Articles + Publications | February 8, 2021

Supreme Court Rules that Possession of Estate Property Does Not Violate Automatic Stay

WRITTEN BY

Kenneth A. Listwak

On January 14, the Supreme Court ruled that more than a mere retention of estate property is needed for a party to violate the automatic stay, vacating and remanding a decision by the U.S. Court of Appeals for the Seventh Circuit (*In re Fulton*, 926 F.3d 916 (7th Cir. 2019)) that held that the City of Chicago (City) violated the automatic stay by retaining vehicles that were impounded before the filing of the owners' bankruptcy petitions. *See City of Chi. v. Fulton*, 141 S. Ct. 585 (2021). The decision resolved a split among several circuit courts.

In *Fulton*, the City of Chicago had refused to return Chapter 13 debtors' cars that the City impounded pre-petition for the debtors' failures to pay fines for various vehicular infractions. Affirming the courts below, the Seventh Circuit ruled that in retaining possession of the cars, the City had acted to "exercise control" over estate property in violation of Section 362(a)(3) of the Bankruptcy Code. The Supreme Court disagreed.

The Court focused on the language of Section 362(a)(3), which stays a creditor from taking "any act . . . to exercise control over property" of the bankruptcy estate and its interplay with Section 542(a), which governs turnover of estate property. The Court analyzed the key words in the statutory language — "stay," "act," and "exercise control" — and found 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" and that such language "implies that something more than merely retaining power is required to violate the disputed provision."

The Court found that this interpretation of the automatic stay is reinforced when considered in the context of the more specific turnover provisions of Section 542(a) of the Bankruptcy Code. With limited exceptions, Section 542(a) requires entities in possession, custody, or control of estate property to return such property to the estate. As the Court noted, "[t]he exceptions to §542(a) shield (1) transfers of estate property made from one entity to another in good faith without notice or knowledge of the bankruptcy petition and (2) good-faith transfers to satisfy certain life insurance obligations."

The Court reasoned that if the automatic stay was violated by a mere retention of property, it would render Section 542(a) superfluous. If Section 362(a)(3) already provided that holding onto estate property violates the automatic stay, a dedicated provision for turnover of estate property held by third parties would be redundant. The reading that best harmonizes Section 362(a)(3)'s automatic stay and Section 542(a)'s turnover provisions, the Court determined, "is that §362(a)(3) prohibits collection efforts outside the bankruptcy proceeding that would change the status quo, while §542(a) works within the bankruptcy process to draw far-flung estate property back into the hands of the debtor or trustee." The Court also observed that if mere retention of property violates the automatic stay, the two exceptions to Section 542(a) would be rendered meaningless — while those protected parties would

not be required to turn over property to the estate under Section 542(a), their retention of such property would violate the automatic stay under Section 362(a)(3), thus requiring immediate turnover nonetheless.

Finally, the Court considered the legislative history of Section 362(a)(3) and found that it led to the same result. The 1984 amendments to the Bankruptcy Code added the phrase “or to exercise control over property of the estate” to Section 362(a)(3). Had Congress intended to add an affirmative turnover obligation to the automatic stay, it is not likely that it would have done so by adding that language to Section 362(a)(3), rather than something more explicit in or through some cross-reference to Section 542. The Court found that the better interpretation of the statutory history is that the 1984 amendments, “by adding the phrase regarding the exercise of control, simply extended the stay to acts that would change the status quo with respect to intangible property and acts that would change the status quo with respect to tangible property without ‘obtaining’ such property.”

Based on its analysis of the language and legislative history of Section 362(a)(3), and considering the function of the automatic stay within the broader context of other provisions of the Bankruptcy Code, the Supreme Court concluded “only that mere retention of estate property after the filing of a bankruptcy petition does not violate §362(a)(3) of the Bankruptcy Code.”

Notably, the Supreme Court did not decide whether such retention might violate any other provision of the Bankruptcy Code, including the turnover provisions of Section 542(a), or what remedies might exist for any such violation. Thus, while entities in possession of estate property as of the petition date need not worry that their continued retention of that property violates Section 362(a)(3) of the Bankruptcy Code, they still would be well advised to promptly consult their counsel to determine the best course to protect themselves and their interest in that property post-petition within the bounds of the Bankruptcy Code.

RELATED INDUSTRIES + PRACTICES

- Bankruptcy + Restructuring