

**95th Annual National Conference of Bankruptcy Judges
October 6-9, 2021 Indianapolis, Indiana**

**WHEN KEEPING SOMETHING MEANS
DOING NOTHING:**

**THE AUTOMATIC STAY & RETENTION
OF ESTATE PROPERTY**

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**When Keeping Something Means Doing
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The Automatic Stay & Retention of Estate
Property**

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I. *City of Chicago v. Fulton*, 141 S. Ct. 585 (2021)

a. Facts

- i. Four different debtors filed chapter 13 petitions after the City of Chicago seized their cars.
- ii. In each case, the City had refused to return the debtor's car notwithstanding the debtor's bankruptcy filing.

b. Bankruptcy Court Decisions

- i. Four different bankruptcy judges in the Northern District of Illinois held that the City's refusal to return the debtors' vehicles violated §362(a)(3), following the Seventh Circuit's decision in *Thompson v. GMAC, LLC*, 566 F.3d 699 (7th Cir. 2009).
 1. *In re Howard*, 584 B.R. 252 (Bankr. N.D. Ill. 2018); *In re Peake*, 588 B.R. 811 (Bankr. N.D. Ill. 2018); *In re Shannon*, 590 B.R. 467, 472 (Bankr. N.D. Ill. 2018); *In re Fulton*, No. 18 BK 02860, 2018 WL 2570109 (Bankr. N.D. Ill. May 31, 2018).
- ii. In one of the cases, *Shannon*, the bankruptcy court held that the City had also violated § 362(a)(4) because "[t]he City's continued possession of Shannon's car, combined with its demand for payment before it will release the car, is an act to enforce its lien," *id.* at 479, and §362(a)(6) because "a passive refusal to cooperate with a debtor in order to coerce the payment of a pre-petition debt" violates §362(a)(6). *Id.* at 478.

c. Seventh Circuit

- i. On consolidated direct appeal from the bankruptcy courts, the Seventh Circuit affirmed, holding that the City “violated the automatic stay pursuant to §362(a)(3) by retaining possession of the debtors’ vehicles after they declared bankruptcy.” *In re Fulton*, 926 F.3d 916, 924 (7th Cir. 2019).
- ii. Although both the City and the Debtors-Appellees raised and argued the question of whether the City violated §§ 362(a)(4) and (a)(6), the court did not reach these arguments. *Id.* at 926 n.1.

d. Supreme Court

- i. The Supreme Court granted certiorari and held that passive retention of estate property does not violate §362(a)(3). *Fulton*, 141 S. Ct. at 589.

1. Text

- a. The Court held that a natural reading of §362(a)(3) leads to the conclusion that retention of property is not an act to exercise control. “The language used in 11 U.S.C.S. § 362(a)(3) suggests that merely retaining possession of estate property does not violate the automatic stay. Under that provision, the filing of a bankruptcy petition operates as a ‘stay’ of ‘any act’ to ‘exercise control’ over the property of the estate. Taken together, the most natural reading of these terms—‘stay,’ ‘act,’ and ‘exercise control’—is that § 362(a)(3) prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed.” *Id.* at 590.
 - i. A **stay** preserves the status quo. *Id.* at 590 (“‘[S]tay’ is commonly used to describe an order that ‘suspend[s] judicial alteration of the status quo.’” (quoting *Nken v. Holder*, 556 U.S. 418, 429 (2009))).
 - ii. An **act to exercise control** requires more than continued possession. *Fulton*, 141 S. Ct. at 590 (“[S]aying that a person engages in an ‘act’ to ‘exercise’ his or her power over a thing communicates more than merely ‘having’ that power. Thus the language of § 362(a)(3) implies that something more than merely retaining power is required to violate the disputed provision.”).

2. Structure of Code

- a. The Seventh Circuit's construction would render § 542(a) largely superfluous. *Id.* at 591 ("Reading 'any act ... to exercise control' in § 362(a)(3) to include merely retaining possession of a debtor's property would make that section a blanket turnover provision. But as noted, § 542 expressly governs '[t]urnover of property to the estate,' and subsection (a) describes the broad range of property that an entity 'shall deliver to the trustee.' That mandate would be surplusage if § 362(a)(3) already required an entity affirmatively to relinquish control of the debtor's property at the moment a bankruptcy petition is filed.")
- b. The Seventh Circuit's construction would render §§ 362(a)(3) and 542 contradictory. §542 carves out exceptions to the turnover command for property of "inconsequential value or benefit to the estate"; § 362(a)(3) is absolute. *Id.*

3. Legislative History

- a. "Exercise control" added to §362(a)(3) in 1984 amendments to the Code, with no legislative history suggesting an intent to require turnover of seized collateral.
- b. The amendments would not likely have affected such an "important change" without an express intent to do so.
 - i. "[T]ransforming the stay in § 362 into an affirmative turnover obligation would have constituted an important change. And it would have been odd for Congress to accomplish that change by simply adding the phrase 'exercise control,' a phrase that does not naturally comprehend the mere retention of property and that does not admit of the exceptions set out in § 542." *Id.* at 592
- e. Justice Sotomayor's concurrence
 - i. Justice Sotomayor concurred in the judgment, but emphasized both that the Court did not decide whether the City violated other provisions of § 362(a) and that it did not determine how §542(a) operates. *Id.* at 592 (Sotomayor, J., concurring) ("The City's conduct may very well violate one or both of these other provisions. The Court does not decide one way or the other.").

- ii. Justice Sotomayor also wrote at length about the harm experienced by debtors stuck in a cycle of poverty exacerbated by traffic and parking fines. *Id.* at 593–94.
- iii. Ultimately, Justice Sotomayor concluded that “any gap left by the Court’s ruling today is best addressed by rule drafters and policymakers, not bankruptcy judges.” *Id.* at 595.

f. Remand to Seventh Circuit

- i. On remand to the Seventh Circuit, the Debtors argued that the Seventh Circuit should consider whether the City violated 362(a)(4) and (a)(6), which were argued but not addressed. *In re Fulton*, 843 F. App’x 799, 800 (7th Cir. 2021).
- ii. The court declined, holding the common question raised and addressed on direct appeal centered on § 362(a)(3). *Id.* It remanded for further proceedings in two cases where alternative arguments were raised below and vacated the other two judgments where only § 362(a)(3) was addressed in the bankruptcy court. *Id.* at 800–01.

g. **Four questions in aftermath of Fulton:**

- i. What should similarly situated debtors do?
- ii. What minimum action will cause a violation of § 362(a)(3)?
- iii. Can retaining estate property violate other Code provisions?
- iv. What steps can, or should, Congress take to remedy the result in Fulton?

II. **What should a debtor do now?**

- a. Attempt a consensual resolution. *See* Robert C. Furr & Jason Rigoli, *Can I Get My Car Back?*, Am. Bankr. Inst. J., June 2021, at 24.
- b. Proceed under § 542(a). *See In re Larimer*, 27 B.R. 514, 516 (Bankr. D. Idaho 1983) (“There is no requirement in the Code that the trustee make demand, obtain a court order, or take any further action in order to obtain a turnover of the estate’s property. Failure of an entity to do so, after notice of the estate’s interest in property held by it, is probably contumacious.”).
- i. Some courts require proceeding by adversary proceeding due to the language of Bankruptcy Rule 7001(1). As Justice Sotomayor noted, “[b]ecause adversary proceedings require more process, they take more time.” *Fulton*, 141 S. Ct. at 594.

- ii. Other courts permit proceeding by contested matter, particularly if no objection is made. *In re Kenny G Enters., LLC*, 692 F. App'x 950, 952 (9th Cir. 2017) (affirming district court's imposition of sanctions for failure to comply with § 542(a) turnover order).

III. **What action by a creditor like the City of Chicago *would* constitute a prohibited act to exercise of control of estate property?**

- a. *Fulton* does not provide any wiggle room: continued retention of estate property, without more, does not violate §362(a)(3). The opinion provides little if any guidance as to what minimum action might constitute a prohibited exercise of control.
- b. The creditor's act needs to be an "affirmative action"—and likely one that changes the creditor or debtor's rights with respect to the estate property.
 - i. Justice Sotomayor's concurrence cited *Cowen* for the proposition that a sale of the debtor's property would violate §362(a)(3). *Fulton*, 141 S. Ct.at 593 n.1 (Sotomayor, J., concurring). ("Even though § 362(a)(3) does not require turnover, whether and when the City may sell impounded cars is an entirely different matter." (citing *In re Cowen*, 849 F.3d 943, 950 (10th Cir. 2017))).
 - 1. This form of self-help would likely violate other provisions of 362(a).
 - ii. Is there something less than a change in ownership that would constitute a prohibited exercise of control?
 - 1. Making use of the property – for example, letting a City employee use the car to commute to work – would likely violate the stay.
 - 1. The City argued that 362(a)(3) is only intended to prohibit acts to take "control" intangible property just as they were stayed from taking acts to "obtain possession" of tangible property. Continuing to control an estate cause of action, even though already being controlled before the bankruptcy filing, would probably also be an exercise of control, like using a piece of seized collateral.

IV. **Does retention of estate property violate other provisions of 362(a)?**

- a. The *Fulton* Court did not go beyond § 362(a)(3). *Fulton*, 141 S. Ct.at 592 n.2 ("In respondent Shannon's case, the Bankruptcy Court determined that by retaining Shannon's vehicle and demanding payment, the City also had violated §§ 362(a)(4) and (a)(6). Shannon presented those theories to the Court of Appeals, but the court did not reach them. 926 F.3d at 926, n. 1. Neither do we.").

- i. Justice Sotomayor noted that “§ 362(a)’s other provisions may require a creditor to return a debtor’s property.” *Id.* at 592 (citing *In re Kuehn*, 563 F.3d 289, 294 (7th Cir. 2009)).
- b. **§362(a)(6)**. Prohibits “any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case.” Is refusing to return the debtor’s property an act to collect a debt?
 - i. Return conditioned on payment. *In re Shannon*, 590 B.R. at 478 (§ 362(a)(3)’s “prohibition includes a passive refusal to cooperate with a debtor in order to coerce the payment of a pre-petition debt.”).
 - ii. College transcripts.
 1. In *Kuehn*, 563 F.3d 289 (7th Cir. 2009), the Seventh Circuit held that a school violates § 362(a)(6) when it refuses to release a debtor’s educational transcript because the debtor has not paid her tuition. *See id.* at 291–92, 294. *See also, e.g., Andrews Univ. v. Merchant (In re Merchant)*, 958 F.2d 738, 741 (6th Cir. 1992); *Virginia Union Univ. v. Parham (In re Parham)*, 56 B.R. 531, 533 (Bankr. E.D. Va. 1986); *Lanford v. Macalester Coll. (In re Lanford)*, 10 B.R. 132, 133 (Bankr. D. Minn. 1981); *In re Ware*, 9 B.R. 24, 25 (Bankr. W.D. Mo. 1981); *In re Heath*, 3 B.R. 351, 355 (Bankr. N.D. Ill. 1980).
 2. Do these cases support a §362(a)(6) violation?
 - a. As in *Shannon*, the schools demanded payment in exchange for the return of the debtor’s property that was in the creditor’s possession as of the petition date.
 - iii. Other “passive” violations of § 362(a)(6) that don’t squarely involve estate property:
 1. Creditor makes educational loan repayment a precondition for a debtor:
 - to attend classes, *In re Parkman*, 27 B.R. 460, 461–62 (Bankr. N.D. Ill. 1983), overruled on other grounds, *Wilson v. Harris Tr. & Sav. Bank*, 777 F.2d 1246 (7th Cir. 1985);
 - to graduate, *Carson v. Logan Coll. of Chiropractic (In re Carson)*, 150 B.R. 228, 231 (Bankr. E.D. Mo. 1993);
 - or to receive a diploma, *California Coast Univ. v. Aleckna (In re Aleckna)*, 543 B.R. 717, 724–25 (Bankr. M.D. Pa. 2016).

2. Creditor demands repayment of prepetition debts to restore utility service that was discontinued prepetition, *In re Parks*, No. 07-18341, 2008 WL 2003163, at *5–6 (Bankr. N.D. Ohio May 6, 2008).
 3. Creditor requires payment of a debtor’s prepetition condominium fees as a condition to the debtor’s participation in meetings of a condominium association, *Gordon Props., LLC v. First Owners Ass’n of Forty Six Hundred (In re Gordon Props., LLC)*, 460 B.R. 681, 692 (Bankr. E.D. Va. 2011).
 4. Creditor refuses to engage in postpetition business with a debtor until the debtor repays a prepetition debt, see *Sportfame of Ohio, Inc. v. Wilson Sporting Goods Co. (In re Sportfame of Ohio, Inc.)*, 40 B.R. 47, 49–50 (Bankr. N.D. Ohio 1984); *In re Haffner*, 25 B.R. 882, 886–87, 886 n.4 (Bankr. N.D. Ind. 1982).
- c. **§362(a)(4)**. Prohibits “any act to create, perfect, or *enforce* any lien against property of the estate.”
- i. *In re Shannon*, 590 B.R. at 479 (Bankr. N.D. Ill. 2018) (“The City’s continued possession of Shannon’s car, combined with its demand for payment before it will release the car, is an act to enforce its lien.”).
 - ii. Is continued retention of estate property an act to enforce a lien?
 1. *Text*. The Bankruptcy Code does not define “enforce” as used in §362(a)(4), but that term’s dictionary definition encompasses actions “to extort” or “compel” a person, as well as actions that “give force or effect to” a legal right. See, e.g., OXFORD-ENGLISH DICTIONARY, “Enforce” (2020) (“to extort . . . concessions . . . from a person” or “to compel observance of (a law)”); MERRIAM-WEBSTER, “Enforce” (2021) (“to compel”); BLACK’S LAW DICTIONARY, “Enforce” (11th ed. 2019) (“To give force or effect to (a law, etc.); to compel obedience to”).
 2. *Other contexts*. Continued possession of collateral might “enforce” a possessory lien because separating a debtor from accessing the collateral incentivizes her to satisfy the debt. See, e.g., *In re Midway Airlines, Inc.*, 383 F.3d 663, 672 (7th Cir. 2004) (“The right to retain possession of the property to enforce a possessory lien continues until such time as the charges for [the creditor’s] services are paid.”) (internal quotation and alteration omitted) (emphasis added); *Bull v. Mitchell*, 114 Ill. App. 3d 177, 181 (Ill. App. Ct. 1983) (same); *In re Patterson*, 967 F.2d 505, 512 (11th Cir. 1992) (bank’s freezing of debtor’s funds due to debt owed to

bank and bank's refusal to grant debtor access to funds were acts "to enforce [bank's] lien in violation of the express terms of Section 362(a)(4)"); *In re Del Grosso*, 111 B.R. 178, 181 (Bankr. N.D. Ill. 1990) (noting that a "possessory lien" permits a creditor to "retain possession of [a debtor's] property" until payment on its claim) (*rev'd on other grounds by* *In re Del Grosso*, 129 B.R. 156 (N.D. Ill. 1991)).

3. *Contrary authority.* Other courts have noted that "enforcing" a lien through continued possession is distinct from foreclosing the lien through sale. *See In re Outboard Marine Corp.*, 304 B.R. 844, 863 (Bankr. N.D. Ill. 2004) (distinguishing "enforcing" a lien from selling the property subject to the lien).

V. What if anything should Congress do to remedy this result?

- a. Does the current system work?
 - i. Justice Sotomayor sees a need for improvement. She explained: "It is up to the Advisory Committee on Rules of Bankruptcy Procedure to consider amendments to the Rules that ensure prompt resolution of debtors' requests for turnover under § 542(a), especially where debtors' vehicles are concerned. Congress, too, could offer a statutory fix, either by ensuring that expedited review is available for § 542(a) proceedings seeking turnover of a vehicle or by enacting entirely new statutory mechanisms that require creditors to return cars to debtors in a timely manner." *Fulton*, 141 S. Ct. at 595.
- b. Should passive retention violate the stay?
 - i. If so, what kind of a demand should a debtor need to make?
 - ii. What exceptions would apply?
- c. Is the current system merely too slow, or too costly?
- d. *See also* Caitlin M. McAuliffe, *Creditors, Keepers: Passive Retention of Estate Property and the Automatic Stay*, 74 Vand. L. Rev. 829, 832 (2021) (proposing that § 362(a)(3) be amended to prohibit "any exercise of control over property of the estate that the debtor may require for the successful completion of its payment plan confirmed under chapters 12 and 13").