Introduction of Case

In January 2021, the Supreme Court issued an opinion in *City of Chicago v. Fulton,* resolving a circuit split on the issue of whether a creditor's refusal to turn over estate property lawfully repossessed pre-petition violated § 362(a)(3) of the Bankruptcy Code.[1] The Court, in a unanimous 8-0 opinion held that "mere retention" of estate property after the filing of a bankruptcy petition is not a violation of § 362(a)(3).[2] However, in his majority opinion, Justice Alito was clear that that the ruling was a narrow one in that the proper recourse for a debtor to obtain estate property retained by a creditor is through the Bankruptcy Code turnover provisions found in § 542.

Statutory Framework

As all bankruptcy (and most general) practitioners are aware, one of the strongest protections a debtor has upon filing a bankruptcy petition is the protection of the automatic stay contained in § 362. The automatic stay is—as the name implies—automatic upon the filing of a bankruptcy petition and stops all collection activity by creditors and acts taken against property of the debtor's estate.[3] Violations of the automatic stay can result in damages and even sanctions when the violations are willful.[4]

The purpose of the stay, as the Fifth Circuit previously explained, "was to give the debtor and its property a breather from creditors' assaults, to prevent a multi-jurisdictional rush to judgment by numerous creditors, and to ensure that the interests of all creditors of similar station were treated equally and fairly."[5]

The *Fulton* case resolved around § 362(a)(3), which prohibits "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."[6] Therefore, once a bankruptcy petition is filed, § 362(a)(3) on its face prohibits parties from taking any action to exercise control over property of a debtor's estate.

While circuit courts across the country were divided on this issue, courts in Texas have generally agreed that a creditor violates the automatic stay by refusing to turn over property lawfully repossessed pre-petition.[7] More recently, courts in Texas have held that a creditor's post-petition retention of estate property constituted an "act . . . to exercise control over property of the estate."[8] In holding that a creditor must return a debtor's vehicle pursuant to § 362(a)(3), the Bankruptcy Court for the Northern District of Texas previously held that a creditor retaining a

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[1] *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021).
[2] *Id.*
[3] There are numerous exceptions to the automatic stay that are outside the scope of this paper, but can be found primarily in 11 U.S.C. §§ 362(b), 362(c), 555, 556, 557, 559, 560, 561.
[4] 11 U.S.C. §362(k).
[5] *In re S.I. Acquisitions*, 817 F.2d 1142, 1148 (5th Cir. 1987).
[6] In a footnote of the *Fulton* opinion, the lower court previously determined that the City in retaining a debtor's vehicle and demanding payment had indeed violated §§ 362(a)(4) and (a)(6). However, that issue did not reach the Court of Appeals nor the Supreme Court.
[7] *See Nissan Motor Acceptance Corp. v. Baker*, 239 B.R. 484, 488 (N.D. Tex, 1999); *In re Zaber*, 223 B.R. 102, 105 (Bankr. N.D. Tex. 1998); *Mitchell v. BankIllinois*, 316 B.R. 891, 899 (S.D. Tex. 2004).
[8] *Toyota Motor Credit Corp. v. Brinkley*, 3:17-CV-3022-S, 2019 WL 317446, at *2 (N.D. Tex. Jan. 23, 2019).

vehicle with "knowledge that the automatic stay was in effect constituted an exercise of control under §362(a)(3)."[9]

The reasoning is straightforward. A debtor requires the use of his/her automobile (or other property) to generate income and in turn provide a return to demanding creditors. In the same vein, creditors have immediate access to the courts to obtain adequate protection and relief from stay.[10] Courts have stressed that creditors should seek protection under § 362(d)-(e) rather than the non-bankruptcy remedy of retaining possession.[11]

Therefore, Texas courts have generally been aligned in holding that creditors should not be able to retain possession of debtor's property seized pre-petition and especially not leverage the property to make unreasonable demands for adequate protection.

Section 542(a) (often known as the turnover provision) is a powerful tool to compel the return of property of a debtor's estate. Section 542(a) requires any third party—including creditors—to surrender any property of the estate that is in their possession when a bankruptcy case is filed.[12] While the automatic stay is self-executing, courts differ on whether § 542 is also self-executing and automatically requires delivery of estate property upon the filing of a bankruptcy petition. For courts that do not find § 542 to be automatic, Rule 7001(1) of the Federal Rules of Bankruptcy Procedure requires a debtor to bring an adversary proceeding to obtain turnover of debtor's property.

One of the foundational cases regarding turnover under § 542 is *United States v. Whiting Pools, Inc.*, where the Supreme Court held that § 542(a) requires a secured creditor that had seized property pre-bankruptcy filing to turn over estate property prior to any adjudication of adequate protection.[13] The reasoning behind the *Whiting Pools* decision is that courts did not want to allow creditors to seize assets of the debtor on the eve of a debtor's bankruptcy filing and not return them, which "would frustrate the congressional purpose behind the reorganization process."[14]

While the *Fulton* case only ruled on the issue of § 362(a)(3), it is critical to identify the interplay between both § 362(a)(3) and § 542 in understanding *Fulton's* effect on your practice.

Factual Background of *Fulton*

The City of Chicago (the "City") impounded four individuals' vehicles for failure to pay parking fines. Each individual that had their car impounded filed a Chapter 13 bankruptcy petition and immediately demanded the City return their vehicles. The City simply refused to release the

[9] *Id.* at 3.
[10] 11 U.S.C. § 362(e)-(f).
[11] *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 (1983); *see also In re Sharon*, 234 B.R. at 686 (quoting *In re Colortran, Inc.*, 210 B.R. 823, 827–28 (9th Cir. BAP 1997), *rev'd in part on other grounds*, 165 F.3d 35 (9th Cir.1998) (stating that "[w]hile the creditor may suggest terms of adequate protection, it may not unilaterally condition the return of the property on its own determination of adequate protection . . . . [A]ny prerequisite to turnover is determined by the bankruptcy court, not by the creditor.")).
[12] There are exceptions the turnover statute. For example, a creditor does not have to turn over property that is of inconsequential value or benefit to the estate. 11 U.S.C. § 542(a).
[13] *Whiting Pools*, 462 U.S. at 198.
[14] *Id.* at 208.

vehicles, arguing that that City was a secured creditor and entitled to possession to secure the debt. The debtors argued that the City's retention of their vehicles violated § 362(a)(3) as the City was exercising control over the debtors' property.

The debtors brought contempt proceedings against the City, and the bankruptcy court in all four instances ruled in favor of the individuals that the City's actions violated the automatic stay by refusing to release the automobiles.[15] The Seventh Circuit subsequently affirmed the bankruptcy court's decisions by holding that "the City violated the automatic stay . . . by retaining possession of the debtors' vehicles after they declared bankruptcy."[16] The City was not simply passively holding onto vehicles, rather its retention was deemed an act to control property of the estate, which impeded debtors' right to regain their financial foothold and repay their creditors.[17]

The City conceded in its own brief that it could not ultimately keep the vehicles indefinitely.[18] Instead, the question was *when* turnover must occur: 1) immediately upon filing of the bankruptcy petition, or 2) after resolving any disputes and adjudication of adequate protection in a § 542 turnover proceeding. The timing of the turnover is crucial for any debtor trying to reorganize their debts. If a debtor is deprived of their vehicle and unable to travel to work, then a debtor likely will fall behind on plan payments possibly forcing a debtor into a Chapter 7 liquidation. The Seventh Circuit concluded that creditors must turn over debtor's property in their possession seized pre-petition and that the turnover "is not dependent on the debtor first bringing a turnover action" under § 542.[19]

Supreme Court Decision

A. The Majority Decision

Writing for the 8-0 Court,[20] Justice Samuel A. Alito, Jr. reasoned that section 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."[21] As drafted, the plain language of § 362(a)(3) "suggests that merely retaining possession of estate property does not violate the automatic stay."[22] Taking together the terms "stay," "act" and "exercise control," the Court reasoned that "§362(a)(3) prohibits affirmative acts that would disturb the status quo of estate property as of the time the bankruptcy petition was filed.[23] Therefore, a creditor merely holding property repossessed pre-petition is not violating § 362(a)(3) but rather maintaining the status quo as the statute intended.

Justice Alito further reasoned that if § 362(a)(3) imposed a turnover obligation, it would render § 542 duplicative. Alito wrote that the better reconciliation of § 362(a)(3) and § 542 was that § 362(a)(3) prohibits collection efforts that would change the status quo, while § 542(a) "works

[15] *Fulton*, 141 S. Ct. at 589.
[16] *In re Fulton*, 926 F.3d 916 (7th Cir. 2019).
[17] *Id*. at 925.
[18] Brief for Petitioner at 44, *City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021) (No-19-357).
[19] *In re Fulton*, 926 F.3d at 924.
[20] Justice Barrett took no part in the consideration or decision of the case.
[21] *Fulton*, 141 S. Ct. at 590.
[22] *Id.*
[23] *Id.*

within the bankruptcy process to draw far-flung estate property back into the hands of the debtor or trustee."[24]

Justice Alito concluded his decision by pointing out what the decision did not decide. The opinion did not reach the issues of whether other provisions of the automatic stay besides § 362(a)(3) were violated, and it did not decide how the turnover obligation in § 542 would have affected the court's analysis. However, the court did leave open the door for a debtor to obtain turnover of their property—mainly an automobile—under the turnover provisions of § 542.

B. Justice Sotomayor Concurrence

Concurring in the ruling, Justice Sotomayor wrote separately to reiterate that the Supreme Court's ruling did not examine other stay violations under § 362(a) that may require a creditor to return debtor's property, as well as a creditor's obligations under §542(a).

Justice Sotomayor expressed lament that while the City's conduct may have been proper under the letter of the law, it did not comply with the spirit of the Bankruptcy Code, which is to give debtors a fresh start. For a debtor to achieve that fresh start, a debtor often needs his/her vehicle to commute to work and earn income to fund a plan to pay creditors. Justice Sotomayor noted that debtors are not powerless given the availability of the turnover process; however, turnover, can be a long, tedious and perhaps expensive process for debtors who are likely already far behind on payments to creditors, which could push debtors further into the red. Forcing debtors to file an adversary to retrieve their vehicle so a debtor can get back and forth to work is not within the spirit of the Bankruptcy Code. Justice Sotomayor concluded her concurrence with a request to legislators to consider amendments to the Bankruptcy Code to ensure prompt return of a debtor's property.

Conclusion

While creditors might celebrate the *Fulton* decision like an Abilene Christian alum celebrated its victory over the University of Texas, it is important to note how narrow the *Fulton* decision is. First, the *Fulton* decision only involved the single issue of whether the City's actions of withholding debtors' vehicles was a violation of § 362(a)(3). It was noted that in one of the debtor's cases, the City was retaining a debtor's vehicle while also demanding payment.[25] The actions of the City in retaining the vehicle and also demanding payment could be a violation of the automatic stay pursuant to §§ 362(a)(4) and (a)(6); however, these issues were not presented to the Supreme Court.[26]

Second, while a creditor may not need to turn over a vehicle pursuant to § 362(a)(3), that does not mean a creditor does not need to deliver the vehicle pursuant to § 542(a). The biggest issue with § 542 is the time and expense a debtor may have to incur in bringing a full blown adversary just to regain possession of their car. Justice Sotomayor pointed out in her concurrence

[24] *Id.* at 591.
[25] *Id.* at 592 n. 2; *In re Shannon*, 590 B.R. 467, 479 (Bankr. N.D. Ill. 2018), *aff'd sub nom*. *In re Fulton*, 926 F.3d 916 (7th Cir. 2019), *vacated and remanded sub nom. City of Chicago, Illinois v. Fulton*, 141 S. Ct. 585 (2021).
[26] *Id.*

that bankruptcy courts across the country are adopting creative solutions to the § 542 adversary process. A bankruptcy court in Idaho has held that the turnover obligation is automatic even without the need for a court order.[27] Likewise, with consent, bankruptcy courts often permit debtors to seek turnover by simple motion (sometimes expedited) instead of a full-blown adversary proceeding.

Moving forward, on a practical basis, debtors should first make a written demand for turnover under § 542(a) and provide reasonable adequate protection—perhaps just proof of insurance. If a creditor still refuses to return the property, the debtor should then file an adversary proceeding and consider whether to couple that adversary with a request for injunctive relief and/or, as appropriate, a motion for enforcement of the automatic stay.

[27] *See In re Larimer*, 27 B. B. 514, 516 (Idaho 1983).