor had a perfected security interest in a specific asset at the moment of bankruptcy, not how that asset would be distributed. Consistency of status is important; parties entering into transactions want to know that the status they bargained for will be respected regardless of how the transaction unfolds. That said, there may be some bankruptcy policy that justifies modifying a creditor's status on its entry into the bankruptcy process. The trustee's avoiding powers, which allow a trustee to avoid security interests that are enforceable under state law, represent such an expression of bankruptcy policy.[56] As I will explain below, some courts have lost sight of that distinction, extending the *Butner* holding to distributional questions.

Congress overruled the specific holding in *Butner* by statute. In 1994, Congress added section 552(b)(2) to the Code to provide that a security interest in rents extends to postpetition rents regardless of whether the applicable state law requires the debtor to take possession (or any other step) to perfect its interest in the rents.[57] Thus, although *Butner* held that a secured party's state-defined property attributes remained in place at the moment of its debtor's bankruptcy filing, fifteen years later Congress redefined one of those property attributes—perfected status in postpetition rents—for bankruptcy purposes.

B. Butner*'s Questionable Progeny*

The *Butner* opinion broke little, if any, new ground. In the thirty-five years since the Court issued it, however, judges, scholars, and litigants have cited it thousands of times for its statement on property rights.[58] Unfortunately, because many of those citations repeat that statement with little background context, *Butner* has morphed into a rule that appears to limit all property right modifications in bankruptcy. In

54. *Butner*, 440 U.S. at 51–54.

55. *Id.* at 55 (internal quotation marks omitted).

56. *See, e.g.*, 11 U.S.C. § 544 (2014) (trustee's strong-arm power); *id.* § 547 (trustee's power to avoid preferential transfers).

57. *See id.* § 552(b)(2) (a security interest in rents extends to postpetition rents to the extent provided in the security agreement, without reference to applicable state law); 5 COLLIER ON BANKRUPTCY ¶ 552.03 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013) (explaining that the purpose of § 552(b)(2) is to give a mortgagee an interest in postpetition rents regardless of any state law possession requirement).

58. A LEXIS search conducted on May 28, 2014 revealed 5126 total citations to the opinion.

this Section, I discuss some notable misuses of *Butner* to illustrate that it should not limit bankruptcy policy making.

1. *If It Is a Right, It Is Defined by State Law*

Courts will sometimes cite *Butner* for the rule that nonbankruptcy law determines all rights held by the debtor and its creditors.[59] This rule should not need a Supreme Court opinion for support; at the moment a debtor enters bankruptcy, only nonbankruptcy law can determine its rights and the rights of its creditors against it and its property.

The Supreme Court adopted an expansive view of *Butner* in *Raleigh v. Illinois Department of Revenue.*[60] At issue in *Raleigh* was not an interest in any specific asset of the debtor; rather, it was the extent of a claim. Specifically, the Court addressed the question of whether nonbankruptcy law determined the burden of proof on a tax claim.[61] The Code itself tells us that nonbankruptcy law determines the enforceability of a claim.[62] The Court held that because the burden of proof is a substantive element of a tax claim, the allocation of the burden was a matter of state law. Not only was there no need to go to *Butner*, because the Code yields to nonbankruptcy law on the substance of claims,[63] but doing so was inaccurate. The *Butner* holding addressed the extent of property rights, not the extent of all claims against the debtor, yet the Court in *Raleigh* expanded the *Butner* holding to encompass all matters affecting a creditor's position in bankruptcy.[64]

Once it had decided that the burden of proof was an "essential element of the claim itself,"[65] it would have reached the same result regardless of whether it had relied solely on the Code or on *Butner*. Despite its misuse of *Butner*, the Court in *Raleigh* recognized the supremacy of bankruptcy law by noting that "Congress of course may do what it likes with entitlements in bankruptcy."[66] Finding no provision in the Code allocating the burden of proof on a tax claim, the Court correctly applied state law.[67] It also subtly elaborated on *Butner* by distinguishing questions of bankruptcy distribution, which are governed by federal bankruptcy law, from those of status, which are "generally a function of underlying substantive law."[68]

59. *See, e.g.*, Raleigh v. Illinois Dep't of Revenue, 530 U.S. 15, 17 (2000).
60. *Id.*
61. *Id.* at 17.
62. 11 U.S.C. § 502(b)(1) (stating that a claim will be allowed unless it is unenforceable under applicable law).
63. *Raleigh*, 530 U.S. at 20.
64. *Id.*
65. *Id.* at 21.
66. *Id.*
67. *Id.* at 20.
68. *Id.* at 24.

2. *What About the Federal Interest?*

Some courts resort to *Butner* in cases where the Code provides for a specific bankruptcy treatment of a creditor's set of entitlements. The Supreme Court's opinion in *Nobelman v. American Savings Bank,*[69] which settled the question of whether a Chapter 13 plan could bifurcate the claim of undersecured home mortgagee, provides an example of such a misuse of *Butner*. The *Nobelman* Court was faced with the arguably ambiguous statement in the Code that a Chapter 13 plan may not "modify the rights" of a holder of a "claim secured only by a security interest in real property that is the debtor's principal residence."[70]

The parties in *Nobelman* asked the Court to resolve a statutory ambiguity, not to determine the extent of a security interest. The question was whether the proscription against modifying the rights of a home mortgagee prohibited modification of only the secured portion of that mortgagee's claim, as several circuits had held,[71] or of the entire claim, as a number of bankruptcy and district courts had held.[72] Although the lower courts disagreed on what it meant to modify the rights of a holder of a secured claim, they treated the question as one of statutory interpretation, not of state law property rights.[73] Some "no-bifurcation" courts also reasoned that the legislative history of the no-modification provision led to the conclusion that a Chapter 13 plan could not modify a home mortgage in any way.[74]

In resolving the split, the Supreme Court focused on the word "rights."[75] It opened its discussion of *Butner* by recognizing that "[i]n the absence of a controlling federal rule," state law determines property rights.[76] This is the first of the Court's *Butner* missteps. The prohibition on modifying the rights of home mortgage creditors is a controlling federal rule. Justice Stevens stressed this in his concurrence in *Nobelman*—the special treatment of home mortgages in Chapter 13 was motivated by the congressional desire to protect the home mortgage market.[77] Once Congress decided to give home mortgage creditors special treatment in bankruptcy, any state determination of protected rights should have yielded to a federally defined list.

69. 508 U.S. 324 (1993).

70. 11 U.S.C. § 1322(b)(2) (2012).

71. *See, e.g.*, Wilson v. Commonwealth Mortg. Corp., 895 F.2d 123, 124 (3d Cir. 1990); Hougland v. Lomas & Nettleton Co. (*In re* Hougland), 886 F.2d 1182, 1182 (9th Cir. 1989).

72. *See, e.g.*, *In re* Davidoff, 136 B.R. 567, 569 (Bankr. M.D. Fla. 1992); *In re* Russell, 93 B.R. 703, 707 (D.N.D. 1988).

73. *See In re* Hynson, 66 B.R. 246, 253 (Bankr. D.N.J. 1986) (observing that reading § 1322(b)(2) to protect only the secured portion of a mortgage creditor's claim would "carr[y] the syntax of the Bankruptcy Code to an absurd conclusion which is at odds with the general principles of statutory construction").

74. *Id.*

75. Nobelman v. Am. Sav. Bank, 508 U.S. 324, 328 (1993).

76. *Id.* at 329.

77. *Id.* at 332 (Stevens, J., concurring).

After looking to *Butner* for guidance, the Court in *Nobelman* set forth a catalog of the rights held by a secured creditor. That list included the creditor's rights to: repayment of the loan in installments at a specified interest rate, retain the lien until full payment of the debt, accelerate the loan on default and proceed against the real estate by foreclosure, and bring an action for a deficiency.[78] Some of these rights, such as the right to foreclose, are properly characterized as property rights because they establish the holder's rights as against the whole world. Others, such as the right to pursue a deficiency, are more properly characterized as contract rights. For the purpose of section 1322(b)(2), however, the distinction should not matter[79]—Congress had acted to protect *all* rights of the holder of a secured claim, so the federal interest was clear and *Butner* was inapplicable.

Butner should not have played any role in the Court's *Nobelman* decision. *Nobelman* was not a dispute about a creditor's status at the moment of bankruptcy; for the Code provision at issue to apply, the creditor must have a security interest in a home.[80] No one contested the property attributes of the mortgagee's security interest in that case; rather, the parties disputed the mortgagee's bankruptcy distribution.[81] That distribution is unquestionably a matter of federal law.

Litigation over the "hanging paragraph" added to Chapter 13 of the Code by the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") amendments provides a vivid illustration of the confusion over the role of *Butner* in bankruptcy law.[82] A model of poor drafting,[83] the hanging paragraph, as interpreted by courts, prohibits Chapter 13 cram down of an undersecured purchase money car loan if the debtor obtained the loan within 910 days before filing for bankruptcy and bought the car for personal use (called a "910 loan").[84] The plain language of the hanging paragraph does not explicitly prohibit cram down, rather, it says that "§ 506 shall not apply" to such loans.[85] Because section 506 is the Code section that bifurcates an undersecured creditor's claim into a secured claim equal to the value of the collateral and an unsecured claim for the deficiency, courts interpret the hanging paragraph to prohibit bifurcation of 910 loans.[86]

The hanging paragraph, like the prohibition of home mortgage modification, codifies a federal policy. In enacting the hanging para-

78. *Id.* at 329.

79. As Charles Tabb explains in his contribution to this symposium, the property/contract distinction may be irrelevant for other bankruptcy purposes as well. Tabb, *supra* note 29, at 798–99.

80. Nobleman, 508 U.S. at 327 (citing 11 U.S.C. § 1322(b)(2) (2012)).

81. *Id.* at 326.

82. 11 U.S.C. § 1325(a) (2012).

83. *See* Thomas F. Waldron & Neil M. Berman, *Principled Principles of Statutory Interpretation: A Judicial Perspective After Two Years of BAPCPA*, 81 AM. BANKR. L.J. 195, 224–28 (2007) (explaining the different ways that courts have dealt with the ambiguities in the hanging paragraph).

84. *In re* Wright, 492 F.3d 829, 831 (7th Cir. 2007).

85. 11 U.S.C. § 1325(a).

86. *See, e.g.*, *In re* Pruitt, 401 B.R. 546, 561 (Bankr. D. Conn. 2009).

graph, Congress intended to ensure that recent car loans are paid in full in Chapter 13. In another article, I explained why courts should not look to state law for the definition of "purchase money security interest" for hanging paragraph purposes.[87] Courts have looked to state law for a definition, citing a *Butner* mandate, even though *Butner* holds that state law does not apply when there is a contrary federal interest.[88] Because the hanging paragraph governs distribution to creditors in bankruptcy, its parameters should be defined entirely by federal law.

Application of the hanging paragraph has proved particularly thorny when the debtor decides to surrender the car rather than keep it and pay under Chapter 13. The surrender cases raise questions that test whether the hanging paragraph leads to a consequence unanticipated by the automobile lenders who pushed for its inclusion in the Code.[89] If the hanging paragraph prohibits bifurcation of an undersecured claim for the purpose of a Chapter 13 plan, what effect does it have when a debtor surrenders her car? Does it also prohibit bifurcation, thus depriving the secured party of its deficiency claim? Courts on both sides of the issue have relied on *Butner* to support their holdings.[90]

On the misuse side, the surrender cases suffer from the same deficiencies as *Nobelman*. Although the court in *Americredit Financial Services v. Tompkins*[91] correctly cited the *Butner* rule as one protecting property interests, it characterized the right of an undersecured creditor to pursue a deficiency as a protected property interest and thus inviolable under *Butner*.[92] The right to pursue a deficiency judgment is based in contract, however, not in property. A creditor's contract rights at the moment of a bankruptcy filing, like a creditor's property rights at that moment, are determined, in the absence of a contrary bankruptcy policy, by nonbankruptcy law. The Code expresses contrary bankruptcy policy in section 502, which disallows, for bankruptcy purposes, some contract claims that are enforceable under nonbankruptcy law.[93] As was the case in *Raleigh*, there was no need to go to *Butner* to protect the undersecured creditor from losing its right to a deficiency.[94] The court could have relied solely on section 502, which would have supported its ultimate finding that the hanging paragraph did not result in disallowance of the credi-

87. *See* Moringiello, *supra* note 10, at 973–79.

88. Butner v. United States, 440 U.S. 50, 55 (1979).

89. For a history of the legislative process that produced the hanging paragraph, see William C. Whitford, *A History of the Automobile Lender Provisions of BAPCPA,* 2007 U. ILL. L. REV. 143, 150.

90. *See, e.g.*, Americredit Fin. Servs., Inc. v. Tompkins, 604 F.3d 753, 757 (2d Cir. 2010) (holding that because *Butner* dictates that bankruptcy law respect state-created property rights, the hanging paragraph does not prohibit an undersecured car lender from collecting a deficiency after surrender); *In re* Pruitt, 401 B.R. at 564 (limiting the effect of *Butner* to the definition of a debtor's rights at the moment it enters bankruptcy).

91. *Tompkins*, 604 F.3d at 753.

92. *Id.* at 758.

93. 11 U.S.C. § 502(b) (2012); COLLIER ON BANKRUPTCY ¶ 502.03 [c] (Alan N. Resnick & Henry J. Sommer, eds. 16th ed.).

94. *See supra* notes 66–69 and accompanying text.

tor's deficiency claim upon surrender.[95] The court mentioned section 502 as a basis for its holding, but attributed the relationship between that section and state law as one mandated by *Butner* rather than by its plain language.[96]

The court also ignored the fact that there was a contrary federal interest in play; Congress had made a special rule for undersecured car lenders in the BAPCPA amendments to the Code. By stating that section 506 "shall not apply" to undersecured car loans, it removed those loans from bankruptcy law's general distribution scheme for secured debts.[97] The court in *Tompkins* correctly stated that creditors "don't need § 506 to create, allow, or recognize security interests."[98] That is a true statement; although section 506 mirrors state law, in that it reflects the fact that a secured creditor, on foreclosure, is entitled to the value of its collateral and to an unsecured claim for the deficiency, if the value of the collateral is not sufficient to satisfy the loan,[99] it is a federal rule, not an incorporation of state law. The hanging paragraph expresses, albeit confusingly, the congressional intention to replace the state law distributional rule for undersecured loans with a federal rule of full payment. Rather than defaulting to *Butner*, the court could have used this federal policy to justify its holding that the undersecured "910 lender" should retain its right to a deficiency upon surrender of the collateral regardless of the fact that the hanging paragraph renders it fully secured absent surrender.

IV. RECOGNIZING THE FEDERAL INTEREST IN THE RIGHTS OF SECURED CREDITORS

Part III set forth various misuses of *Butner* to illustrate that the frequency of its citation and expansiveness of its interpretation renders almost useless any guidance given by the opinion. The decisions that give proper weight to both halves of the *Butner* rule illustrate that the rule places few, if any, limits on the treatment that Congress may give secured creditors.

Some courts recognize that at most, the *Butner* principle is a default rule that applies in the absence of a contrary bankruptcy rule. The opinion in *Tidewater Finance Co. v. Moffett* (*In re Moffett*)[100] illustrates an appropriate application of both halves of *Butner.* The plaintiff secured creditor in *Moffett* had repossessed the debtor's car before the debtor

95. *See* 11 U.S.C. § 502(b) (2012) (listing the grounds for disallowance of a creditor's claim).

96. *Tompkins*, 604 F. 3d at 758.

97. *Id.* at 757.

98. *Id.* at 758.

99. 11 U.S.C. § 506(a) (2012) ("[A] . . . claim . . . secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim."); U.C.C. § 9-615 (2014) (directing that the proceeds of sale of collateral be applied to the outstanding secured obligation and giving the secured party the right to collect a deficiency if the proceeds of sale are not sufficient to satisfy the debt).

100. 288 B.R. 721 (Bankr. E.D. Va. 2002).

filed for Chapter 13.[101] The debtor proposed in her plan to recover and keep her car.[102] In its motion for relief from the automatic stay, the creditor argued (wrongly) that, according to the Virginia law that governed rights in the vehicle, the right of the debtor after repossession was not a right in the vehicle itself, but rather an intangible right to redeem the vehicle.[103] The creditor then argued that because the debtor could redeem the car under state law only by paying the full amount of the debt in a lump sum, the debtor was unable to cure the default and reinstate the accelerated claim in Chapter 13.[104] In addressing the flaws in this argument, the court stressed that *Butner* does not allow state property law to trump federal bankruptcy law.[105] Instead, the right to cure and reinstate an accelerated claim is a bankruptcy right that "cannot be frustrated by the law of any state."[106] The court saw its decision as "entirely consistent" with *Butner* in that it held that "state law determines the debtor's property interests, but bankruptcy law determines the treatment of those interests."[107]

Other courts have recognized that *Butner* provides no more than a starting point for the determination of rights in bankruptcy. The opinion in another Chapter 13 hanging paragraph surrender case, *In re Pruitt*, provides a particularly well-reasoned example that stressed that the use of state law in the bankruptcy distributional scheme is "wholly at the prerogative of Congress, subject only to any Constitutional provision that might otherwise constrain Congress."[108] As I have noted above, many courts invert the *Butner* rule by citing it to provide a presumption in favor of state law.[109] The court in *Pruitt* situates *Butner* in its proper place by recognizing that *Butner* is simply a statement of congressional choice to permit state law to "define the *pre-existing, i.e.* pre-bankruptcy, rights of the parties to a bankruptcy case."[110]

V. CONCLUSION: WHAT TO DO ABOUT THE RIGHTS OF SECURED CREDITORS

Other authors in this symposium have explored the substantive questions of the extent of the secured creditor's rights in bankruptcy. The increased use of secured credit raises questions about the legal limits of blanket liens[111] and the proceeds in which a secured creditor can claim an

101. *Id.* at 723.
102. *Id.*
103. *Id.* at 726.
104. *Id.* at 730–31.
105. *Id.* at 725.
106. *Id.* at 731.
107. *Id.* at 730–31.
108. 401 B.R. 546, 554 (Bankr. D. Conn. 2009).
109. *Id.* at 564.
110. *Id.* at 565 (emphasis in original).
111. *See* Barry E. Adler, *Priority in Going Concern Surplus*, 2015 U. Ill. L. Rev. 811, 812; Janger, *supra* note 37, at 595.

interest.[112] These are difficult questions that resurrect debates about the proper role of bankruptcy law in resolving the financial distress of a business. Policymakers should not look to *Butner* for help in resolving those questions. Only nonbankruptcy law can determine the rights of a debtor and its creditors before the debtor enters bankruptcy. The rights of a secured creditor are thus governed by state law and no federal interest intervenes. It is at the moment of bankruptcy, however, where the *Butner* rule has relevance, but because it yields to the "federal interest," the rule itself provides little guidance as to whether bankruptcy law should modify a state law property rule.

Bankruptcy law modifies several state law rights at the bankruptcy entry point. The trustee's power to avoid preferential transfers provides one example.[113] The Code's invalidation of transfer restrictions provides another.[114] The increasingly specific definitions of value in consumer cases that were added to the Code by the BAPCPA amendments illustrate that *Butner* and state law do not constrain Congress in deciding the extent of a security interest in bankruptcy.[115]

Bankruptcy's distributional rules reflect federal policies. As a result, the in-bankruptcy treatment of secured creditors is not limited by *Butner*, but should be informed by the analysis in another Supreme Court case, *United States v. Kimbell Foods*.[116] *Kimbell Foods* is not a bankruptcy case, rather, it discussed whether state law should serve as a federal rule of decision to determine the priority of liens arising in federal loan programs.[117] The Court in *Kimbell Foods* gave great deference to state commercial law, recognizing that "[i]n structuring financial transactions, businessmen depend on state commercial law to provide the stability essential for reliable evaluation of the risks involved."[118] The Court was reluctant to fashion a federal rule that differed from the otherwise applicable state law, not because a unique federal priority scheme was otherwise inappropriate, but because imposing one would lack the careful legislative deliberation that should accompany a rule that could upset settled commercial expectations.[119]

In addressing some of the issues raised in this symposium, Congress must be cognizant of the commercial expectations of debtors and creditors and, with that knowledge, determine whether bankruptcy rules should disturb those expectations. Even if one concedes that, outside of bankruptcy, a party should be able to direct all of its property to a blan-

112. Harner, *supra* note 7, at 527.
113. 11 U.S.C. § 547 (2012).
114. *Id.* at § 541(c).
115. *See id.* at § 506(a)(2) (defining "value" of personal property in cases involving an individual debtor, with a more specific definition when that personal property was acquired for the debtor's personal, family, or household use).
116. 440 U.S. 715 (1979).
117. For a longer discussion of *Kimbell Foods*, see Moringiello, *supra* note 10, at 990–93.
118. *Kimbell Foods*, 440 U.S. at 739.
119. *Id.* at 739–40.

ket lien secured creditor,[120] that need not be the result under bankruptcy law. Conversely, a secured creditor can expect under state law to receive its collateral, or the value of its collateral, upon its debtor's default.[121] If the bankruptcy process enhances that value, however, the question of whether the creditor should receive the enhanced value is a question of federal, not state, law.

If the increased use of secured credit by firms has changed the historic balance of Chapter 11, then any discussion of the rights of secured creditors in bankruptcy should be rooted in federal policy, not in state law. Congress can modify state law property rights in bankruptcy,[122] but should do so with a clearly stated policy goal informed by careful deliberation. By limiting its protection of state law property rights to situations in which a federal interest does not require a contrary result, *Butner* does little to inform that deliberation.

120. *See* Harris & Mooney, *supra* note 19, at 2061.

121. *Id.* at 2041.

122. Congress did exactly that fifteen years after the Supreme Court ruled in *Butner* by adding § 552(b) to the Code. *See* note 62 and accompanying text.