U.S. Supreme Court Holds That a Creditor's "Mere Retention" of Bankruptcy Estate Property Does Not Violate One Automatic Stay Provision, But Leaves a Number of Other Questions Unanswered

*J.R. Smith and Nathan Kramer**

The U.S. Supreme Court addressed issues related to the automatic stay and a creditor's ability to retain property of a debtor's estate upon the commencement of a bankruptcy case. The authors of this article discuss the decision and the open issues.

The U.S. Supreme Court issued its decision in *City of Chicago, Illinois v. Fulton*,[1] which addresses issues related to the automatic stay and a creditor's ability to retain property of a debtor's estate upon the commencement of a bankruptcy case.

Background

The *Fulton* decision is a consolidation of four similar cases where the city of Chicago impounded debtor cars pre-petition in response to unpaid traffic tickets and fines. After filing for bankruptcy, each debtor requested that the city return the respective vehicles. In each case, the city refused to return the vehicles. The debtors then filed motions claiming that the city violated Section 362(a)(3) of the Title 11 of the U.S. Code (the "Bankruptcy Code"), which provides that the initiation of a bankruptcy case "operates as a stay, applicable to all entities, of . . . any act to obtain possession of property of the estate or . . . to exercise control over property of the estate."[2]

The U.S. Bankruptcy Court for the Northern District of Illinois found that the city's retention of the debtors' vehicles violated the automatic stay and ordered that the city return the vehicles to the debtors. The U.S. Court of Appeals for the Seventh Circuit affirmed the bankruptcy court's decision. The city appealed

*J.R. Smith is a partner at Hunton Andrews Kurth representing corporate debtors, secured and unsecured creditors, bondholders, lessors, equity interests and trustees in connection with U.S. and international/cross-border restructurings, workouts, Chapter 11, Chapter 15 cross-border bankruptcies, SIPA proceedings, and crisis management. Nathan Kramer is an associate at the firm focusing on corporate restructuring, bankruptcy, creditors' rights, and other insolvency-related matters. The authors may be contacted at jrsmith@huntonak.com and nkramer@huntonak.com, respectively.

the Seventh Circuit's decision to the Supreme Court.

The Supreme Court's Decision

The Supreme Court granted certiorari to resolve a split at the court of appeals level concerning whether a creditor violates Section 362(a)(3) of the Bankruptcy Code by retaining possession of property of the bankruptcy estate after the debtor files his or her bankruptcy petition.[3]

The Supreme Court vacated and remanded the Seventh Circuit's decision, holding that the "mere retention of property does not violate § 362(a)(3)."[4]

The Supreme Court reasoned that Section 362(a)(3) "halts any affirmative act that would alter the status quo as of the time of the filing of a bankruptcy petition."[5] Exercising control over property of the estate, as that phrase is used in Section 362(a)(3), "implies that something more than merely retaining power is required to violate the disputed provision."[6]

Furthermore, to the extent that the language of Section 362(a)(3) is ambiguous, such ambiguity is resolved in favor of the creditor for two reasons elucidated by reading Section 362(a)(3) in conjunction with Section 542(a) of the Bankruptcy Code.[7] First, Section 542(a) of the Bankruptcy Code governs turnover of property of the debtor's bankruptcy estate, and (with certain, limited good-faith exceptions) compels an entity "in possession, custody or control" of property of the estate to turnover such property to the bankruptcy trustee.[8] The Court reasoned that turnover pursuant to Section 542(a) "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."[9]

Second, Section 542(a) carves out an exception to the turnover requirement for property that is "of inconsequential value or benefit to the estate."[10]

The Court held that it would be an "odd construction" if Section 362(a)(3) compelled immediate turnover of all estate property, when Section 542(a) expressly does not compel turnover of inconsequential property. Thus, the Court held that Section 362(a)(3) does not require that a creditor immediately turnover a debtor's vehicle as soon as the debtor files his or her bankruptcy petition.

While the *Fulton* decision resolves the narrow circuit split concerning whether "mere retention" of property of the estate violates Section 362(a)(3) of the Bankruptcy Code, it leaves a number of related questions unanswered. The opinion specifically states that the Court does not decide whether the city's retention of the debtors' vehicles violates any of the other provisions of Section 363(a) of the Bankruptcy Code.[11] Justice Sotomayor, in concurrence, specifically emphasizes:

> that the Court has not decided whether and when § 362(a)'s other provisions may require a creditor to return a debtor's property. Those provisions stay, among other things, "any act to create, perfect, or enforce any lien against property of the estate" and "any act to collect, assess, or recover a claim against [a] debtor" that arose prior to bankruptcy proceedings. §§ 362(a)(4), (6); *see, e.g.*, *In re Kuehn*, 563 F.3d 289, 294, 61 Collier Bankr. Cas. 2d (MB) 1212, 243 Ed. Law Rep. 624, Bankr. L. Rep. (CCH) P 81465 (7th Cir. 2009) (holding that a university's refusal to provide a transcript to a student-debtor "was an act to collect a debt" that violated the automatic stay). Nor has the Court addressed how bankruptcy courts should go about enforcing creditors' separate obliga-

tion to "deliver" estate property to the trustee or debtor under § 542(a). 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.[12]

Conclusion

While the *Fulton* decision is favorable to creditors, whether a creditor's "mere retention" of estate property violates any other subsection of 362(a) remains an important open issue. The narrow *Fulton* decision leaves unresolved a number of questions concerning whether and under what circumstances creditors can retain estate property in connection with other common pre-bankruptcy collection remedies, such as attachment and garnishment, without violating subsections 362(a)(4) and (a)(6).

Absent future clarity from the Supreme Court, such questions likely will continue to generate disputes between debtors and creditors and splits at the court of appeals level. Until there are any future Supreme Court or legislative developments, creditors should continue to proceed with caution in situations where they are retaining property and take heed of the prevailing lower court decisions in the relevant jurisdictions.

NOTES:

[1]*City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021).

[2]11 U.S.C.A. § 362(a)(3).

[3]*Compare In re Fulton*, 926 F.3d 916, 924, 67 Bankr. Ct. Dec. (CRR) 100, Bankr. L. Rep. (CCH) P 83412 (7th Cir. 2019), cert. granted, 140 S. Ct. 680, 205 L. Ed. 2d 449 (2019) and vacated and remanded, 141 S. Ct. 585, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021), *In re Weber*, 719 F.3d 72, 81, 69 Collier Bankr. Cas. 2d (MB) 1168, Bankr. L. Rep. (CCH) P 82484 (2d Cir. 2013) (abrogated by, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021)), *In re Del Mission Ltd.*, 98 F.3d 1147, 1151–52, 29 Bankr. Ct. Dec. (CRR) 1155, 36 Collier Bankr. Cas. 2d (MB) 1658, Bankr. L. Rep. (CCH) P 77176, 36 Fed. R. Serv. 3d 512 (9th Cir. 1996) (abrogated by, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021)), and *In re Knaus*, 889 F.2d 773, 774–75, 19 Bankr. Ct. Dec. (CRR) 1691, Bankr. L. Rep. (CCH) P 73117 (8th Cir. 1989) (abrogated by, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021)) (holding that a creditors' passive retention of repossessed cars or other property in which the estate has an ownership interest violates the automatic stay); *with In re Denby-Peterson*, 941 F.3d 115, 132, 67 Bankr. Ct. Dec. (CRR) 236, Bankr. L. Rep. (CCH) P 83459 (3d Cir. 2019), and *In re Cowen*, 849 F.3d 943, 950, 63 Bankr. Ct. Dec. (CRR) 211, 77 Collier Bankr. Cas. 2d (MB) 438 (10th Cir. 2017) (holding creditors do not violate the automatic stay by passively retaining possession of property in which the estate has an interest).

[4]*City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 589, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021).

[5]*City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 589, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021).

[6]*City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 589, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021).

[7]*City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 589, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021).

[8]11 U.S.C.A. § 542(a); *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 590–92, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021).

[9]*City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585, 591, 208 L. Ed. 2d 384, 69 Bankr. Ct. Dec. (CRR) 160, Bankr. L. Rep. (CCH) P 83578 (2021).

[10]*Chicago, Illinois v. Fulton*, 141 S.Ct. 585, 591 at *4.

[11]*City of Chicago, Illinois v. Fulton*, 141 S.Ct. 585, 595 at *4 & n.2 ("Nor do we settle the meaning of other subsections of § 362(a). We hold only that mere retention of estate property after the filing of a bankruptcy petition does not violate § 362(a)(3) of the Bankruptcy Code. hellip; [T]he Bankruptcy Court determined that by retaining [a debtor's] vehicle and demanding payment, the City also had violated §§ 362(a)(4) and (a)(6). [The debtor] 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.").

[12]*In re Kuehn*, 563 F.3d 289, 294 at *4 (Sotomayor, J., concurring).