

US Supreme Court Holds That Merely Holding Estate Property Is Not A Violation of the Automatic Stay

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On January 14, 2021, in *City of Chicago of Illinois v. Fulton*, the US Supreme Court ruled that section 362(a)(3) of the Bankruptcy Code does **not** require a non-debtor to return to the debtor property in the non-debtor's possession. This decision resolves a circuit split between the Second, Seventh, Eighth, Ninth and Eleventh Circuits, which impose an affirmative duty on creditors to turn over repossessed property after a bankruptcy filing, and the Third, Tenth and District of Columbia Circuits, which have held that the retention of property only maintains the status quo. In the view of those circuits, simply holding property is not an affirmative act causing a stay violation.

Writing for the majority (8/0), Justice Samuel Alito analyzed the text and statutory history of sections 362(a)(3) and 542 of the Bankruptcy Code, reversing the Court of Appeals for the Seventh Circuit on grounds that the circuit court incorrectly concluded that the City of Chicago violated section 363(a)(3) when it refused to return individuals debtors' vehicles that the City had impounded before the filing of their bankruptcy petitions due to the debtors' failures to pay fines.

Rationale

Setting out the applicable statutes, Justice Alito explained that Section 362(a)(3) stays "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." In Justice Alito's view, "the most natural reading" of the words "stay," "act" and "exercise control" mean 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." He explained that the "combination" of these words "halts any affirmative act that would alter the status quo as of the time of the filing of the bankruptcy petition."

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Justice Alito noted that the language of 362(a)(3), if read on its own, could lead to the conclusion the Seventh Circuit reached below. However, he concluded that “any ambiguity” in that section “is resolved decidedly in” Chicago’s favor under section 542 of the Bankruptcy Code. Justice Alito reasoned that reading 362(a)(3) to proscribe the “the mere retention of property” would create several problems when also considering section 542’s requirements.

Setting aside some exceptions, section 542(a) provides that “an entity . . . in possession . . . of property that the trustee may use, sell, or lease under section 363 of this title . . . , shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.” Justice Alito explained that reading section 362(a)(3) broadly to provide a debtor with a mechanism for turnover under that provision would “largely” render the actual turnover provision of the Bankruptcy Code, section 542, “superfluous.” He then concluded that the two sections would contradict one another because section 542 has exceptions where section 362(a)(3) has none.

Narrow Holding

The Court’s holding is narrow. Justice Alito explained that “[w]e hold only that the mere retention of estate property after the filing of a bankruptcy petition does not violate §362(a)(3) of the Bankruptcy Code.” He emphasized that the ruling does not “settle the meaning of other subsections of §362(a)” and did “not decide how the turnover obligation in §542 operates.”

In her six-page concurrence, Justice Sotomayor wrote “separately to emphasize that the Court had not decided whether and when §362(a)’s other provisions may require a creditor to return a debtor’s property.” She also noted that the Court had not “addressed how bankruptcy courts should go about enforcing creditors’ separate obligations to ‘deliver’ estate property to the trustee or debtor under §542(a).”

Implications

The implications of this decision appear to be more practical than substantive. A debtor remains free to recover estate property, but the mechanism for recovering that property has arguably shifted. Rather than filing a stay-enforcement motion, which are generally resolved quickly and with little expense, *Chicago* appears to limit a debtor’s path to recovery to an adversary proceeding for turnover of estate property. Turnover proceedings, as Justice Sotomayor noted, “can be quite slow.” Accordingly, the practical result of this decision is that a debtor may now face increased time and expense in seeking to compel the return of property. This may also shift the burden of showing whether an interest secured by estate property is adequately protected to the debtor seeking to recover estate property. Of course, depending on the factual circumstances of the case, a debtor may

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resurrect a speedier result under section 362(4) and (6).

The practical implications for creditors are noteworthy as well. The ruling in this case provides creditors in possession of estate property as of the date of a bankruptcy filing assurance that they are not running afoul the automatic stay if they opt to hold onto property. This decision also appears to provide creditors with substantial leverage in demanding adequate protection in exchange for the return of property. But remember, this case turns on the notion that a creditor is simply maintaining the pre-petition status quo in continuing to hold the property post-petition. Certainly, creditors should be cognizant that they risk violating the automatic stay if they take further action against the debtor and the debtor's property above and beyond simply holding the property.

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