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Insights

Does Retention of Property Violate the Automatic Stay in Bankruptcy? The Supreme Court Weighs In.

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On January 14, 2021, the Supreme Court of the United States resolved a circuit split by unanimously holding that the "mere retention of property" by a creditor after the time a debtor files its bankruptcy petition does not violate the automatic stay under § 362(a)(3) of the United States Bankruptcy Code, 11 U.S.C. §§ 101, *et seq.* ("Bankruptcy Code"). In *City of Chicago v. Fulton*, the City of Chicago ("City") impounded individuals' vehicles for failure to pay vehicular fines, and when those individuals subsequently filed for relief under chapter 13 of the Bankruptcy Code, the City refused to return the vehicles.[1] The debtors argued, and the United States Bankruptcy Court for the Northern District of Illinois and 7th Circuit Court of Appeals agreed, that the City's retention of the vehicles violated § 362(a)(3), which operates as a stay of any act "to exercise control over property" of the estate.[2]

The Supreme Court disagreed. A plain reading of § 362(a)(3) indicates that it "prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed," and merely retaining property does not alter the status quo of a bankruptcy estate.[3] Also, since the City already had possession of the vehicles, the City was not altering the status quo, or "exercising" control of the property, when the debtors filed for relief under the Bankruptcy Code. Interestingly, the Court conceded that the debtors' alternative interpretation, which argues that an omission to act is a sufficient act for purposes of § 362(a)(3), was not entirely incorrect.[4] Instead, the Court reasoned that this interpretation was less persuasive because "to exercise control" for purposes of § 362(a)(3) implied something more than "mere retention," or an omission to act.[5]

Furthermore, the Court reasoned that § 542(a) supported its holding. Generally, under § 542(a), an entity in possession of property of the bankruptcy estate "shall" deliver the property to the bankruptcy trustee.[6] The Court ruled that accepting the debtors' interpretation of § 362(a)(3), namely that mere retention of a bankruptcy estate's property was a violation of the automatic stay, would render § 542(a) superfluous and unnecessary. Also, § 542(a) has certain exceptions, which seemingly contradicts debtors' interpretation of § 362.

Takeaway: Clearly, the ramifications of *City of Chicago v. Fulton* extend beyond chapter 13 cases. For one, the decision is an interpretation of the automatic stay in bankruptcy, which applies to voluntary and involuntary petitions filed any under chapter of the Bankruptcy Code.[7] Thus, the mere retention of a debtor's property, as long as it was retained before the petition, does not by itself violate the automatic stay. However, the retention of

property in addition to other acts or conduct, such as demanding payment, can still run afoul of the automatic stay. Moreover and as the Court noted, a trustee (or a chapter 11 debtor-in-possession) has the right to make a demand of a party for turnover of property pursuant to § 542(a), which the party "shall" honor. Further, because the decision expressly was limited to addressing § 362(a)(3), the Court carefully noted that it was not ruling on whether the debtors could assert claims under §§ 362(a)(4) and (a)(6), which prohibit an act to enforce a lien on property and an act to recover a claim, because the 7th Circuit Court of Appeals had not reached these questions.[8] Nevertheless, the Supreme Court's opinion resolves a circuit split and provides much needed clarity for creditors in possession of debtor property.

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[1] *City of Chicago, Illinois v. Fulton*, No. 19-357, 2021 WL 125106 (U.S. Jan. 14, 2021).
[2] *Id. See also* 11 U.S.C. § 362(a)(3).
[3] *Id.*
[4] *Id.* at 3.
[5] *Id.*
[6] 11 U.S.C. § 542(a).
[7] 11 U.S.C. § 362(a).
[8] One of the respondents argued that the City's retention of her vehicle and demand for payment violated the automatic stay, but the Court did not address that argument. *City of Chicago, Illinois v. Fulton*, No. 19-357, 2021 WL 125106 n. 2 (U.S. Jan. 14, 2021).