

"Mere Retention" of Property Does Not Violate the Automatic Stay

Related Professionals

Carl Petkoff
843.720.1773
cpetkoff@maynardnexsen.com

Practices

Bankruptcy & Restructuring
Credit Unions

Article

05.12.2021

Earlier this year, the United States Supreme Court resolved an important question for banks, credit unions and other creditors who have a security interest in personal property owned by a debtor and lawfully take possession of the property shortly before the debtor files a bankruptcy petition.^[1] The appeal involved four consolidated cases in which the City of Chicago impounded the debtors' vehicles to secure payment of unpaid traffic fines and refused to release the vehicles after the debtors filed Chapter 13 petitions.^[2]

The issue before the Supreme Court involved the interpretation of an apparent conflict between different sections of the Bankruptcy Code. The specific question presented to the Court was whether the automatic stay requires creditors, upon filing of a bankruptcy petition, to promptly turn over property to the bankruptcy estate or whether the bankruptcy trustee or debtor must take some affirmative step, such as filing an adversary proceeding, to recover the property.

Under the Bankruptcy Code, the filing of a bankruptcy petition "creates an estate" consisting of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The petition also "operates as a stay" of certain acts by creditors to collect on debts owed by the debtor, including "any act . . . to exercise control over property of the [bankruptcy] estate." *Id.* § 362(a)(3). Creditors who violate the automatic stay may be subject to sanctions imposed by the bankruptcy court. *Id.* § 362(k). The Bankruptcy Code also requires that any entity, in possession of property of the bankruptcy estate which the trustee could use, sell, or lease, deliver such property to the trustee, subject to certain exceptions. *Id.* § 542(a). Unlike the automatic stay provision, this turnover provision is not self-executing.

Six of the United States Courts of Appeals had previously considered this question. Four of these courts concluded that creditors were required to immediately turn over property of the debtor to the trustee,

while the other two courts concluded that the statute bars only affirmative “acts” to exercise control over estate property—not mere passive retention of property already in the creditor’s possession.

In resolving the split in the Courts of Appeals, the Supreme Court adopted the minority rule, concluding that a creditor’s mere retention of estate property after the filing of a bankruptcy petition does not constitute an act to “exercise control” over property of the estate in violation of the Bankruptcy Code’s automatic stay.^[3]

The Court reached this result based on the text and structure of the Bankruptcy Code. Specifically, the Court reasoned that reading § 362(a)(3) to cover mere retention of property would render § 542’s central command—that an entity in possession of certain estate property must deliver such property to the trustee—unnecessary. Stated differently, such an interpretation would render the automatic stay and turnover provisions contradictory. Thus, the most natural reading of § 362(a)(3) merely prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition is filed.

In light of the Supreme Court decision, creditors no longer have to immediately turn over collateral in their possession. Creditors should consult with their bankruptcy counsel in order to best protect their interests.

Banks, credit unions and other financial institutions should review their policies and procedures in light of this new Supreme Court decision. If you need any advice on this or other Bankruptcy issues, please contact me or one of the attorneys in our Bankruptcy & Creditors’ Rights Group.

[1] *City of Chicago v. Fulton*, 141 S. Ct. 585, 208 L. Ed. 2d 384 (2021).

[2] The Chicago Municipal Code allows the City to obtain a possessory lien on a motor vehicle it impounds for unpaid traffic fines.

[3] Importantly, the rule announced by the Court applies to lenders who obtain a security interest in personal property to secure payment of a loan and lawfully repossess the property upon default by the borrower before the borrower files a bankruptcy petition.