



AMERICAN
BANKRUPTCY
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2018 Hon. Eugene R. Wedoff Seventh Circuit Consumer Bankruptcy Conference

It Was So Much Fun; Let's Do It Again: Cars, Parking and Municipal Violations, Take Two

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Cars, Parking, and Municipal Ordinances, Take Two

The issues one year later

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The questions for discussion

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- 2) Does § 362(b)(3) provide an exception to collateral return for possessory liens?
- 3) Does § 362(b)(4) provide an exception to collateral return for possessory liens?
- 4) Are postpetition consumer claims in Chapter 13 covered exclusively by § 1305?
- 5) If § 1305 is not exclusive, can postpetition vehicle fines incurred by a Chapter 13 debtor be treated as an administrative expense under § 503(b)(1)(A)?
- 6) May a plan or order of confirmation provide that property of the estate will not revert in the debtor upon confirmation without a showing of cause under § 1327(b)?

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§ 362 (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of . . .

(3) 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;

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§ 362 (b) **The filing of a petition** under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, **does not operate as a stay**—

(3) under subsection (a) of this section, **of any act** to perfect, or **to maintain or continue the perfection of, an interest in property** to the extent that the trustee's rights and powers are subject to such perfection **under section 546(b)** of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title;

§ 546(b)

(1) **The rights and powers of a trustee** under sections 544, 545, and 549 of this title **are subject to any generally applicable law that—**

(A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or

(B) **provides for** the maintenance or **continuation of perfection** of an interest in property to be effective **against an entity that acquires rights** in such property **before** the date on which **action is taken to effect such** maintenance or **continuation**.

City Ordinance 9-92-080

Release procedure for impounded vehicles.

(f) Any vehicle impounded by the City or its designee shall be subject to a possessory lien in favor of the City in the amount required to obtain release of the vehicle.

Case Name	Judge	May City Keep the Car?	Major Holding
<i>Avila</i> 3/21/17	Cassling	Yes	§ 362(b)(3) allows continued possession of vehicle seized pre-filing.
<i>Walker</i> 12/20/17 <i>Cross</i> 5/25/18 <i>Fulton</i> 6/5/18	Schmetterer	No	Only positive “action” is allowed by § 362(b)(3). Passive retention of a vehicle is not an “act” authorized by § 362(b)(3). Authorized action may include a motion for stay relief.
<i>Scott</i> <i>Howard</i> 4/16/18	Cox	No	Ordinance granting possessory lien is invalid under Illinois law on home rule
<i>Kennedy</i> 5/4/18	Shah	Yes	§ 362(b)(3) does not deny due process and the City ordinance is not preempted by the Code
<i>Peake</i> 8/15/18	Thorne	No	Under § 362(b)(3) an act to continue perfection of a property interest must be a positive act
<i>Shannon(?)</i> 9/7/18	Doyle	No	Compelled loss of possession does not terminate lien

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- § 362 (b) **The filing of a petition** under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, **does not operate as a stay**—
- (4) under paragraph (1), (2), (3), or (6) of subsection (a) of this section, **of the commencement or continuation of an action** or proceeding **by a governmental unit . . . to enforce such governmental unit’s or organization’s police and regulatory power**, including the enforcement of a judgment **other than a money judgment**, obtained in an action or proceeding by the governmental unit to enforce such governmental unit’s or organization’s police or regulatory power;

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- § 1305(a) A proof of claim may be filed by any entity that holds a claim against the debtor—
 - (1) for taxes that become payable to a governmental unit while the case is pending; or
 - (2) that is a consumer debt, that arises after the date of the order for relief under this chapter, and that is for property or services necessary for the debtor’s performance under the plan.
- (b) Except as provided in subsection (c) of this section, a claim filed under subsection (a) of this section shall be allowed or disallowed under section 502 of this title, but shall be determined as of the date such claim arises, and shall be allowed under section 502(a), 502(b), or 502(c) of this title, or disallowed under section 502(d) or 502(e) of this title, the same as if such claim had arisen before the date of the filing of the petition.

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 - (1) for taxes that become payable to a governmental unit while the case is pending; or
 - (2) that is a consumer debt, that arises after the date of the order for relief under this chapter, and that is for property or services necessary for the debtor’s performance under the plan.
- . . .
- (c) A claim filed under subsection (a)(2) of this section shall be disallowed if the holder of such claim knew or should have known that prior approval by the trustee of the debtor’s incurring the obligation was practicable and was not obtained.

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-
- § 503(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—
 - (1 (A) the actual, necessary costs and expenses of preserving the estate including—
 - (i) wages, salaries, and commissions for services rendered after the commencement of the case; and
 - (ii) wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor

In addition to the statutory definition of administrative claim, there is what has been called the "Reading" administrative claim. In *Reading Co. v. Brown*, 391 U.S. 471, 88 S. Ct. 1759, 20 L. Ed. 2d 751 (1968), the Supreme Court held that innocent third parties who suffered losses from a fire at a plant operating under Chapter XI of the Bankruptcy Act were entitled to assert administrative claims. The Supreme Court in *Reading* described the statutory objective of bankruptcy as "fairness to all persons having claims against an insolvent." 391 U.S. at 477.

Goldberg v. Spuza (In re ER Urgent Care Holdings, Inc.), 474 B.R. 298, 301-02 (Bankr. S.D. Fla. 2010)

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- § 1327
- (a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.
- (b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.
- (c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

Cars, Parking, and Municipal Ordinances, Take Two

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Chicago parking ticket cases to be resolved in the Seventh Circuit.

Major Automatic Stay Issue Inches Toward the Supreme Court

The protracted battle over parking fines between the City of Chicago and chapter 13 debtors may draw to a conclusion next year, unless the Supreme Court takes an interest in the question. If the Supreme Court weighs in, the high court could use parking tickets to decide whether the automatic stay is automatic after all.

In three consolidated, direct appeals to the Seventh Circuit, bankruptcy judges in Chicago had concluded that the city must turn over an impounded car automatically when the owner files a chapter 13 petition. The appeals court entered a scheduling order calling for the last brief to be filed on November 19.

Fiscally speaking, the issue is important for Chicago. Bankruptcy Judge Deborah L. Thorne said that Chicago relies on parking fines and red-light tickets for 7% of its budget. According to the most recent decision by Bankruptcy Judge Carol A. Doyle of Chicago, the fines generate \$260 million for the city annually.

In substance, the question is whether the automatic stay in Section 362 requires the city to turn over impounded cars automatically. The city is fighting an uphill battle because Seventh Circuit law favors debtors.

In *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009), the Seventh Circuit ruled that passively holding an asset is an act to “exercise control” that violates the automatic stay under Section 362(a)(3). The appeals court held that a lender must return an auto it had repossessed. After return, the lender may seek adequate protection.

Brandishing *Thompson*, Chicago residents who lost their cars could file chapter 13 petitions to regain possession of their vehicles, even if they have no intention of confirming their chapter 13 plans. Hoping to avoid *Thompson*, Chicago adopted legislation specifically giving the city a possessory lien against vehicles that were impounded as a result of unpaid fines.

Among other things, the city argues that the possessory lien invokes the exception to the automatic stay in Section 362(b)(3). That section makes the stay inapplicable to “any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee’s rights and powers are subject to such perfection under section 546(b)” The city believes that retaining possession is a means for maintaining perfection and is thus excepted from the automatic stay.



In August, Bankruptcy Judge Thorne dissected and rejected the Section 362(b)(3) theory in *In re Peake*, 18-16544, 2018 BL 292576 (Bankr. N.D. Ill. Aug. 16, 2018). *Peake* is one of the cases on direct appeal to the Seventh Circuit. To read ABI's discussion of *Peake*, [click here](#).

In the newest decision on September 7, Judge Doyle analyzed and rejected a plethora of arguments by the city, including a contention that *Thompson* was wrongly decided.

Judge Doyle provided an especially detailed analysis of Section 362(b)(3). She dismissed Chicago's theories, concluding that "the City cannot shoehorn itself into any provision of Section 546(b) to qualify for Section 362(b)(3), an exception intended only to let parties preserve their lien rights in bankruptcy, not to retain possession of the debtor's property."

Judge Doyle found nothing special in Chicago's statutory lien rights. She said "the City is really contending that possessory lien holders get better treatment in bankruptcy than other lien holders. Not so [A]ll secured creditors in a chapter 13 case are entitled to the same treatment."

Having concluded that the exception to the automatic stay did not apply, Judge Doyle said that the city's refusal to return the car on request "violated at least three provisions in the automatic stay — § 362(a)(3), § 362(a)(4), and § 362(a)(6) — and the dictates of *Thompson*."

Chicago has not been without victories. In May, a district judge reversed the bankruptcy court and validated the city's theories under Section 362(b)(3). *City of Chicago v. Kennedy*, 17-5945, 2018 BL 159358, 2018 WL 2087453 (N.D. Ill. May 4, 2018).

The Circuit Split

Even if Chicago loses in the Seventh Circuit, the city could file an attractive petition for *certiorari*, because two circuits disagree with *Thompson*. See, e.g., *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017), where the Tenth Circuit held that passively holding an asset of the estate, in the face of a demand for turnover, does not violate the automatic stay in Section 362(a)(3) as an act to "exercise control over property of the estate." The District of Columbia Circuit holds the same opinion.

The Second, Ninth and Eighth Circuits are in accord with *Thompson* and hold that retaining property after demand for turnover does violate the automatic stay.

The Supreme Court might use parking tickets as the vehicle for resolving the widening circuit split, but someone else might beat Chicago to the punch.

Although there was no *certiorari* petition in *Cowen*, the same underlying issue is on direct appeal to the Tenth Circuit from *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-5006,



2017 BL 235622 (Bankr. D. Kan. July 7, 2017), where Bankruptcy Judge Robert E. Nugent of Wichita, Kan., was forced to rule, contrary to two prior decisions of his own, that the automatic stay did not prevent a statutory worker's compensation lien from attaching automatically after bankruptcy to a recovery in a lawsuit.

Because the issues in *Garcia* and *Cowen* are so similar, the *Garcia* appeal is likely to be a precursor to a motion for rehearing *en banc* or a *certiorari* petition to resolve the circuit split. Whether Chicago or *Garcia* is the launching pad, the split over the automatic stay is an issue the Supreme Court should tackle in the next couple of terms.

For ABI's discussion of *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-3247 (10th Cir.), [click here](#). The appeal is scheduled for oral argument on September 26.

[Judge Doyle's opinion is](#) *In re Shannon*, 18-4116 (Bankr. N.D. Ill. Sept. 7, 2018).

Bankruptcy Law Letter

JULY 2018 | VOLUME 38 | ISSUE 7

THE AUTOMATIC STAY UNDER § 362(a)(3)— ONE MORE TIME

By Eugene R. Wedoff

One of most significant issues in consumer bankruptcy currently in dispute is whether § 362(a)(3) of the Bankruptcy Code requires creditors to return to a debtor any collateral—most commonly automobiles—that they repossessed before the bankruptcy filing. In 1984, subsection (a)(3) was amended. Before the amendment, it only applied the automatic stay to “any act to obtain possession of property of the estate or of property from the estate,” and so only prevented creditors from seizing a debtor’s property during the bankruptcy case. The 1984 amendment expanded the provision by extending the stay to apply to any act “to exercise control over property of the estate.” Debtors used this amendment to argue that after the filing of a bankruptcy case, § 362(a)(3) not only prevented creditors from seizing the debtor’s property, but also prohibited them from continuing to hold whatever property they had seized earlier, since by retaining what was now estate property, they would be exercising control over it.

The initial response to this argument was a string of circuit court and BAP decisions agreeing with the debtors, establishing a majority rule that creditors were indeed stayed by § 362(a)(3) from continuing to hold estate property repossessed before a debtor’s bankruptcy filing and that they were required to return that property to a debtor otherwise entitled to it.¹ This string was unbroken until last year,² when the Tenth Circuit issued *WD Equipment v. Cowen*, holding § 362(a)(3) imposes no duty on creditors to return repossessed collateral.³

One notable aspect of the new circuit split is that *Cowen’s* rejection of the majority rule cites a *Bankruptcy Law Letter* written by Professor Ralph Brubaker in 2013.⁴ With the issuance of *Cowen*, and a set of related questions about the automatic stay, another look at the issues raised in that *Law Letter* may be timely.

THE MAJORITY RATIONALE

The majority interpretation of § 362(a)(3) is based on plain language. The Second Circuit’s decision made the point this way:

Mat #42023157

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[S]ection 362 forbids any act to . . . “exercise control” over the property of the estate. We need consult only an ordinary dictionary to confirm that a typical definition of “control” is: “To exercise authority over; direct; command.” Webster’s New World College Dictionary (4th ed. 2002). In light of that definition, we see no way to avoid the conclusion that, by keeping custody of the vehicle and refusing [the debtor] access to or use of it, [the secured creditor] was “exercising control” over the object in which the estate’s equitable interest lay, and its retention of the vehicle violated the stay.⁵

The decision found additional linguistic support in the nature of the 1984 amendment, pointing out that “obtaining possession” of estate property held by the debtor had already been stayed, so that

“exercising control” had to mean something more. “This significant textual enlargement is consonant with our understanding . . . that Congress intended to prevent creditors from retaining property of the debtor . . . without regard to what party was in possession of the property in question when the petition was filed.”⁶

THE MINORITY RATIONALE

The 2013 *Law Letter* is probably the most complete statement challenging the majority interpretation of § 362(a)(3).⁷ The *Law Letter* sets out four grounds for questioning the majority interpretation. Each of these grounds, however, can itself be questioned.

1. Upholding established law

The *Law Letter*’s initial argument is based on the Supreme Court’s *Dewsnup* rationale: that an established principle of bankruptcy law should not be interpreted as changed by an amendment unless the change is set out unambiguously or supported by legislative history.⁸ This approach to statutory construction has been widely criticized, as even the Supreme Court has noted.⁹ But applying the approach here is problematic in any event, since it is difficult to see the bankruptcy principle that is contradicted by interrupting a creditor’s exclusive possession of estate property. The *Letter* suggests that creditors were only required to return collateral to debtors after a court determined that their interests would be adequately protected: “adequate protection before turnover.”¹⁰ But under the Bankruptcy Code, adequate protection was not automatically required. It always had to be requested.¹¹

Before the 1984 expansion of § 362(a)(3), if a creditor was unwilling to return collateral, the debtor would have to seek a court order requiring turnover under § 542(a), and in response the creditor could request adequate protection under § 363(e). Only if the creditor made that request could it be said that adequate protection was a prerequisite for turnover.¹² The 1984 amendment, in prohibiting a creditor from retaining collateral sought by a debtor, did not change the secured creditor’s right to adequate protection under § 363(e), it only changed the party with possession of the prop-

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BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter*, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

erty during the time that the court considered a creditor's request for protection.

That change can be seen as consistent with the general operation of the automatic stay. Before the 1984 amendment, the stay took away a creditor's nonbankruptcy right to repossess collateral when the debtor was in default under a secured loan; the debtor was allowed to keep collateral until the court determined, in ruling on a creditor's motion for relief from the stay, that there was a lack of adequate protection. The amendment resulted in the same status being applied to property that was repossessed before the bankruptcy. Rather than changing a fundamental bankruptcy policy, the amendment can be seen as extending the basic policy underlying the stay: that the debtor should be able to use all estate property until the creditor requests relief.

The majority decisions reflect this understanding, as set out in the Seventh Circuit's *Thompson* decision:

The primary goal of reorganization bankruptcy is to group all of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts; this necessarily extends to all property, even property lawfully seized prepetition. See *Whiting Pools, Inc.*, 462 U.S. at 203-04, 103 S.Ct. 2309; see also *In re Yates*, 332 B.R. 1, 5 (10th Cir. BAP 2005) ("As a practical matter, there is little difference between a creditor who obtains property of the estate before bankruptcy is filed, or after bankruptcy is filed. The ultimate result is the same—the estate will be deprived of possession of that property. This is precisely the result § 362 seeks to avoid."). An asset actively used by a debtor serves a greater purpose to both the debtor and his creditors than an asset sitting idle on a creditor's lot.¹³

2. *The meaning of an "act to exercise control"*

The *Law Letter* next suggests that the phrase "acts to exercise control over estate property" is in fact ambiguous—"extremely vague"—and cites in support the *Inslaw* decision of the D.C. Circuit.¹⁴ But the ambiguity addressed by *Inslaw* was whether, by refusing to pay damages on a claim asserted by the debtor, a creditor was engaging in an exercise of control.¹⁵ *Inslaw* found this application of § 362(a)(3) unsupported.¹⁶ But this is not an indication of a difficulty in understanding the

meaning of exercising control over property; rather, the question was the nature of the property involved. An estate's cause of action is property of the estate; the recovery that a debtor hopes to obtain from the cause of action is not estate property. In *Citizens Bank v. Strumpf*, the Supreme Court made exactly this distinction in holding that a bank's temporary freeze on a depositor's account did not violate § 362(a)(3). The provision might have been violated, the Court said, if the bank had "exercised dominion over property" as it would have "if a bank account consisted of money belonging to the depositor and held by the bank."¹⁷

In fact, however, [a bank account] consists of nothing more or less than a promise to pay, from the bank to the depositor, and [the bank's] temporary refusal to pay was neither a taking of possession of [the debtor's] property nor an exercising of control over it, but merely a refusal to perform its promise.¹⁸

Inslaw, then, gives no basis for finding that § 362(a)(3) is ambiguous.

But even if there were some difficulty in measuring the full extent of exercising control over estate property, the question would remain: why is a creditor holding exclusive possession of estate property not exercising control over it? The *Law Letter* answers this question by quoting dicta in *Inslaw*: "The automatic stay, as its name suggests, serves as a restraint only on acts to gain possession or control over property of the estate," and suggests that § 362(a)(3) cannot apply if "a creditor does nothing and simply retains possession of property that the creditor already has in its possession."¹⁹ The difficulty with this argument is apparent from the *Inslaw* quotation, which speaks of "gaining" rather than "exercising" control. While "gain" refers to a past achievement ("[t]o come into possession or use of; acquire"), "exercise,"—the statutory term—refers to ongoing activity ("[t]o put into play or operation, employ").²⁰ The plain meaning of exercising control in § 362(a)(3) applies to continuing exclusive possession of collateral.

The Tenth Circuit's *Cowen* decision not only accepts the limitation of § 362(a)(3) suggested in the *Law Letter* but adds another argument about the provision's meaning, asserting that because the word "act" means "doing something," § 362(c)(2) "stays entities from doing something to obtain pos-

session of or to exercise control over the estate's property" rather than "passively holding onto an asset," as the Seventh Circuit stated in *Thompson*.²¹ But, of course, the creditors in each of the majority decisions did "do something"—they prevented the debtors from obtaining access to the collateral. Although each creditor's action was not new, it was an ongoing, continuing exercise of control, and so proscribed by the statutory language.

Moreover, if exercising control over estate property did not include maintaining exclusive possession of the property, there would be the question of what it does include. It cannot mean selling the property or otherwise using it to reduce the creditor's claim, since § 362(a)(6) separately stays any act "to collect, assess, or recover a claim against the debtor." The *Law Letter* suggests that if the nondebtor party to an executory contract terminates the contract of the estate, it will be exercising control over estate property, and cites a Ninth Circuit decision, *In re Computer Communications*, in support of that interpretation.²² However, *Computer Communications* held that terminating the contract was an "act to obtain possession of property of the estate," not an act to exercise control.²³

Finally, the *Law Letter* suggests that if someone not in possession of estate assets files a lawsuit that belongs to the estate, the filing could be seen as exercising control over an estate asset. Again, though, this is more likely to be seen as obtaining possession of the asset. And even if one or more of these hypothetical applications of exercising control were reasonable, it is difficult to imagine that they were a significant enough problem in 1984 that Congress would specially legislate to address them. The common meaning of exercising control over a piece of property—holding it to the exclusion of others—is not only the plain meaning of the amendment but is the only meaning addressing an issue significant enough to prompt legislation.

3. *The meaning of "property of the estate"*

The *Law Letter* continues its statutory construction by turning to the meaning of "property of the estate." It cites an article by Professor Thomas Plank arguing that when the Bankruptcy Code uses the term "property of the estate," it does not mean

"property" in the ordinary sense—individual items or pieces of property—but rather the particular property interests that the debtor holds at the time the bankruptcy case is filed.²⁴ With this understanding, the *Law Letter* reasons (1) that the "property of the estate"—over which a creditor may not exercise control under § 362(a)(3)—does not include the right of possession, since the debtor did not have that right at the time the case was filed and (2) that to bring that right into the estate, the debtor would have to obtain turnover under § 542(a).²⁵

The difficulty with this argument is in its premise. Apart from the bankruptcy court decision in *Hall*, which cites the *Law Letter* extensively,²⁶ no judicial decision appears to accept Professor Plank's understanding of "property of the estate," and this understanding is inconsistent with the manner in which the Bankruptcy Code uses the term. One example of the difficulty is § 363(f), which allows the sale of property under § 363(b) and (c), free and clear of "any interest in such property of an entity other than the estate" if one of a set of conditions is met, including that the interest of the other party is in bona fide dispute.²⁷ Subsections (b) and (c) only provide for sales of "property of the estate," and so, at least in § 363, the Code uses that term to mean the entire property to which the debtor claims title, even if another party is in possession at the time of filing or holds a bona fide claim of interest adverse to the debtor. With this understanding of property of the estate, the debtor's entire property is similarly subject to the protection of § 362(a)(3).

4. *The balance of harms*

Finally, the *Law Letter* compares the different costs imposed on debtors and creditors under the conflicting interpretations of § 362(a)(3).²⁸ For creditors, it says, returning collateral on demand by a debtor, as required by the majority interpretation, will likely result in—

- (a) the complete loss of any possessory lien,
- (b) the risk of full loss of value in uninsured collateral through theft or accidental damage, and
- (c) the deprivation of compensation for the value

lost through depreciation or the expense of seeking an order granting adequate protection.

These costs would be removed under the minority interpretation because it requires the debtor to file a turnover proceeding to regain possession of collateral, and, if demanded by the creditor, the debtor would have to prove adequate protection before turnover was granted.

For debtors, the *Law Letter* acknowledges the cost imposed by the minority interpretation: they will be unable to use a vehicle (or other collateral) that may be needed for work, schooling, and health care until the court rules on turnover, and the period of deprivation may be a long one—the time needed to file and obtain emergency relief in the adversary proceeding mandated by Fed. R. Bankr. P. 7001(1) for turnover under § 522(a). The majority interpretation of § 352(a)(3), by allowing debtors to obtain immediate return of the collateral without a turnover proceeding, removes this cost.

Although this balance shows harm to parties under both interpretations, the *Law Letter* suggests that the greater harm is imposed by the majority interpretation:

A well-advised debtor . . . would *never* offer *any* adequate protection in demanding turnover and would *always* put the secured creditor to the burden of moving for stay relief/adequate protection before the bankruptcy court, or use the prospective burden of doing so as leverage in adequate protection negotiations, but only *after* securing turnover *without* providing *any* adequate protection, which (as we've seen) holds the (not unrealistic) prospect of entirely eviscerating the secured creditor's right to receive adequate protection.²⁹

Accordingly—and consistent with its view of the difficulties it sees with the majority interpretation—the only recommendation that *Law Letter* makes for improving the law on return of collateral is a rule change that would allow debtors prompt access to turnover.³⁰

The balance set out by the *Law Letter*; however, may need adjustment. Although its description of harm to debtors is accurate, its view of the harm to creditors appears to be overstated in each of the respects it discusses.

(a) *Possessory liens are not eliminated by § 362(a)(3).*

Possessory liens generally terminate when the creditor holding the lien loses possession of the collateral.³¹ For this reason the *Law Letter* sees the majority interpretation of § 362(a)(3)—requiring creditors to give up the collateral they possess—as resulting in the loss of any possessory lien.³² It criticizes the Eighth Circuit BAP's opinion in *In re WEB2B Payment Solutions, Inc.*, which deals with a possessory lien, for bending the majority rule by suggesting that a possessory lien holder could withhold surrender of the collateral “until the bankruptcy court is able to make a determination as to whether, and to what extent, the creditor is entitled to adequate protection.”³³ That suggestion, the *Law Letter* states, cannot be reconciled with the majority decisions, including the Eighth Circuit's opinion in *Knaus*, which allow for no exceptions to return of collateral under § 362(a)(3).³⁴

But there are two problems with the idea that § 362(a)(3) would cause the loss of a possessory lien. The first is that, under the common law, a possessory lien only terminates when the creditor loses possession if the creditor gives up possession voluntarily. The Restatement of Security explains this in a comment:

The lien is a legal interest dependent upon possession. Where the lienor voluntarily gives up the possession, his lien, at least so far as it is a legal interest, is gone. The lienor . . . does not lose his legal interest if he is deprived without his consent of his possession either by the bailor [owner] or a third person. If the lienor's surrender of possession is voluntary but obtained by fraud, the lienor can recover the chattel unless third persons in the meantime have acquired interests. Where possession is taken without the consent of the lienor, even a bona fide purchaser is subject to the lien, provided the chattel is non-negotiable.³⁵

Accordingly, a retention lien continues to apply to collateral even if a legal obligation required the creditor to return it.³⁶

The *WEB2B* decision reflects this rule. The collateral in the case was cash of a Chapter 7 debtor that a creditor had received subject to a possessory lien. The trustee requested that the creditor turnover all of the cash. Under an agreement with the

trustee, and without any proceeding in the bankruptcy court, the creditor retained what it considered a sufficient amount of cash to satisfy its claims against the debtor and gave the balance to the trustee. Later, the retained collateral proved insufficient to cover these claims, and the creditor argued that the transferred collateral had been given to the trustee under compulsion, so that the possessory lien should continue to apply to it, citing the Supreme Court's *Whiting Pools* decision under § 542(a) to argue that the Bankruptcy Court should have determined what adequate protection would apply to the continuing lien. The BAP rejected this argument, holding that the transfer was voluntary, so that the possessory lien terminated when the collateral was transferred.³⁷ The BAP did suggest that the creditor could have requested a court determination of adequate protection before turning over the property, but this was plainly dicta. If payment to the trustee had actually been compelled, rather than voluntary, so that the possessory lien continued in place, the creditor would have been able to seek a ruling on adequate protection after the transfer. The BAP, however, had no reason to consider the effect of an involuntary transfer on possessory liens, whether made pursuant to § 362(a)(3) or any other provision of law; indeed, § 362(a)(3) is not mentioned in the decision.

The second problem with the *Law Letter's* treatment of possessory liens is that if nonbankruptcy law did result in termination of the lien after an involuntary transfer, an exception to the automatic stay—§ 362(b)(3)—would prevent § 362(a)(3) from going into effect, and the creditor would not be required to give up possession. This exception to the stay was explained in a decision of the Ninth Circuit BAP, *Hayden v. Wells*.³⁸ In that case, Chapter 13 debtors relied on § 362(a)(3) to obtain the return of their vehicle from a company with a possessory lien for its services in towing and storing the automobile. The BAP held that the § 363(b) stay exception required denial of the debtors' request, and explained the exception's effect:

[I]f state law provides that a creditor's security interest is superior to the rights of any entity obtaining its interest in the property prior to the date the creditor takes action to maintain or continue perfection

of its lien, the creditor's post-petition act to maintain or continue perfection of the lien does not violate the automatic stay. *Boggan v. Hoff Ford, Inc. (In re Boggan)*, 251 B.R. 95, 99 (9th Cir. BAP 2000) (holding that automobile dealership that retained possession of debtor's automobile as security for repayment of unpaid repair bill pursuant to Idaho law did not violate automatic stay).³⁹

A recent decision by the Bankruptcy Court for the Northern District of Illinois, *In re Avila*, cited *Hayden* in holding that § 362(b)(3) permits the City of Chicago to retain vehicles impounded for traffic violations because return of the vehicle under § 362(a)(3) would terminate the City's possessory lien for the impounding; the Seventh Circuit's *Thompson* decision was held inapplicable because of the § 363(b)(3) stay exception.⁴⁰ No appeal was taken from this order, but other judges in the Northern District of Illinois have disagreed with its holding, one ruling that the municipal ordinance granting the City's lien exceeds the City's police power,⁴¹ and the other ruling that § 363(b)(3) "applies only to 'acts' taken by creditors" and "passive possession of a debtor's property for the purposes of maintaining possession does not constitute an 'act.'" ⁴² These decisions have been appealed, and the appeals are pending in the district court.

But the *Hayden* and *Avila* decisions can be questioned on grounds other than those set out in the Chicago appeals. If applicable nonbankruptcy would not result in termination of a possessory lien after the lienholder was compelled to surrender possession, then there would be no need for the lienholder to retain possession in order to maintain or continue perfection of its lien, and the stay exception would not apply. The possessory lien would be given no different treatment than a purchase money lien. But in determining the effect of § 362(a)(2) on possessory liens, it is plain that regardless of whether the lien remains effective under the common law or under the § 362(b)(3) stay exception, the creditor does not lose its lien.

(b) *Transfers of uninsured vehicles may be prevented by annulment of the automatic stay.*

It is also unlikely that § 362(a)(3) will require creditors to return uninsured vehicles to debtors. In addition to allowing a creditor to seek termination or modification of the automatic stay for a lack

of adequate protection, § 362(d)(1) allows the stay to be annulled. Annulment has been consistently understood as retroactively terminating the stay, and so validating whatever action would otherwise have been a stay violation.⁴³ Although there is a lack of consistency in the language used by the courts discussing the grounds for stay annulment, there is general agreement that a balancing of the interests of the parties is required.⁴⁴ Among the factors that have generally been considered in this balancing are the good faith of the debtor in seeking enforcement of the stay and the harm to the creditor if the stay is enforced.⁴⁵ Courts may also grant annulment “if grounds for relief from the stay existed and a motion, if filed, would likely have been granted prior to the automatic stay violation [and] if failure to grant retroactive relief would cause unnecessary expense to the creditor.”⁴⁶

Under this precedent, if a creditor that had repossessed an uninsured car was faced with a demand by a Chapter 13 debtor to return the car under § 362(a)(2), the creditor could refuse until the debtor obtained insurance, and if the debtor sought to hold the creditor in violation of the automatic stay, the creditor could file a motion for annulment of the stay and almost certainly prevail.⁴⁷ By attempting to obtain use of a vehicle without insurance, the debtor would be acting in bad faith; if the creditor had been able to present a motion for stay relief, it would have been granted; and the harm to the creditor if the stay were enforced would be the potential loss of the full value of its security interest.⁴⁸

Of course, the creditor would still have to incur the expense of seeking stay annulment if the debtor charged the creditor with a stay violation. But since the courts would routinely grant such annulment motions, the debtor would have little reason to seek enforcement of § 362(a)(3); the cost of drafting and presenting the motion for stay enforcement would be wasted.

(c) *Chapter 13 provides substantial protection against declines in the value of collateral, without the need for creditor action.*

The remaining harm that the *Law Letter* sees imposed by the majority interpretation of § 362(a)(3) is the loss of value in a repossessed ve-

hicle that would occur while the debtor uses the vehicle without having to provide adequate protection that could have been ordered by the court, without a motion by the creditor, if the debtor had been required to seek a turnover under § 524(a). In Chapter 13, however, adequate protection is automatically required of any debtor holding collateral from the outset of the case; no creditor action is required. Section 1326(a)(1)(C) requires adequate protection payments to the secured creditor, unless the court orders otherwise, commencing no later than 30 days after the case is filed. It is unlikely that if debtors were required to file adversaries seeking turnover, the courts would order more in adequate protection than such payments. And to comply with the payment requirement would be grounds for stay relief and even dismissal of the case.⁴⁹

All of this suggests that the balance of harms resulting from the two interpretations of § 362(a)(3) is different from that set out in the 2013 *Law Letter*. While the minority interpretation does indeed impose substantial costs on debtors unable to use their vehicles, the majority interpretation does not impose costs on creditors to the extent that the *Law Letter* suggests.

POTENTIAL RESOLUTION OF THE CIRCUIT CONFLICT

Because the *Cowen* case was remanded for further proceedings (which could involve the imposition of sanctions on the creditors) there is no possibility, at least immediately, of Supreme Court review. The *Cowen* interpretation of § 362(a), however, might be subject to fuller consideration by the Tenth Circuit itself. In a Chapter 7 case in the District of Kansas, *Davis v. Tyson Prepared Foods*, an issue arose that the bankruptcy judge found similar to the question in *Cowen*.⁵⁰ In *Davis*, a worker was injured on the job and sought workers compensation benefits, but after filing a bankruptcy case, also filed a state court complaint against the company that supplied the item that caused her injury and obtained a judgment against that supplier. Under Kansas law, the employer was subrogated to the worker's right to recover from the supplier to the extent of the employer's work-

ers compensation payments to her, and a lien supporting this subrogation attaches to the judgment against the supplier.⁵¹

Does the attachment of this lien violate the automatic stay? If so, the estate would be entitled to the judgment, and the trustee has so argued. The bankruptcy court, however, held that the lien did not violate the automatic stay, because though the lien attached postpetition, it did so automatically, with no “act” violating the stay. The Tenth Circuit has granted direct review of this decision, and a decision applying *Cowen* is likely, but whatever decision is reached by the panel, a petition for en banc review or certiorari, challenging *Cowen*, seems likely.

CONCLUSION

Because of the large number of Chapter 13 cases in which an automobile of the debtor has been repossessed, the question whether the automatic stay requires return of vehicle will remain an important one. As set out in the 2013 *Law Letter* and in this one, it is also a complicated one.

ENDNOTES:

¹See *In re Knaus*, 889 F.2d 773, 775, 19 Bankr. Ct. Dec. (CRR) 1691, Bankr. L. Rep. (CCH) P 73117 (8th Cir. 1989); *In re Del Mission Ltd.*, 98 F.3d 1147, 1151-52, 29 Bankr. Ct. Dec. (CRR) 1155, 36 Collier Bankr. Cas. 2d (MB) 1658, Bankr. L. Rep. (CCH) P 77176, 36 Fed. R. Serv. 3d 512 (9th Cir. 1996) (expressly adopting the reasoning of *In re Abrams*, 127 B.R. 239, 241-43, 21 Bankr. Ct. Dec. (CRR) 1283, 25 Collier Bankr. Cas. 2d (MB) 15, Bankr. L. Rep. (CCH) P 74023 (B.A.P. 9th Cir. 1991), holding that failure to return a repossessed car after receiving notice of the debtor’s bankruptcy violated § 362(a)(3)); *Thompson v. General Motors Acceptance Corp., LLC*, 566 F.3d 699, 703, 61 Collier Bankr. Cas. 2d (MB) 1611, Bankr. L. Rep. (CCH) P 81490 (7th Cir. 2009); and *In re Weber*, 719 F.3d 72, 81, 69 Collier Bankr. Cas. 2d (MB) 1168, Bankr. L. Rep. (CCH) P 82484 (2d Cir. 2013). Accord, *In re Yates*, 332 B.R. 1, 54 Collier Bankr. Cas. 2d (MB) 1901, 8 A.L.R. Fed. 2d 837 (B.A.P. 10th Cir. 2005) (abrogated by, *In re Cowen*, 849 F.3d 943, 63 Bankr. Ct. Dec. (CRR) 211, 77 Collier Bankr. Cas. 2d (MB) 438 (10th Cir. 2017)); *In re Sharon*, 234 B.R. 676, 1999 FED App. 0009P (B.A.P. 6th Cir. 1999); *In re Carrigg*, 216 B.R. 303, 31 Bankr. Ct. Dec. (CRR) 1324, Bankr. L. Rep. (CCH) P 77657 (B.A.P. 1st Cir. 1998). See also *In re Rozier*, 348 F.3d 1305 (11th

Cir. 2003), certified question answered, 278 Ga. 52, 597 S.E.2d 367, 54 U.C.C. Rep. Serv. 2d 31 (2004), and *In re Rozier*, 376 F.3d 1323, 1324, Bankr. L. Rep. (CCH) P 80137 (11th Cir. 2004) (requiring return of collateral obtained prepetition as long as the collateral remained estate property after repossession).

Because § 362(a)(3) applies only to estate property, however, these decisions do not require return of collateral to debtors who are not entitled to possess estate property—including all Chapter 7 debtors. Any right to receive repossessed property in Chapter 7 cases would belong to the trustee. *In re Perry*, 540 B.R. 710, 725 (Bankr. C.D. Cal. 2015), aff’d in part, rev’d in part, 2017 WL 1276075 (C.D. Cal. 2017) (“If a creditor fails to turn over the debtor’s property, the [Chapter 7] debtor cannot bring actions under § 362(a)(3) prior to the debtor’s exemption in the assets being perfected, because such actions may only be brought by the trustee. After the exemption reverts the property in the debtor, the debtor cannot bring a § 362(a)(3) action because the asset is then no longer property of the estate.”). In this *Law Letter*, “debtor” is used to mean a debtor entitled to possession of estate property.

²The only arguably inconsistent circuit decision issued before 2017 is *U.S. v. Inslaw, Inc.*, 932 F.2d 1467, 21 Bankr. Ct. Dec. (CRR) 1077, Bankr. L. Rep. (CCH) P 74056, 37 Cont. Cas. Fed. (CCH) P 76104 (D.C. Cir. 1991), which held that a creditor—the United States Department of Justice—was not required to return to the debtor computer programming material whose ownership was in dispute, reasoning that a party claiming ownership of property could not be required to surrender the property to a debtor with a competing ownership claim before the ownership dispute was adjudicated. In that context, the court stated both that “it is difficult to believe that Congress intended a [stay] violation whenever someone already in possession of property mistakenly refuses to capitulate to a bankrupt’s assertion of rights in that property” and that the stay “serves as a restraint only on acts to gain possession or control over property of the estate,” rather than “creat[ing] an affirmative duty to remedy past acts of fraud or bias or harassment.” *Id.* at 1473-74. *Inslaw* did not consider whether § 362(a)(3) requires the return of collateral when the debtor’s ownership of the property is undisputed, and indeed cites *Knaus*, the leading case so holding, for the rule that “turnover of property admitted to belong to the debtor is required.” 932 F.2d at 1472.

³*In re Cowen*, 849 F.3d 943, 63 Bankr. Ct. Dec. (CRR) 211, 77 Collier Bankr. Cas. 2d (MB) 438 (10th Cir. 2017). The facts in *Cowen* make it a somewhat unattractive case for upsetting the rule requiring repossessed collateral to be returned to debtors. The vehicle involved in the case was a truck that a Chapter 13 debtor used in his business

and was subject to a purchase money security interest held by another individual, Bert Dring. The circuit court opinion explains how the truck came to be repossessed:

Mr. Dring lured Mr. Cowen under false pretenses to his place of business to repossess the Kenworth [truck]. Mr. Dring asked Mr. Cowen, who had brought along his young son, to leave the keys in the ignition, engine running, and to step out of the truck. As Mr. Cowen exited the vehicle, Mr. Dring jumped in, grabbed the keys, and declared the truck “repossessed.” When Mr. Cowen asked what was going on, Mr. Dring told him to take his son and leave—immediately. A group of five men gathered around Mr. Dring while he brandished a can of mace above his head and threatened to use it if Mr. Cowen did not leave. Mr. Cowen pushed his young son behind him to protect him, and the two left the lot on foot.

Id. at 945. After Cowen filed a Chapter 13 bankruptcy case, Dring objected to any bankruptcy treatment of the truck. The decision explains:

Mr. Dring claimed that he sold the Kenworth sometime prior to the bankruptcy filing. (Initially, he claimed he had sold the Kenworth to an unknown Mexican national for cash in an undocumented sale just days before Mr. Cowen filed for bankruptcy. Later, Mr. Dring produced bill of sale, purporting to show that he sold the Kenworth to a Mr. Garcia for \$16,000 in cash on August 4 [two days before the bankruptcy filing].)

Id. at 946. The bankruptcy court found that Dring (and a relative involved in the repossession of another of Cowen’s trucks) had probably forged documents, given perjured testimony, and coached witnesses during a hearing on the adversary proceeding that Cowen brought to enforce the automatic stay. Id.

⁴Cowen, 849 F.3d at 949-50, quoting Ralph Brubaker, Turnover, Adequate Protection, and the Automatic Stay (Parts I and II): Who Is “Exercising Control” Over What?, 33 Bankr. L. Letter Nos. 8-9 (Sept. & Aug. 2013).

⁵Weber v. SEFCU (In re Weber), 719 F.3d at 79. See also, Thompson, 566 F.3d at 702 (making the same point, citing a different dictionary).

⁶Weber v. SEFCU (In re Weber), 719 F.3d at 80.

⁷The 2013 *Law Letter* gives a much fuller set of reasons than *Cowen* does for rejecting the majority interpretation. For a judicial decision discussing these reasons and extensively citing the *Law Letter*, see In re Hall, 502 B.R. 650, 59 Bankr. Ct. Dec. (CRR) 6 (Bankr. D. D.C. 2014).

⁸Brubaker, 33 Bankr. L. Letter No. 9 at 8-9, citing *Dewsnup v. Timm*, 502 U.S. 410, 419, 112 S. Ct. 773, 116 L. Ed. 2d 903, 22 Bankr. Ct. Dec. (CRR) 750, 25 Collier Bankr. Cas. 2d (MB) 1297, Bankr. L. Rep. (CCH) P 74361A (1992).

⁹See *Bank of America, N.A. v. Caulkett*, 135 S.

Ct. 1995, n.1, 192 L. Ed. 2d 52, 61 Bankr. Ct. Dec. (CRR) 31, 73 C.B.C. 1485, Bankr. L. Rep. (CCH) P 82807 (2015):

From its inception, *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992), has been the target of criticism. See, e.g., id., at 420-436, 112 S. Ct. 773 (Scalia, J., dissenting); In re Woolsey, 696 F.3d 1266, 1273-1274, 1278 (CA10 2012); In re Dever, 164 B. R. 132, 138, 145 (Bkrcty. Ct. CD Cal. 1994); Carlson, Bifurcation of Undersecured Claims in Bankruptcy, 70 Am. Bankr. L. J. 1, 12-20 (1996); Ponoroff & Knippenberg, The Immovable Object Versus the Irresistible Force: Re-thinking the Relationship Between Secured Credit and Bankruptcy Policy, 95 Mich. L. Rev. 2234, 2305-2307 (1997); see also *Bank of America Nat. Trust and Sav. Assn. v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 463, 119 S. Ct. 1411, 143 L. Ed. 2d 607, and n. 3 (1999) (Thomas, J., concurring in judgment) (collecting cases and observing that “[t]he methodological confusion created by *Dewsnup* has enshrouded both the Courts of Appeals and . . . Bankruptcy Courts”).

¹⁰Brubaker, 33 Bankr. L. Letter No. 9 at 2.

¹¹See 11 U.S.C.A. § 363(e), providing for adequate protection “on request of an entity that has an interest in [estate] property”; *U.S. v. Whiting Pools, Inc.*, 1983-2 C.B. 239, 462 U.S. 198, 204, 103 S. Ct. 2309, 2313, 76 L. Ed. 2d 515, 10 Bankr. Ct. Dec. (CRR) 705, 8 Collier Bankr. Cas. 2d (MB) 710, Bankr. L. Rep. (CCH) P 69207, 83-1 U.S. Tax Cas. (CCH) P 9394, 52 A.F.T.R.2d 83-5121 (1983) (“At the secured creditor’s insistence, the bankruptcy court must place such limits or conditions . . . as are necessary to protect the creditor.”).

¹²See In re R. Purbeck & Associates, Ltd., 12 B.R. 406, 408 (Bankr. D. Conn. 1981) (“[A] secured creditor may insist upon adequate protection as a condition precedent to the turnover of property since the property may not be used, sold or leased under section 363 without it.”).

¹³Thompson, 566 F.3d at 702.

¹⁴Brubaker, 33 Bankr. L. Letter No. 9 at 3, citing *Inslaw*, 932 F.2d at 1474. The clarity of the 1984 amendment to § 362(a)(3) is a critical question under the *Dewsnup* approach to statutory construction. There is no relevant legislative history for the 1984 amendment to § 362(a)(3), but *Dewsnup* recognizes that this cannot defeat the effect of clear statutory language. See *Dewsnup*, 502 U.S. at 419-20, 112 S. Ct. at 779 (“Of course, where the language is unambiguous, silence in the legislative history cannot be controlling.”).

¹⁵*Inslaw*, 932 F.2d at 1472 (defining the “property” at issue as the debtor’s “intangible trade secret rights” and the asserted “exercise of control” as the use of these rights contrary to the parties’ contract).

¹⁶*Inslaw*, 932 F.2d at 1472 (“Whenever a party against whom the bankrupt holds a cause of action

(or other intangible property right) acted in accord with his view of the dispute rather than that of the debtor-in-possession or bankruptcy trustee, he would risk a determination by a bankruptcy court that he had ‘exercised control’ over intangible rights (property) of the estate.”)

¹⁷*Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 21, 116 S. Ct. 286, 290, 133 L. Ed. 2d 258, 28 Bankr. Ct. Dec. (CRR) 97, 33 Collier Bankr. Cas. 2d (MB) 869, Bankr. L. Rep. (CCH) P 76666A (1995).

¹⁸*Strumpf*, 516 U.S. 16, 21, 116 S. Ct. 286, 290 (1995).

¹⁹*Brubaker*, 33 Bankr. L. Letter No. 9 at 3, quoting *Inslaw*, 932 F.2d at 1474.

²⁰*American Heritage College Dictionary* 556, 479 (3d ed. 1997)

²¹*Cowen*, 849 F.3d at 949, quoting *New Oxford American Dictionary* 15 (3d ed. 2010) and *Thompson*, 566 F.3d at 703.

²²*Brubaker*, 33 Bankr. L. Letter No. 9 at 4, citing *In re Computer Communications, Inc.*, 824 F.2d 725, 16 Bankr. Ct. Dec. (CRR) 615, 17 Collier Bankr. Cas. 2d (MB) 556, Bankr. L. Rep. (CCH) P 71933 (9th Cir. 1987).

²³*Computer Communications*, 824 F.2d at 728.

²⁴*Brubaker*, 33 Bankr. L. Letter No. 9 at 4-5, citing *Thomas E. Plank, The Outer Boundaries of the Bankruptcy Estate*, 47 *Emory L.J.* 1194, 1209, 1213 (1998).

²⁵*Brubaker*, 33 Bankr. L. Letter No. 9 at 5.

²⁶*Hall*, 502 B.R. at 667.

²⁷*Precision Industries, Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537, 544, 41 Bankr. Ct. Dec. (CRR) 65, 49 Collier Bankr. Cas. 2d (MB) 1765, Bankr. L. Rep. (CCH) P 78836 (7th Cir. 2003) summarizes the operation of § 362(f) this way:

Section 363 generally provides for the use, sale, or lease of property belonging to the bankruptcy estate. [S]ubsections (b) and (c) permit the trustee of a bankruptcy estate to sell estate property either within the normal course of a debtor’s business (in which case the sale may take place without prior notice and a hearing) or outside the normal course of business (in which case . . . notice and hearing are mandatory). Subsection (f) makes clear that the property, under specified conditions, may be sold unencumbered of interests held by others

²⁸*Brubaker*, 33 Bankr. L. Letter No. 9 at 6-9.

²⁹*Brubaker*, 33 Bankr. L. Letter No. 9 at 7-8.

³⁰*Brubaker*, 33 Bankr. L. Letter No. 9 at 9.

³¹*In re Borden*, 361 B.R. 489, 494, 62 U.C.C. Rep. Serv. 2d 158 (B.A.P. 8th Cir. 2007) (“[P]ossession is generally required for a possessory lien.”).

³²*Brubaker*, 33 Bankr. L. Letter No. 9 at 6-7.

³³*In re WEB2B Payment Solutions, Inc.*, 488 B.R. 387, 393, 57 Bankr. Ct. Dec. (CRR) 202, Bankr. L. Rep. (CCH) P 82449 (B.A.P. 8th Cir. 2013).

³⁴*Brubaker*, 33 Bankr. L. Letter No. 9 at 8.

³⁵Restatement of Security § 80 cmt. c (1941). Among the decisions applying this common law rule is *Finch v. Miller*, 531 P.2d 892, 893 (Or. 1975)(en banc) (holding that a possessory lien was not lost by the debtors’ removing the collateral from the creditor’s possession without the creditor’s consent).

³⁶See *Gangloff Industries, Inc. v. Generic Financing and Leasing, Corp.*, 907 N.E.2d 1059, 69 U.C.C. Rep. Serv. 2d 113 (Ind. Ct. App. 2009) (holding that a possessory lien continued in effect after the secured creditor had given up possession of the collateral pursuant to an erroneous court order).

³⁷*WEB2B*, 488 B.R. at 393.

³⁸*In re Hayden*, 308 B.R. 428, 51 Collier Bankr. Cas. 2d (MB) 1688, Bankr. L. Rep. (CCH) P 80084 (B.A.P. 9th Cir. 2004).

³⁹*Hayden*, 308 B.R. at 432.

⁴⁰*In re Avila*, 566 B.R. 558, 560, 77 Collier Bankr. Cas. 2d (MB) 709 (Bankr. N.D. Ill. 2017).

⁴¹*In re Howard*, 584 B.R. 252 (Bankr. N.D. Ill. 2018).

⁴²*In re Fulton*, 2018 WL 2392854 (Bankr. N.D. Ill. 2018), opinion amended and superseded, 2018 WL 2570109 (Bankr. N.D. Ill. 2018)

⁴³See, e.g., *In re Siciliano*, 13 F.3d 748, 751, 30 Collier Bankr. Cas. 2d (MB) 667, Bankr. L. Rep. (CCH) P 75656 (3d Cir. 1994) *In re Schwartz*, 954 F.2d 569, 573, 22 Bankr. Ct. Dec. (CRR) 845, 26 Collier Bankr. Cas. 2d (MB) 649, Bankr. L. Rep. (CCH) P 74539, 92-1 U.S. Tax Cas. (CCH) P 50069, 69 A.F.T.R.2d 92-548 (9th Cir. 1992); *Sikes v. Global Marine, Inc.*, 881 F.2d 176, 178-79, 19 Bankr. Ct. Dec. (CRR) 1224, Bankr. L. Rep. (CCH) P 73061 (5th Cir. 1989) (rejected by, *In re Servico, Inc.*, 144 B.R. 933, 23 Bankr. Ct. Dec. (CRR) 687, 27 Collier Bankr. Cas. 2d (MB) 1239, Bankr. L. Rep. (CCH) P 74936 (Bankr. S.D. Fla. 1992)); *In re Albany Partners, Ltd.*, 749 F.2d 670, 675, 12 Bankr. Ct. Dec. (CRR) 787, 12 Collier Bankr. Cas. 2d (MB) 244, Bankr. L. Rep. (CCH) P 70184 (11th Cir. 1984) (rejected by, *In re Victoria Ltd. Partnership*, 187 B.R. 54, 27 Bankr. Ct. Dec. (CRR) 1210, Bankr. L. Rep. (CCH) P 76666 (Bankr. D. Mass. 1995)).

⁴⁴See *In re Myers*, 491 F.3d 120, 129, 48 Bankr. Ct. Dec. (CRR) 133, Bankr. L. Rep. (CCH) P 80962 (3d Cir. 2007) (“Even those cases that have subscribed to a narrow conception of the power to retroactively annul the stay have affirmed that balancing the equities is the appropriate test.”)

⁴⁵See *In re National Environmental Waste Corp.*, 129 F.3d 1052, 1055, 31 Bankr. Ct. Dec. (CRR) 876, Bankr. L. Rep. (CCH) P 77541 (9th Cir. 1997); *Easley v. Pettibone Michigan Corp.*, 990 F.2d

905, 911, 28 Collier Bankr. Cas. 2d (MB) 1002 (6th Cir. 1993).

⁴⁶In re Stockwell, 262 B.R. 275, 281, 37 Bankr. Ct. Dec. (CRR) 244 (Bankr. D. Vt. 2001).

⁴⁷The Bankruptcy Court for the District of New Jersey appears to have had a practice that informally came to this result without requiring the filing of a motion to annul the stay. See In re Denby-Peterson, 576 B.R. 66, 81, 93 U.C.C. Rep. Serv. 2d 1367 (Bankr. D. N.J. 2017) (“For at least the last 20 years . . . the practice in this district has been that a creditor holding a car repossessed prepetition may request proof of insurance naming it as loss payee prior to turnover without violating the stay. But once proof of insurance has been produced, the creditor violates the stay by not returning the car.”). The court questioned the basis for this practice and suggested that the minority interpretation of § 362(a)(3) is preferable, at least if there is a dispute about the debtor’s ownership of the vehicle, but that for personal property free of liens, the creditor may violate the automatic stay by failing to return the property to the debtor on request. *Id.* at 82-83.

⁴⁸One court has treated the lack of vehicle insurance as grounds for automatically annulling the

automatic stay. The Bankruptcy Court for the Western District of Missouri has adopted a local rule, Rule 4070-1, prohibiting a debtor from operating an uninsured vehicle and giving the secured creditor, after notice to the debtor and an opportunity to obtain insurance, the right to repossess the vehicle without seeking relief from the automatic stay. When this rule was challenged, the court found that it was supported by annulment under § 362(d)(2). In re Suggs, 354 B.R. 903, 912 (Bankr. W.D. Mo. 2006), *rev’d and remanded*, 377 B.R. 198 (B.A.P. 8th Cir. 2007) (The Court . . . essentially annuls the automatic stay and retroactively validates the repossession. A rule authorizing the creditor’s action and the entry of such an order is therefore not inconsistent with § 362.”).

⁴⁹See In re Hicks, 2011 WL 2414419 (Bankr. N.D. Ala. 2011).

⁵⁰In re Garcia, 2017 WL 2951439 (Bankr. D. Kan. 2017).

⁵¹K.S.A. § 44-504.

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Bankruptcy Law Letter

AUGUST 2013 | VOLUME 33 | ISSUE 8

TURNOVER, ADEQUATE PROTECTION, AND THE AUTOMATIC STAY (PART I): ORIGINS AND EVOLUTION OF THE TURNOVER POWER

By Ralph Brubaker

In the recent decision of *In re Weber*,¹ the Second Circuit joins a growing majority of appellate courts holding that a secured creditor who has lawfully repossessed collateral prepetition must, once the debtor files bankruptcy, immediately and unconditionally surrender that collateral to the appropriate estate representative (usually a Chapter 13 debtor) on pain of contempt for a willful violation of the automatic stay.² This issue of *Bankruptcy Law Letter* is the first of a two-part analysis and critique of that majority position. This month's issue will trace the origins and evolution of the turnover power through the 1984 amendments to the Bankruptcy Code, which amended the automatic stay provision of § 362(a)(3) in a manner that the majority courts believe effects a dramatic change in prior turnover practice—to wit, that a secured creditor can no longer retain collateral repossessed prepetition pending provision of court-ordered adequate protection. Next month's issue will critically examine the courts' interpretation of that amendment to § 362(a)(3).

As we shall see, the majority position is highly dubious³ and seems driven more by certain “practical considerations” (as the courts themselves have put it) than a sound, principled interpretation of the meaning of the relevant Code provisions. Admittedly, the governing law is nuanced and opaque—thus, the appeal of a more “pragmatic” response. The facts of *Weber* are straightforward and typical, though, so that is a good place to begin.

Prepetition Repossession of Collateral and the Post-Petition Stand-Off

In 2006, the State Employees Federal Credit Union (SEFCU) obtained a security interest in Chris Weber's pickup truck to secure four loans from SEFCU to Weber. In 2009, Weber defaulted on those loans, and on January 10, 2010, SEFCU lawfully repossessed Weber's pickup truck, which he evidently used in his construction business. Unable to fully redeem the pickup truck under applicable New York

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law (which would require payment of all amounts owing SEFCU if those debts had been accelerated upon default, plus reasonable costs of repossession), Weber filed a Chapter 13 petition on January 14. Weber's counsel immediately notified SEFCU of the bankruptcy filing and demanded return of Weber's pickup. SEFCU did not return the vehicle, apparently taking the position that it could retain possession pending a turnover order from the bankruptcy court that afforded SEFCU adequate protection of its lien. So on January 22, Weber filed an adversary proceeding against SEFCU seeking turnover of the pickup under Code § 542(a) and alleging a willful violation of the § 362(a)(3) automatic stay provision.

On March 1, the Bankruptcy Court entered an order to show cause why (1) the vehicle should not be returned and (2) SEFCU should not be sanctioned

for a stay violation. After a hearing on the show-cause order, SEFCU evidently voluntarily surrendered the vehicle to Weber on March 5. Weber's adversary proceeding continued as to the alleged stay violation, however, for which Weber sought actual damages from inability to use the vehicle between the January 14 petition and the March 5 return date, as well as attorney's fees and punitive damages under Code § 362(k)(1).

The bankruptcy court ultimately granted SEFCU summary judgment on the authority of *In re Alberto*,⁴ which held that mere retention of possession already lawfully acquired prepetition is *not* an “act to . . . exercise control over property of the estate” within the meaning of Code § 362(a)(3). The district court reversed, however, and the Second Circuit affirmed the district court, holding that “by failing to deliver the repossessed vehicle to the debtor-in-possession promptly after receiving notice of the pending petition, SEFCU willfully violated section 362(a).”⁵

The History of Secured Creditor Turnover

Full understanding of the automatic stay question at issue in cases such as *Weber* requires appreciation of the proper relationship between the automatic stay provision of § 362(a)(3) and the § 542(a) turnover provision. As the Supreme Court has stated in the context of the corollary § 542(b) turnover provision, “we will not give § 362(a)(3) . . . an interpretation that would proscribe what § 542(b)'s” turnover provision was “plainly intended to permit.”⁶

The Supreme Court's *Whiting Pools* decision⁷ is, of course, the seminal case on secured creditor turnover under the Bankruptcy Code. As the *Weber* court correctly recognized, though (and unlike many other courts), *Whiting Pools* does *not* resolve the stay violation question. And as the *Whiting Pools* Court acknowledged, § 542(a) was simply a codification of turnover powers that had developed under “judicial precedent predating the Bankruptcy Code,” and “[n]othing in the legislative history evinces a congressional intent to depart from that [pre-Code] practice.”⁸ That pre-Code practice, therefore, remains highly relevant for interpreting the turnover power as codified in § 542(a).

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BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: USA, US Possessions, and Canada—.00 annually. For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter*, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

Historical Common-Law Principles of In Rem Jurisdiction

Many aspects of now-codified federal bankruptcy law have their origins in common law principles of in rem jurisdiction, and turnover powers are yet another example. As Justice Jackson explained:

The turnover procedure is one not expressly created or regulated by the Bankruptcy Act. It is a judicial innovation by which the court seeks efficiently and expeditiously to accomplish ends prescribed by the statute, which, however, left the means largely to judicial ingenuity.⁹

The express statutory provisions of federal bankruptcy law vesting title to a bankrupt's property in a representative of the bankruptcy estate, to be administered for the benefit of the bankrupt's creditors, under the supervision and control of a federal bankruptcy court, have always been considered to give that federal court in rem jurisdiction over that property. "By operation of law, the filing of the petition in bankruptcy cause[s] all property of the debtor to pass into the custody of the bankruptcy court, under the control of a trustee or receiver, an officer of the court."¹⁰ As Justice Fuller famously stated in *Mueller v. Nugent*, "the filing of the petition is a caveat to all the world, and in effect an attachment and injunction" pursuant to which "title to the bankrupt's property became vested in the trustee with actual or constructive possession, and placed in the custody of the bankruptcy court."¹¹

"Such . . . in rem jurisdiction is closely linked to the power to enjoin interferences with property within the control of a federal court."¹² "In fact, the essence of such . . . in rem jurisdiction is in the power to enjoin collateral interference with that property and its administration."¹³ As Justice Brandeis put it:

All property in the possession of a bankrupt of which he claims the ownership passes, upon the filing of a petition in bankruptcy, into the custody of the court of bankruptcy. To protect its jurisdiction from interference, that court may issue an injunction. The power is not peculiar to bankruptcy or to the federal courts. It is an application of the general principle that, where a court of competent jurisdiction has, through its officers, taken property into its possession, . . . the court may not only issue all writs necessary to protect its possession from physical interference, but is entitled to determine all questions respecting the same.¹⁴

Of course, "[d]etermining exactly what property is within the exclusive possession and control of a federal bankruptcy court can be a nettlesome problem, especially with respect to property in the possession of a third party," and "[t]raditionally, such property has been considered within the 'constructive' possession of a federal bankruptcy court only to the extent the third party raises no substantial defenses to turnover of the property."¹⁵

A turnover order, then, was conceived as an incident to a bankruptcy court's in rem jurisdiction over a debtor's bankruptcy estate. It was considered in the nature of an injunctive order, the violation of which was punishable by contempt.¹⁶ Moreover, this injunctive turnover power directly implicated the historical summary-plenary distinction that pervaded multiple dimensions of federal bankruptcy jurisdiction and procedure.¹⁷

Of course, a debtor's property often included things not within the possession of the court, such as a disputed cause of action against a third party or tangible property held under a substantial claim of right by a third party, a so-called adverse claimant. A court of bankruptcy had no summary jurisdiction to adjudicate disputes with adverse claimants. Such a dispute could be resolved only by an ordinary civil action (a plenary suit) . . .¹⁸

All other bankruptcy proceedings, however, were resolved through summary proceedings in the federal bankruptcy court, and this "procedural divide established under the early American bankruptcy statutes . . . simply adopted the English practice requiring a formal plenary suit in assignee [now trustee] actions to recover money or property from an adverse claimant."¹⁹

To the extent a debtor's property was in the possession of a third party raising no adverse claim to retain possession, though, a federal bankruptcy court could summarily issue an injunctive turnover order against that party. Indeed, that was the holding of *Mueller v. Nugent*:

In other words, the question reduces itself to this: Has the bankruptcy court the power to compel the bankrupt or his agent to deliver up money or other assets of the bankrupt, in his possession or that of some one for him, [in summary proceedings] on petition and rule to show cause? Does a mere refusal by the bankrupt or his agent so to deliver up oblige the trustee to

resort to a plenary suit in the [former trial-level] circuit court or a state court, as the case may be?

If it be so, the grant of jurisdiction to cause the estates of bankrupts to be collected, and to determine controversies relating thereto, would be seriously impaired, and in many respects rendered practically inefficient.

The bankruptcy court would be helpless indeed if the bare refusal to turn over could conclusively operate to drive the trustee to an action to recover as for an indebtedness, or a conversion, or to proceedings in chancery, at the risk of the accompaniments of delay, complication, and expense, intended to be avoided by the simpler methods of the bankrupt law.

* * *

[W]here property of a bankrupt has come into the hands of a third party before the filing of the petition in bankruptcy, as the agent of the bankrupt, and to which he asserts no adverse claim, the bankruptcy court has [the] power by summary proceedings to compel the surrender of the property to the trustee in bankruptcy duly appointed.²⁰

Turnover by a Secured Creditor in Possession of Repossessed Collateral

Within the context of this framework of general principles governing common-law turnover powers, a secured creditor who had, in the enforcement of its lien rights, lawfully taken possession of its collateral before the bankruptcy filing, was (as Judge Friendly put it) “the archetypal ‘adverse claimant’”²¹ who was *not* subject to a turnover order.²² Indeed, “[g]enerally, a creditor in possession of collateral could liquidate the collateral without interference” from the bankruptcy court.²³

The Supreme Court’s *Continental Illinois* decision²⁴ authorized a more expansive conception of bankruptcy courts’ general injunctive powers in reorganization proceedings.²⁵ Relying upon *Continental Illinois*’ generous construction of the scope of bankruptcy courts’ injunctive powers under 1898 Act § 2a(15) (the predecessor to present Code § 105(a)), as well as express codification in the statutory reorganization provisions of bankruptcy courts’ in rem “jurisdiction of the debtor and its property, wherever located” (the predecessors to 28 U.S.C.A. § 1334(e)(1)),²⁶ the lower courts held that bankruptcy courts also had a more expansive turnover power in reorganization proceedings as well.

Thus, in reorganization proceedings “a bank-

ruptcy court had broad power to order secured creditors in possession following the debtor’s default to turn over the collateral,”²⁷ with the leading case being the First Circuit’s decision in *Reconstruction Finance Corp. v. Kaplan*.²⁸ In any such turnover proceeding, though, “the bankruptcy court was required to protect the secured creditor from harm before ordering return of the property items.”²⁹

Code § 542(a)’s Codification of Pre-Code Turnover Powers

The legislative history of the Code § 542(a) turnover provision has been the subject of careful scholarly study, including by Judge Friendly in his Second Circuit opinion in *Whiting Pools*.³⁰ Indeed, the Supreme Court commented that “we find Judge Friendly’s careful analysis of this history for the Court of Appeals to be unassailable,”³¹ and Judge Friendly’s analysis ultimately concluded that the most “natural reading of § 542 is that it was intended to codify *RFC v. Kaplan*,”³² which was representative of the pre-Code practice pursuant to which “the bankruptcy court could order the turnover of collateral in the hands of a secured creditor.”³³

Indeed, more generally, Code § 542(a) “gives an explicit statutory basis for the traditional turnover order against persons other than the debtor.”³⁴ As the Supreme Court explained the traditional turnover power in *Maggio v. Zeitz*, it was a use of the bankruptcy court’s general equitable powers under the statutory predecessor to Code § 105(a) to enforce the debtor’s statutory turnover obligation under the predecessor to Code § 521(4).³⁵ With codification of a correlative turnover obligation for third parties in possession of property of the estate in § 542(a), then, bankruptcy courts can use their § 105(a) equitable powers to enter an injunctive turnover order against third parties as “necessary or appropriate to carry out the provisions of” § 542(a).³⁶

The most noteworthy implication of this historical perspective on the intended function of § 542(a)—the perspective that the Supreme Court itself promulgated in *Whiting Pools*—is that “§ 542(a) is *not* self-executing.”³⁷ It simply provides an express statutory basis for a bankruptcy court to enter an injunctive order compelling turnover of identified property in the possession of a third party.

Consistent with the pre-Code turnover practice that § 542(a) was intended to codify, then, a third party's mere possession of that property, in and of itself (before entry of any turnover order), does not contravene any injunctive orders of the court; only a knowing violation of a duly entered turnover order is contemptuous conduct. Indeed, if § 542(a) were itself a self-executing injunctive order, a subsequent turnover order would be entirely unnecessary. "Injunctions . . . are *not* enforced by further injunctions; injunctions are enforced by contempt citations."³⁸

Whiting Pools, Code § 542(a), and Secured Creditor Turnover

While *Whiting Pools* is often considered a decision construing the scope of property of the estate under the Bankruptcy Code, in actuality, its holding only addressed the extent of a bankruptcy court's turnover powers under Code § 542(a). Its discussion of property of the estate, while largely dicta, was confusing (and somewhat confused) and is a central obstacle to properly resolving the turnover conundrum presented by cases like *Weber*.

The debtor in that case was Whiting Pools, Inc., which ran a swimming pool sales and service business, and Whiting Pools had fallen behind on its employment tax payments to the IRS. IRS assessments resulted in a tax lien attaching to all of Whiting Pools' property, and in January 1981, the IRS seized a bunch of Whiting Pools' property pursuant to the tax lien, with the intention of selling that property at a public auction and using the proceeds to pay the taxes owing. The day after the IRS seized the property, though, Whiting Pools filed Chapter 11.

Even though the IRS had a lien on and possession of the seized property on the petition date, Whiting Pools still owned the property. Whiting Pools' Chapter 11 estate, therefore, succeeded to that ownership interest under Code § 541(a)(1). Consequently, any attempt by the IRS to proceed with the tax sale post-petition would be an act to enforce a lien against property of the estate, in violation of the § 362(a)(4) automatic stay provision.

The IRS, therefore, moved for relief from stay to

proceed with the tax sale, and Whiting Pools counterclaimed, seeking turnover of the seized property under Code § 542(a). The bankruptcy court denied the IRS relief from stay and ordered turnover of possession of the seized property, on the condition that Whiting Pools provide adequate protection of the value of the IRS's lien rights through retention of the lien, specified cash payments to the IRS, and lifting of the stay upon any payment default. The IRS contested the turnover order in the Supreme Court, contending that it could not be forced to turn over the property that it had seized prepetition.

The § 542(a) Turnover Power Enhances Property of the Estate

Although the Supreme Court sent conflicting signals on this point, it is abundantly clear that Whiting Pools, as DIP representative of the bankruptcy estate, had no right to regain possession of the seized property under Code § 541(a)(1) as mere successor to "all legal or equitable interests of the debtor in property as of the commencement of the case." Of course, the "interests of the debtor in property" referenced in § 541(a)(1) are those "[p]roperty interests . . . created and defined by state law."³⁹ On the petition date, the debtor did *not* have possession of the seized property—the relevant state-law "interest in property" at stake; the IRS had possession of the seized property. Moreover, on the petition date, Whiting Pools did not have any right to regain possession of the seized property by simply promising a bunch of future cash payments to the IRS. And Code § 541(a)(1) manifestly (in the words of the legislative history) "is not intended to expand the debtor's rights against others more than they exist at the commencement of the case."⁴⁰

So the bankruptcy estate automatically succeeds to no greater property rights on the petition date than those of the debtor, and thus, to the extent the debtor has no state-law right to possession of the property on the petition date, the estate acquires no possessory rights under Code § 541(a)(1). In *Whiting Pools*, nonbankruptcy law clearly gave the IRS rightful possession of the seized property on the petition date, so the debtor's Chapter 11 estate did *not* (and could not) succeed to possession or a right of possession under Code § 541(a)(1).

The IRS argued that the same limitation applied

to turnover of property of the estate under Code § 542(a):

The Government concludes that, at the commencement of the case, the debtor's only interests in the property seized by the IRS were those explicitly set forth in § 6331 *et seq.* of the IRC [a right to notice of the seizure and sale, a right to redemption prior to sale, and a right to any surplus proceeds from the sale], that therefore only those interests became part of the "property of the estate", and that turnover of these interests would be inappropriate since the debtor cannot "use, sell, or lease" them.⁴¹

The Supreme Court, however, rejected this argument as an inapt limitation on the scope of the § 542(a) turnover power, which provides, by its express terms, for the estate to obtain "possession" of property from a third party.⁴² The Court thus construed the turnover provision of Code § 542(a) as augmenting property of the estate with a right of possession the debtor did *not* have on the petition date, in the same way that a trustee's avoiding powers enhance property of the estate beyond the debtor's petition-date property interests.

In the words of the Court: "In effect, § 542(a) grants to the estate a possessory interest in certain property of the debtor that was not held by the debtor at the commencement of the reorganization proceedings."⁴³ "Indeed, if this were not the effect, § 542(a) would be largely superfluous in light of § 541(a)(1)" because "[i]nterests in the seized property that could have been exercised by the debtor . . . are already part of the estate by virtue of § 541(a)(1)."⁴⁴ "The fact that § 542(a) grants the trustee greater rights than those held by the debtor prior to the filing of the petition is consistent with [avoiding power] provisions of the Bankruptcy Code that address the scope of the estate."⁴⁵ "Several of these provisions bring into the estate property in which the debtor did not have a possessory [or other] interest at the time the bankruptcy proceedings commenced. Section 542(a) is such a provision."⁴⁶ And when the estate successfully obtains possession of property pursuant to § 542(a), possession itself also becomes property of the estate under the express terms of § 541(a)(7) as an "interest in property that the estate acquires after the commencement of the case."

The Right to Adequate Protection Replaces the Right of Possession

By its express terms, though, Code § 542(a) only compels turnover of "property that the trustee [or DIP] may use, sell, or lease under section 363." Thus, the *Whiting Pools* Court also held that the secured creditor subjected to turnover, "under section 363(e), remains entitled to adequate protection for its interests."⁴⁷ Because "the right to adequate protection . . . replace[s] the protection afforded by possession,"⁴⁸ then "[a]t the secured creditor's insistence, the bankruptcy court must place such limits or conditions on the trustee's power to sell, use, or lease property as are necessary to protect the creditor."⁴⁹ Indeed, Code § 363(e) even expressly provides that the bankruptcy "court . . . shall *prohibit*" a "*proposed* . . . use, sale, or lease" to the extent "necessary to provide adequate protection" of a secured creditor's lien rights.

Adequate Protection Precedes Turnover

Given the pre-Code turnover practice that § 542(a) was intended to codify (as the *Whiting Pools* Court noted), it seems clear that Congress contemplated that such adequate protection determinations would be made in the context of proceedings on a trustee's request for a turnover order, as was the case under pre-Code practice. Indeed, the legislative history notes that § 542(a) "is not intended to require an entity to deliver property to the trustee if such entity has obtained an order of the court authorizing the entity to retain possession, custody, or control of the property."⁵⁰

Moreover, the automatic stay provision as originally enacted (and extant when *Whiting Pools* was decided) was also fully consistent with the pre-Code turnover practice, pursuant to which a repossessing secured creditor's mere possession of the repossessed collateral, in and of itself (before entry of any turnover order), does not contravene any injunctive orders of the court; only a knowing violation of a duly entered turnover order is contemptuous conduct. The only possessory conduct (as such) enjoined by the originally enacted version of the § 362(a)(3) automatic stay provision was "any *act to obtain possession* of property of the estate or of property from the estate," and a secured creditor's mere

retention of possession already obtained before the bankruptcy filing (and its imposition of the automatic stay) clearly did *not* violate this stay provision.

Extension of *Whiting Pools* to Chapter 13 Cases

Whiting Pools was decided in the context of a Chapter 11 reorganization proceeding, and the Supreme Court's reasoning expressly relied upon "the congressional goal of encouraging reorganizations" and the fact that a "reorganization effort would have small chance of success . . . if property essential to running the business were excluded from the estate."⁵¹ Thus, the *Whiting Pools* Court was careful to confine its holding to turnover of repossessed collateral in a Chapter 11 case.⁵² In fact, there is some textual support for the position that a Chapter 13 debtor has no turnover rights at all under Code § 542(a), as that provision is conspicuously absent from the list of "rights and powers of a trustee" that Code § 1303 confers upon a Chapter 13 debtor.⁵³

Code § 1303, however, does expressly afford a Chapter 13 debtor a trustee's right to use, sell, or lease property of the estate under Code § 363, and it is precisely such "property that the trustee may use, sell, or lease under section 363" that is subject to turnover under Code § 542(a). Moreover, while § 542(a) provides that any party in possession of such property "shall deliver to the trustee, and account for, such property," Code § 1306(b) provides that in a Chapter 13 case, "the debtor shall remain in possession of all property of the estate." Thus, the text of the Code can be fairly read to afford a Chapter 13 debtor turnover rights under Code § 542(a), as an incident to the debtor's right to possess and use property of the estate. And likewise, just as Chapter 11's general policy objective of encouraging reorganization over liquidation is promoted through turnover of repossessed collateral, so too is Chapter 13's general policy objective of encouraging debt repayment plans by allowing a debtor to keep all of his/her property.⁵⁴

In both Chapter 11 and Chapter 13 cases, then, the § 542(a) turnover power works in tandem with the § 362(a)(4) automatic stay provision preventing the repossessing secured creditor from selling the

collateral. The DIP is given full use of repossessed collateral in order to facilitate confirmation and consummation of a successful reorganization/repayment plan, provided that the secured creditor's lien rights are adequately protected. Consequently, most courts have concluded that *Whiting Pools*' construction of the scope of the § 542(a) turnover power is equally applicable in Chapter 13, and the Second Circuit in *Weber* reached the same conclusion.

The 1984 Amendment to § 362(a)(3) Enjoining any Act to Exercise Control over Property of the Estate

If the above history of the § 542(a) turnover power were the end of the story, then cases like *Weber* would be easily resolved. The secured creditor clearly could retain possession of collateral repossessed prepetition pending a determination of necessary adequate protection, made by the bankruptcy court in the context of a trustee or DIP's request for turnover of the repossessed collateral.

The only thing, then, that makes these cases at all difficult is the 1984 amendment to Code § 362(a)(3), which added the following italicized language:

(a) ... a [bankruptcy] petition ... operates as a stay, applicable to all entities, of—

(3) 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;

Indeed, the determinative nature of this amendment is revealed by the fact that,

under the Code, prior to the § 362(a)(3) amendment, the common [pre-Code] practice of conditioning turnover orders on proof of adequate protection continued. Courts uniformly supported the practice that "[a] secured creditor may insist upon adequate protection as a condition precedent to the turnover of property since the property may not be used, sold, or leased under section 363 without it."⁵⁵

Next month's issue of *Bankruptcy Law Letter* will analyze and critique the courts' varying interpretations of the effect of the "exercise control" amendment to § 362(a)(3) as applied to a secured creditor's retention of collateral repossessed prepetition.

ENDNOTES:

¹In re Weber, 2013 WL 1891371 (2d Cir. 2013).

²See *Thompson v. General Motors Acceptance Corp., LLC*, 566 F.3d 699, 61 Collier Bankr. Cas. 2d (MB) 1611, Bankr. L. Rep. (CCH) P 81490 (7th Cir. 2009); In re Knaus, 889 F.2d 773, 19 Bankr. Ct. Dec. (CRR) 1691, Bankr. L. Rep. (CCH) P 73117 (8th Cir. 1989); In re Yates, 332 B.R. 1, 54 Collier Bankr. Cas. 2d (MB) 1901, 8 A.L.R. Fed. 2d 837 (B.A.P. 10th Cir. 2005); In re Sharon, 234 B.R. 676, 1999 FED App. 0009P (B.A.P. 6th Cir. 1999); In re Abrams, 127 B.R. 239, 21 Bankr. Ct. Dec. (CRR) 1283, 25 Collier Bankr. Cas. 2d (MB) 15, Bankr. L. Rep. (CCH) P 74023 (B.A.P. 9th Cir. 1991).

³Judges Teel, Spector, and Stosberg have written particularly thoughtful opinions challenging the majority approach. See In re Sharon, 234 B.R. 676, 688, 1999 FED App. 0009P (B.A.P. 6th Cir. 1999) (Stosberg, J., dissenting); In re Bernstein, 252 B.R. 846, 36 Bankr. Ct. Dec. (CRR) 211, 45 Collier Bankr. Cas. 2d (MB) 297 (Bankr. D. D.C. 2000) (Teel, B.J.); In re Barringer, 244 B.R. 402, 43 Collier Bankr. Cas. 2d (MB) 1615 (Bankr. E.D. Mich. 1999) (Spector, B.J.); In re Young, 193 B.R. 620 (Bankr. D. D.C. 1996) (Teel, B.J.). Accord Charles J. Tabb, *The Law of Bankruptcy* § 3.6, at 262-64 & § 5.13, at 442 n.4, 444 (2d ed. 2009); Ralph Brubaker, *Which Comes First: the Turnover or the Adequate Protection?*, 20 Bankr. L. Letter No. 12, at 1 (Dec. 2000); Thomas E. Plank, *The Outer Boundaries of the Bankruptcy Estate*, 47 Emory L.J. 1194, 1267-71 (1998).

The Eleventh Circuit's case law on the subject, while also departing from the majority approach, is badly misguided, as this contributing author has argued in a previous issue of *Bankruptcy Law Letter*. Ralph Brubaker, *Turnover Rights Revisited (or Repudiated Sub Silentio?)*: Who "Owns" Collateral Repossessed by a Secured Creditor?, 22 Bankr. L. Letter No. 8, at 1 (Aug. 2002). See also Stephen J. Ware, *Security Interests, Repossessed Collateral, and Turnover of Property to the Bankruptcy Estate*, 2002 Utah L. Rev. 775.

⁴In re Alberto, 271 B.R. 223 (N.D. N.Y. 2001).

⁵Weber, 2013 WL 1891371, at *10.

⁶*Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 116 S. Ct. 286, 133 L. Ed. 2d 258, 28 Bankr. Ct. Dec. (CRR) 97, 33 Collier Bankr. Cas. 2d (MB) 869, Bankr. L. Rep. (CCH) P 76666A (1995).

⁷*U.S. v. Whiting Pools, Inc.*, 1983-2 C.B. 239, 462 U.S. 198, 103 S. Ct. 2309, 76 L. Ed. 2d 515, 10 Bankr. Ct. Dec. (CRR) 705, 8 Collier Bankr. Cas. 2d (MB) 710, Bankr. L. Rep. (CCH) P 69207, 83-1 U.S. Tax Cas. (CCH) P 9394, 52 A.F.T.R.2d 83-5121 (1983).

⁸*Whiting Pools*, 462 U.S. at 208.

⁹*Maggio v. Zeitz*, 333 U.S. 56, 61 (1948).

¹⁰Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-*

Debtor Releases in Chapter 11, 1997 U. Ill. L. Rev. 959, 1043 n.314.

¹¹*Mueller v. Nugent*, 184 U.S. 1, 14, 22 S. Ct. 269, 46 L. Ed. 405 (1902). See also *International Bank v. Sherman*, 101 U.S. 403, 406, 25 L. Ed. 866, 1879 WL 16671 (1879) ("The filing of the petition was a caveat to all the world. It was in effect an attachment and injunction.").

¹²Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 Wm. & Mary L. Rev. 743, 839 n.357 (2000).

¹³Ralph Brubaker, *Money Judgments, Governmental Police and Regulatory Powers, and the Automatic Stay*, 21 Bankr. L. Letter No. 2, at 1, 5 (Feb. 2001).

¹⁴*Ex parte Baldwin*, 291 U.S. 610, 615 (1934).

¹⁵Brubaker, 21 Bankr. L. Letter No. 2, at 5. See Brubaker, 41 Wm. & Mary L. Rev. at 792.

¹⁶See *Maggio v. Zeitz*, 333 U.S. 56, 68 S. Ct. 401, 92 L. Ed. 476 (1948); *Oriel v. Russell*, 278 U.S. 358, 363-67, 49 S. Ct. 173, 73 L. Ed. 419 (1929) (there is "no doubt that a motion to commit the bankrupt for failure to obey an order of the court to turn over to the receiver in bankruptcy the property of the bankrupt is a civil contempt," and "this sort of an order of 'turnover' finds its analogy in the inquiry in contempt proceedings for violating an injunction issued by a court of general jurisdiction"); *Mueller v. Nugent*, 184 U.S. at 13 ("if the [turnover] order . . . was in itself a lawful order, the power of the district court to commit" the person in possession of the bankrupt's money "until he surrendered the money to the trustee, or otherwise satisfied the trustee with respect thereto, was unquestionable under . . . the general jurisdiction of the court to enforce its orders in the collection of assets").

¹⁷See generally Ralph Brubaker, *A "Summary" Statutory and Constitutional Theory of Bankruptcy Judges' Core Jurisdiction After Stern v. Marshall*, 86 Am. Bankr. L.J. 121, 122-30 (2012).

¹⁸Ralph Brubaker, *Nondebtor Releases and Injunctions in Chapter 11: Revisiting Jurisdictional Precepts and the Forgotten Callaway v. Benton Case*, 72 Am. Bankr. L.J. 1, 23-24 (1998).

¹⁹Brubaker, 86 Am. Bankr. L.J. at 126.

²⁰*Mueller v. Nugent*, 184 U.S. at 14.

²¹*U.S. v. Whiting Pools, Inc.*, 674 F.2d 144, 148, 8 Bankr. Ct. Dec. (CRR) 1138, 5 Collier Bankr. Cas. 2d (MB) 1584, 82-1 U.S. Tax Cas. (CCH) P 9269, 50 A.F.T.R.2d 82-6080 (2d Cir. 1982), judgment aff'd, 1983-2 C.B. 239, 462 U.S. 198, 103 S. Ct. 2309, 76 L. Ed. 2d 515, 10 Bankr. Ct. Dec. (CRR) 705, 8 Collier Bankr. Cas. 2d (MB) 710, Bankr. L. Rep. (CCH) P 69207, 83-1 U.S. Tax Cas. (CCH) P 9394, 52 A.F.T.R.2d 83-5121 (1983).

²²See *Phelps v. U. S.*, 1975-1 C.B. 372, 421 U.S.

330, 95 S. Ct. 1728, 44 L. Ed. 2d 201, 75-1 U.S. Tax Cas. (CCH) P 9467, 35 A.F.T.R.2d 75-1505 (1975).

²³Thomas E. Plank, *The Creditor in Possession Under the Bankruptcy Code: History, Text, and Policy*, 59 Md. L. Rev. 253, 266 (2000).

²⁴Continental Illinois Nat. Bank & Trust Co. of Chicago v. Chicago, R.I. & P. Ry. Co., 294 U.S. 648, 55 S. Ct. 595, 79 L. Ed. 1110 (1935).

²⁵See Brubaker, 72 Am. Bankr. L.J. at 25-26.

²⁶See Brubaker, 72 Am. Bankr. L.J. at 31 n.130, 34 n.139, 40 n.171; Plank, 59 Md. L. Rev. at 269 n.64. It is not at all clear, however, that these provisions did anything more than simply codify accepted, traditional principles of in rem jurisdiction. Indeed, in *Continental Illinois*, “in its discussion of the source of the reorganization court’s injunctive powers, the Supreme Court emphasized the court’s jurisdiction over the debtor’s reorganization, not its jurisdiction over the debtor’s property.” Brubaker 72 Am. Bankr. L.J. at 31 n.130. It does nicely illustrate, though, how the courts viewed the scope of their injunctive powers as ineluctably linked to and essentially coextensive with (and thus limited by) the reach of their in rem jurisdiction.

²⁷Whiting Pools, 674 F.2d at 150 (Friendly, C.J.). See id. at 148-49 n.7, 150-52; Plank, 59 Md. L. Rev. at 284-91; Patrick A. Murphy, *Use of Collateral in Business Rehabilitations: A Suggested Redrafting of Section 7-203 of the Bankruptcy Reform Act*, 63 Cal. L. Rev. 1483, 1492-95 (1975).

²⁸R. F. C. v. Kaplan, 185 F.2d 791 (1st Cir. 1950).

²⁹Plank, 59 Md. L. Rev. at 291 (footnote omitted).

³⁰See Whiting Pools, 674 F.2d at 152-56. See also Plank, 59 Md. L. Rev. at 292-307.

³¹Whiting Pools, 462 U.S. at 207 n.16.

³²Whiting Pools, 674 F.2d at 155.

³³Whiting Pools, 462 U.S. at 208. “Nothing in the legislative history evinces a congressional intent to depart from that [pre-Code] practice.” Id. Thus, “the bankruptcy court generally has power under § 542 to order the turnover of property repossessed or executed upon by a secured creditor . . . following the debtor’s default and prior to his bankruptcy.” Whiting Pools, 674 F.2d at 156.

³⁴Plank, 59 Md. L. Rev. at 303 (footnotes omitted).

³⁵See *Maggio v. Zeitz*, 333 U.S. at 61-63.

³⁶11 U.S.C.A. § 105(a).

³⁷Bernstein, 252 B.R. at 849 (emphasis added).

³⁸Ralph Brubaker, *Of State Sovereign Immunity and Prospective Remedies: The Bankruptcy Dis-*

charge as Statutory Ex parte Young Relief, 76 Am. Bankr. L.J. 461, 555 (2002).

³⁹*Butner v. U.S.*, 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979).

⁴⁰S. Rep. No. 95-989, at 82 (1978); H.R. Rep. No. 95-595, at 367 (1977).

⁴¹Whiting Pools, 674 F.2d at 149-50.

⁴²Moreover, § 542(a) uses the general bundled term “property” to thus more colloquially refer to that which the third party must relinquish possession of, rather than the more precise bundle-of-sticks method of describing various “interests” in property used throughout § 541(a). This suggests that the *Whiting Pools* Court correctly interpreted § 542(a) as a means of affirmatively enhancing the estate with a particular property interest—possession—that the estate would not otherwise have.

⁴³Whiting Pools, 462 U.S. at 207.

⁴⁴Whiting Pools, 462 U.S. at 207 n.15.

⁴⁵Whiting Pools, 462 U.S. at 207 n.15.

⁴⁶Whiting Pools, 462 U.S. at 205.

⁴⁷Whiting Pools, 462 U.S. at 212-13.

⁴⁸Whiting Pools, 462 U.S. at 207.

⁴⁹Whiting Pools, 462 U.S. at 204.

⁵⁰124 Cong. Rec. S17, 413 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini); 124 Cong. Rec. H11,096 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards).

⁵¹Whiting Pools, 462 U.S. at 204, 203.

⁵²“Our analysis in this case depends in part on the reorganization context in which the turnover order is sought. We express no view on the issue whether § 542(a) has the same broad effect in [Chapter 7] liquidation or [Chapter 13] adjustment of debt proceedings.” Whiting Pools, 462 U.S. at 208 n.17.

⁵³See David Gray Carlson, *Turnover of Collateral in Bankruptcy: Must a Secured Party-in-Possession Volunteer?*, 6 J. Bankr. L. & Prac. 483, 507-08 (1997) (making this argument).

⁵⁴See generally *In re Robinson*, 36 B.R. 35, Bankr. L. Rep. (CCH) P 69574 (Bankr. E.D. Ark. 1983).

⁵⁵Young, 193 B.R. at 626 (quoting *In re R. Purbeck & Assocs.*, 12 B.R. 406, 408 (Bankr. D. Conn. 1981)).

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Bankruptcy Law Letter

SEPTEMBER 2013 | VOLUME 33 | ISSUE 9

TURNOVER, ADEQUATE PROTECTION, AND THE AUTOMATIC STAY (PART II): WHO IS “EXERCISING CONTROL” OVER WHAT?

By *Ralph Brubaker*

This issue of *Bankruptcy Law Letter* is the second of a two-part analysis and critique of the Second Circuit's recent decision of *In re Weber*.¹ In its *Weber* opinion, the Second Circuit joins a growing majority of appellate courts holding that a secured creditor who has lawfully repossessed collateral prepetition must, once the debtor files bankruptcy, immediately and unconditionally surrender that collateral to the appropriate estate representative (usually a Chapter 13 debtor) on pain of contempt for a willful violation of the automatic stay.²

The majority position is highly dubious,³ though, and seems driven more by certain “practical considerations” (as the courts themselves have put it) than a sound, principled interpretation of the meaning of the relevant Code provisions.

Last month's issue traced the origins and evolution of the turnover power through the 1984 amendments to the Bankruptcy Code, which amended the automatic stay provision of § 362(a)(3) in a manner that the majority courts believe effects a dramatic change in prior turnover practice—to wit, that a secured creditor can no longer retain collateral repossessed prepetition pending provision of court-ordered adequate protection. This month's issue critically examines the courts' interpretation of that amendment to § 362(a)(3).

The 1984 Amendment to § 362(a)(3) Enjoining any Act to Exercise Control over Property of the Estate

If the pre-1984 history of the § 542(a) turnover power were the end of the story, then cases like *Weber* would be easily resolved. The secured creditor clearly could retain possession of collateral repossessed prepetition pending a determination of necessary adequate protection, made by the bankruptcy court in the context of a trustee or DIP's request for turnover of the repossessed collateral.

The only thing, then, that makes cases such as *Weber* at all difficult is the 1984 amendment to Code § 362(a)(3), which added the following italicized language:

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(a) . . . a [bankruptcy] petition . . . operates as a stay, applicable to all entities, of—

* * * *

(3) 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*;

Indeed, the determinative nature of this amendment is revealed by the fact that,

under the Code, prior to the § 362(a)(3) amendment, the common [pre-Code] practice of conditioning turnover orders on proof of adequate protection continued. Courts uniformly supported the practice that “[a] secured creditor may insist upon adequate protection *as a condition precedent* to the turnover of property since the property may not be used, sold, or leased under section 363 without it.”⁴

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BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: USA, US Possessions, and Canada—.00 annually. For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter*, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

Turnover First, Then Adequate Protection

Those courts finding a stay violation when a secured creditor retains possession of collateral repossessed prepetition interpret the “exercise control” language added to § 362(a)(3) as an amendment directed at precisely that situation. As the Sixth Circuit BAP stated, “[w]ithholding possession of property from a bankruptcy estate is the essence of ‘exercising control’ over” property of the estate.⁵ Thus, these courts see § 362(a)(3) as a correlative enhancement of the estate’s § 542(a) turnover rights:

The duty to turn over the property is not contingent upon any predicate violation of the stay, any order of the bankruptcy court, or any demand by the creditor. Rather, the duty arises upon the filing of the bankruptcy petition. The failure to fulfill this duty, regardless of whether the original seizure was lawful, constitutes a prohibited attempt to “exercise control over the property of the estate” in violation of the automatic stay.⁶

As with any conduct stayed by § 362(a), to the extent the operation of the stay (in this case, by compelling turnover) will impair the value of the creditor’s lien, the creditor’s “[e]ntitlement to adequate protection in the first instance . . . is triggered by a creditor’s request to the bankruptcy court, and if you don’t ask for it, you won’t get it.”⁷ Under this interpretation of § 362(a)(3), then, a secured creditor cannot withhold possession of the repossessed collateral pending provision of adequate protection. Rather, the secured creditor must affirmatively request adequate protection from the bankruptcy court via, for example, a stay relief motion.

This turnover-adequate protection approach, though, is entirely dependent upon an interpretation of “exercise control” that includes mere retention of pre-existing possession, and that interpretation, while perhaps superficially appealing, is not at all compelling and, indeed, is highly problematic.

Adequate Protection Before Turnover

Pre-1984 Established Practice

The opposite minority approach resists the broader interpretation of “exercise control” because of its dramatic departure from pre-1984 practice, emphasizing the Supreme Court’s interpretive

canon that presumes continuity in the law and continuation of established practice, in the absence of an unambiguous statutory directive or some legislative history indicating an intention to reverse the established practice. **Dewsnup subject to plain meaning?**

When Congress amends the bankruptcy laws, it does not write “on a clean slate.” Furthermore, this Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in . . . practice that is not the subject of at least some discussion in the legislative history.⁸

Some majority courts contest the notion that their interpretation is a reversal of pre-1984 practice.⁹ This contention, however, simply is not credible, and of course, these courts cite *no* pre-1984 instances in which a repossessing secured creditor’s mere retention of possession of its collateral (in the absence of a turnover order) was held to be contemptuous conduct, in and of itself (presumably because there are none).¹⁰

Moreover, the meaning of “exercise control” in amended § 362(a)(3), as a trigger for violation of an injunction, is extremely vague and has been a perennial source of difficulty in determining its scope. As the D.C. Circuit explained, the problem lies in the potentially “extraordinary” sweep of an unbounded notion of “exercise control,” particularly given the indubitable breadth of the notion of “property of the estate” as including any kind of “interest” of the debtor in any kind of tangible or intangible property.

[Section 362(a)(3)] cannot require that every party who acts in resistance to the debtor’s view of its rights violates [the automatic stay] if found in error by the bankruptcy court. . . . Since willful violations of the stay expose the offending party to liability for compensatory damages, costs, attorney’s fees, and, in some circumstances, punitive damages, it is difficult to believe that Congress intended a violation whenever someone already in possession of property mistakenly refuses to capitulate to a bankrupt’s assertion of rights in that property.¹¹

What’s more, there is absolutely no legislative history explaining Congress’s objective in adding the intractably vague “exercise control” language to § 362(a)(3). At a minimum, then, the majority interpretation seems to run counter to the prevailing presumption *against* such a stark reversal of estab-

lished practice. The problems with the majority interpretation, however, do not end there, as careful application of the statutory language seems to make the alternative, minority interpretation equally (if not more) plausible.

“Control” as Distinct from “Possession”

Adequate protection-turnover courts disagree with the notion that the language employed in the 1984 amendment to § 362(a)(3) was directly specifically at retention of possession. Indeed, use of the word “control” in the 1984 amendment to § 362(a)(3) suggests that the drafters meant to distinguish the newly prohibited “control” from the already-prohibited acts to obtain “possession,” in order to reach nonpossessory conduct that would nonetheless interfere with the estate’s authority over a particular property interest. Indeed, the legislative history explaining the originally enacted version of § 362(a)(3) also suggested such a distinction, although the original statutory language clearly did not address nonpossessory “control.”¹²

An “Act” as Distinct from Failure to Act

The minority interpretation also reasons from the automatic stay’s general function of merely preserving the petition-date status quo while parties’ relative rights and obligations can be ascertained through the appropriate bankruptcy process, and preserving the petition-date status quo in this context means permitting the creditor to remain in possession of the property pending provision of adequate protection as ordered by the bankruptcy court.

By prohibiting only an “act . . . to exercise control,” the 1984 amendment to § 362(a)(3) does, in fact, seem in accord with a general design of preventing affirmative conduct that would upset the petition-date status quo or otherwise interfere with the trustee’s or DIP’s “control” of property of the estate. “The automatic stay, as its name suggests, serves as a restraint only on acts to gain possession or control over property of the estate.”¹³ By contrast, if a creditor does nothing and simply retains possession of property that the creditor already has in its possession, it seems difficult to say that the creditor has performed an “act” prohibited by the stay. Indeed, that is essentially how the Supreme Court

interpreted § 362(a)(3) in the *Citizens Bank v. Strumpf* case, where the Court said that a bank's refusal to pay to the Chapter 13 DIP-depositor sums on deposit in the debtor's bank account "was neither a taking of possession of [debtor's] property nor an exercising of control over it, but merely a refusal to perform its promise" to repay deposited sums.¹⁴

Under this view, then, the "exercise control" amendment prohibits only affirmative conduct directed at "control" rather than "possession" of estate property. Such prohibited nonpossessory "control," in the absence of stay relief from the bankruptcy court, might include a nondebtor counterparty's unilateral postpetition termination of an executory contract,¹⁵ or the postpetition efforts of someone other than the trustee or DIP (such as an individual shareholder or creditor of a corporate debtor or even the individual debtor in a Chapter 7 case) to prosecute a cause of action belonging to the debtor's bankruptcy estate.¹⁶

Thus, a § 542(a)/105(a) turnover *cause of action* to recover possession may well be a cause of action that is properly considered property of the estate, and the efforts of anyone other than the trustee or DIP to assert or otherwise interfere with the trustee or DIP's exclusive authority to assert the estate's turnover rights might well be considered a prohibited "act . . . to exercise control over property of the estate" within the meaning of § 362(a)(3). But "it is difficult to believe that Congress intended a violation whenever someone already in possession of property . . . refuses to capitulate to a bankrupt's assertion of rights in that property."¹⁷

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Exceptions to a Secured Creditor's Turnover Obligation

The minority, adequate protection-turnover courts also reject the broader interpretation of § 362(a)(3) as inconsistent with, rather than complementing, the design of the turnover provisions. Unlike § 362(a)(3), the estate's turnover rights are not absolute. As the Supreme Court specifically noted in *Whiting Pools*, "there are explicit limitations on the reach of § 542(a),"¹⁸ pursuant to which turnover is *not* required. Yet, under the broad interpretation of "exercise control," failure to turn over property when turnover is *not* required, nonetheless, would constitute a stay violation.

For example, § 542(a) expressly provides that property is *not* subject to turnover if "such property is of inconsequential value or benefit to the estate." Determinations regarding value and benefit of property are not self-evident incorrigible propositions, particularly when one takes into account the estate's adequate protection obligations with respect to property encumbered by a lien. Thus, § 542(a) (on its face) seems to contemplate such a determination by the bankruptcy court in the context of a turnover action initiated by the estate, similar to the procedure for such value and benefit determinations in the context of abandonment of property of the estate.¹⁹ If the court in that turnover action determines that the property is of inconsequential benefit to the estate and, thus, *not* subject to turnover, under the broad interpretation of "exercise control," the court would nonetheless be compelled to reach the absurd conclusion that the defendant violated the automatic stay by retaining possession of that property.

The *Weber* court, therefore, was simply incorrect in its assertion that § 542(a) is "self-executing" and "requires that any entity in possession of property of the estate deliver it to the trustees, *without condition*."²⁰ As the historical evolution of the turnover power clearly reveals, "§ 542(a) is *not* self-executing."²¹ And given that truism, it seems highly unlikely that Congress would indirectly impose a self-effectuating turnover obligation via § 362(a)(3) that exceeds the scope of the § 542(a) turnover provision. Indeed, it is only by means of a post-hoc boot-strap, under the influence of the overly broad interpretation of § 362(a)(3), that the courts have misconstrued § 542(a) as somehow being self-executing when (on its face) it clearly cannot be, and its origins further confirm that conclusion.

Possession Becomes Property of the Estate Only Upon Turnover

Limiting the reach of the automatic stay in a manner compatible with the turnover provisions simply requires a modicum of care and precision in specifying the "property" protected by § 362(a)(3). By its terms, § 362(a)(3) only prohibits acts to exercise control over "property of the estate." In its definition of "property of the estate," the "Bankruptcy Code explicitly adopts the legal understanding of 'prop-

erty' as interests in property," which "reflects the 'bundle of sticks' metaphor" for property interests, and "its use in the definition of property of the estate and its use throughout the Code reflect Congress's deliberate choice."²² As Professor Plank puts it:

The explicit use of the bundle of sticks metaphor in § 541(a)(1) shows that Congress intended to distinguish the debtor's interest in a property item and a third party's interest in the property item. To the extent that a third party has an interest in a property item in which the debtor has an ownership interest, that interest is excluded from the interest of the debtor in that property item.²³

With respect to turnover, the particular property interest (the "stick" in the metaphorical property "bundle of sticks") that is at stake is, of course, the one expressly referenced in § 542(a)—"possession." When a secured creditor is in possession on the petition date, the secured creditor's continued postpetition retention of possession is not an exercise of control over "property of the estate," because as the Supreme Court indicated in *Whiting Pools*, under those circumstances possession is *not* a property interest to which the estate automatically succeeds on the filing date under § 541(a)(1).²⁴ Rather, possession becomes "property of the estate" under § 541(a)(7) only to the extent the estate successfully invokes turnover through § 542(a), which (as we've seen) clearly contemplates initiation of a turnover action, in which the creditor can then raise any defenses to turnover specified by § 542(a).

Of course, the most prominent among the "explicit limitations on the reach of § 542(a)" that the Supreme Court specifically highlighted in *Whiting Pools* is "that the property be usable under § 363."²⁵ By express incorporation of § 363, then, when the estate seeks turnover of property "proposed to be used, sold, or leased, by the trustee, the court . . . shall *prohibit* or *condition* such use, sale, or lease as is necessary to *provide adequate protection*" of the secured creditor's lien rights.²⁶

Not surprisingly, this more careful analysis of the statutory language and the relationship between § 542(a) and cognate provisions in §§ 362 and 363 ultimately reinforces the clear implications of the history of the pre-Code turnover power because, as the Supreme Court acknowledged in *Whiting Pools*, § 542(a) is simply a codification thereof. Sections

542(a) and 363(e), together, make a secured creditor's obligation to turn over repossessed collateral (for use by the trustee or DIP) contingent upon the trustee or DIP requesting a turnover order from the court, and in the context of that turnover proceeding, the bankruptcy court can then make a determination regarding what the estate must do to adequately protect the value of the secured creditor's lien rights (such as maintaining insurance and making periodic cash payments) and thus fulfill the express statutory condition (1) to the estate's right to use the property under § 363 and thus also (2) to the secured creditor's obligation to turn over the property under § 542—fully consistent with the pre-Code turnover power that § 542(a) was intended to codify.

The majority courts' contrary interpretation rests upon an overly aggressive interpretation of the 1984 amendment to § 362(a)(3) attributable to a specious understanding of the "property" protected by that provision. Regrettably, though, much of the blame for this confusion lies with the Supreme Court's *Whiting Pools* opinion. There is one particular passage from *Whiting Pools* that seems to lend credibility to the majority courts' interpretation of § 362(a)(3) and, thus, figures prominently in their justificatory rationales. It is, at most, however, simply loose (and erroneous) dictum.

At one point the *Whiting Pools* opinion states that "§ 541(a)(1) is intended to include in the estate any property made available to the estate by other provisions of the Bankruptcy Code,"²⁷ thus implying that any possessory right granted the estate by § 542(a) is somehow immediately considered property of the estate under § 541(a)(1) "as of the commencement of the case," *before* the estate actually obtains possession via turnover. Both that statement itself, though, and the implication attributed to it are false. Indeed, the *Whiting Pools* Court itself subsequently contradicts that statement by acknowledging that the plain language of § 541(a)(1) does not and cannot "grant[] to the estate a possessory interest . . . that was not held by the debtor at the commencement of the" bankruptcy case—thus, the Court's reliance on § 542(a) to do that work.²⁸

Moreover, that statement entirely overlooks those subparagraphs of § 541(a), such as (a)(3) and (a)(7),

that (unlike § 541(a)(1)) are by their express terms “intended to include in the estate any property made available to the estate by other provisions of the Bankruptcy Code,”²⁹ such as the avoiding power provisions to which the *Whiting Pools* Court expressly likened § 542(a). And in the context of those avoiding power provisions, many lower courts (including the Second Circuit itself) have *refused* to indulge the *Whiting Pools* suggestion that property recoverable thereby should somehow be considered property of the estate “as of the commencement of the case” under § 541(a)(1), before the estate actually recovers the property at issue. For example, in *In re Colonial Realty Co.*, the Second Circuit flatly rejected the contention that “fraudulently transferred property [i]s part of the bankruptcy estate under § 541(a)(1) prior to its recovery,” holding that the language and structure of § 541(a) “clearly reflects the congressional intent that such property is *not* to be considered property of the estate until it is recovered.”³⁰

Thus, it may well be true that “[w]ithholding possession of property from a bankruptcy estate is the essence of ‘exercising control’ over possession,”³¹ as the majority courts repeatedly (and tellingly) emphasize. But such an exercise of control over possession is a violation of the § 362(a)(3) automatic stay only if possession is property of the estate. When a secured creditor is in possession on the petition date, though, possession is *not* property of the estate, and possession only becomes property of the estate once the estate actually obtains possession via turnover.

Only through reliance upon *Whiting Pools*’ dangerously misleading dictum could the Second Circuit in *Weber* come to the bizarre conclusion that “*Whiting Pools* teaches that filing of a petition will generally transform a debtor’s equitable [ownership] interest into a bankruptcy estate’s possessory right.”³² And the Second Circuit could only conclude that SEFCU’s “‘exercising control’ over the object in which the estate’s equitable [ownership] interest lay”³³—i.e., retaining possession of the car—was a stay violation by construing “property of the estate” in a colloquial sense (i.e., the car) rather than the legal “interest in property” bundle-of-sticks meaning expressly employed in the Bankruptcy Code’s definition of “property of the estate.”³⁴

No Protection Is Not Adequate Protection

The majority courts’ interpretation of § 362(a)(3) essentially turns that provision into a self-executing turnover provision, requiring *no* adequate protection and with *no* turnover defenses at all. That interpretation, of course, makes the “explicit limitations on the reach of § 542(a)”³⁵ entirely superfluous. Indeed, if failure to immediately turn over repossessed collateral once the debtor files bankruptcy is exercising control over property of the estate in violation of the stay, then § 542(a) itself seems superfluous and unnecessary—other than to fill out the circular reasoning that § 542(a) somehow makes possession property of the estate over which the creditor is exercising control—circular reasoning that then completely ignores the “explicit limitations on the reach of § 542(a).”³⁶ Moreover, interpreting § 362(a)(3) as an independent, self-executing turnover provision not only mandates immediate turnover for the estate’s proposed use without any provision of adequate protection, it can also fully jeopardize the secured creditor’s entire “right to adequate protection [that] replace[s] the protection afforded by possession.”³⁷

Because most courts hold that a secured creditor’s right to receive adequate protection is triggered only through the filing of the creditor’s request with the court, many courts have also held that the extent of adequate protection to which the creditor is entitled (i.e., the value of the creditor’s lien) must be measured as of the date the secured creditor files its request with the court. If § 362(a)(3) compels immediate turnover by a secured creditor when the debtor files bankruptcy, faithful compliance with this obligation will mean that, as a practical matter, turnover will invariably precede the creditor’s filing of a formal motion for adequate protection with the bankruptcy court. Consequently, in those courts measuring adequate protection as of the date of the creditor’s motion, the secured creditor will be subjected to a period during which its lien is subject to wholesale dissipation with no recourse.

For example, a possessory lien (such as a service provider’s lien,³⁸ an execution lien,³⁹ or a security interest perfected by possession⁴⁰) will vanish the moment the creditor relinquishes possession to the trustee or DIP, thus immediately terminating the

creditor's right to adequate protection. Likewise, if the creditor turns over uninsured property that is promptly destroyed by fire, the creditor's right to adequate protection also goes up in smoke. The secured creditor's inevitable and entirely understandable desire to delay the turnover at least long enough to preserve the right to receive the "indubitable equivalent" specifically mandated by the Code, certainly does not suggest conduct that should be considered sanctionable contempt. Indeed, in *Citizens Bank v. Strumpf*,⁴¹ the Supreme Court was presented with a similar conflict between a broad interpretation of the automatic stay and the express statutory protections afforded a secured creditor by the § 542(b) turnover provision, and the Court held that the former must yield to the latter.

In the *Strumpf* case, when the debtor filed Chapter 13, he was in default on a \$5,000 loan debt owed Citizens Bank and also had a checking account with the Bank. In response to the debtor's bankruptcy filing, the Bank put a temporary freeze on any further withdrawals from the account while it sought permission from the bankruptcy court to exercise its setoff rights with respect to the account. Although § 542(b) mandates turnover to the estate of debt payments owing a debtor, this obligation is expressly abated "to the extent that such debt may be offset under section 553." The bankruptcy court nonetheless held the Bank in contempt for violation of the automatic stay, forcing the Bank to remove its freeze on the debtor's account. The court subsequently granted the Bank relief from stay to exercise its setoff rights, but by that point there were no more funds in the account to setoff.

The Supreme Court, however, held that the bankruptcy court erred in construing the stay in a manner that eviscerated the setoff rights expressly preserved by § 542(b)—i.e., the automatic stay should *not* be interpreted as a self-executing turnover provision that exceeds the scope of the § 542(b) turnover provision. Likewise, "[t]he right of adequate protection cannot be rendered meaningless by an interpretation of §§ 362(a)(3) and 542(a) that would compel turnover even before an opportunity for the court's granting of adequate protection."⁴² Indeed, in a very recent decision from the Eighth Circuit BAP, *In re WEB2B Payment Solutions, Inc.*,⁴³ the court's reasoning (although dicta) implicitly

acknowledges that the majority courts' interpretation of § 362(a)(3) as applied to a secured creditor's retention of possession of collateral is inconsistent with *Strumpf*.

In *WEB2B*, the court held that a secured creditor with a security interest perfected by possession did, in fact, lose its perfected lien (and thus its right to any adequate protection) upon turnover of the collateral to the Chapter 7 trustee, notwithstanding the fact that immediate turnover seemed compelled by the Eighth Circuit's early, influential, now-majority interpretation of § 362(a)(3) in *In re Knaus*.⁴⁴ The BAP, though, also suggested (without discussing or even citing *Knaus*) that "[t]aken together, *Whiting Pools* and *Strumpf* provide a roadmap for creditors whose rights in collateral will be relinquished with possession," to wit, "that a creditor in [the] position . . . where relinquishment of possession will in and of itself destroy the creditor's rights . . . may withhold turning the collateral over until the bankruptcy court is able to make a determination as to whether, and to what extent, the creditor is entitled to adequate protection."⁴⁵

Carving out an exception for a secured creditor whose "relinquishment of possession will in and of itself destroy the creditor's rights," however, cannot (by any stretch of the imagination) be wrung from the language of § 362(a)(3). If " 'exercising control' over the object in which the estate's equitable [ownership] interest lay"⁴⁶—i.e., retaining possession—violates § 362(a)(3), that is the case whether or not the secured creditor's "relinquishment of possession will in and of itself destroy the creditor's rights." As the *Sharon* majority acknowledged, "[t]here is *no* 'exception' to § 362(a)(3) that excuses . . . refusal to deliver possession."⁴⁷

And neither is it a sufficient response to suggest that "[i]f the creditor is concerned that its interest will be irreparably harmed if the property is turned over before [a] motion for relief from stay can be heard it may request an emergency hearing under § 362(f)."⁴⁸ If retaining possession, in and of itself, is a violation of § 362(a)(3), as the majority courts hold, then any such emergency hearing "would come only after a period during which the creditor is in contempt."⁴⁹ Indeed, even in the more routine case in which the mere filing of the creditor's stay relief

motion will preserve the creditor's right to adequate protection of the value of its lien as of that moment (although, of course, not guarantee that the estate will or can actually provide that protection), even retaining possession of the collateral long enough to file a motion with the bankruptcy court is, under the majority interpretation of § 362(a)(3), a willful and contemptuous stay violation.

The Relative Balance of Burdens and Harms

The majority courts, of course, are not entirely oblivious to the immense difficulties surrounding their interpretation of § 362(a)(3). Rather, they choose to simply overlook or give short shrift to those problems because they believe that “a myriad of policy considerations” “militate in favor of placing the onus on the creditor, rather than on the debtor, to seek judicial relief.”⁵⁰ Indeed, as a practical matter, that is all that is at stake with this interpretive issue: who should bear the burden of initiating proceedings in the bankruptcy court should the parties fail to agree on the terms for a consensual turnover, with the most significant bone of contention being what is required in the way of adequate protection of the secured creditor's lien. And these “practical considerations”⁵¹ seem to be driving the majority courts' resolution of the interpretive issue. Indeed, majority courts fully acknowledge that the secured creditor *is* entitled to adequate protection of its lien and that the bankruptcy court retains ultimate authority to set the terms of adequate protection (should the parties themselves fail to agree on adequate protection).

According to the majority courts, though, “allowing the creditor to maintain possession of the asset until it subjectively feels that adequate protection is in place, or until the debtor moves for the asset's return, unfairly tips the bargaining power in favor of the creditor.”⁵² The problem, though, is that the majority interpretation tips the balance to the opposite extreme, virtually assuring that there will *never* be a negotiated turnover with agreed adequate protection because *no* adequate protection whatsoever is necessary to obtain immediate turnover (under pain of contempt sanctions) under the majority interpretation. A well-advised debtor, therefore, would *never* offer *any* adequate protection in demanding turnover and would *always* put the secured

creditor to the burden of moving for stay relief/adequate protection before the bankruptcy court, or use the prospective burden of doing so as leverage in adequate protection negotiations, but only *after* securing turnover *without* providing *any* adequate protection, which (as we've seen) holds the (not unrealistic) prospect of entirely eviscerating the secured creditor's right to receive adequate protection.

That “practical” implication of the majority interpretation is extremely troubling because, as Judge Spector perceptively pointed out, “we are dealing here with a property interest—the creditor's right of possession. The contention that a creditor loses that interest on the strength of nothing more than the trustee's [or DIP's] say-so may well be at odds with the Fifth Amendment”⁵³ and, at a minimum, seems inconsistent with the statutory allocation of the burden of proof regarding adequate protection to the trustee or DIP, *not* the secured creditor.⁵⁴ As Judge Teel has correctly noted, prepetition repossession itself “is often undertaken to assure adequate protection (such as when a car is uninsured or a lack of interest payments has increased the liability above the car's liquidation value).”⁵⁵

The majority courts' willingness to provide such an extreme (to the point of potentially unconstitutional) advantage to the estate in adequate protection negotiations undoubtedly flows from the fact that this issue recurs most frequently in Chapter 13 cases, where the entire reason for the bankruptcy filing may well be so that the debtor can regain possession and use of a vehicle necessary for work-related transportation. Indeed, being without a vehicle for any extended period of time may jeopardize the debtor's job or business, an understandable concern that the majority interpretation addresses quite effectively.

If the debtor must initiate proceedings in the bankruptcy court to obtain turnover of the repossessed vehicle (under the minority interpretation of § 362(a)(3)), Bankruptcy Rule 7001(1) mandates an adversary proceeding with formal summons and complaint, and all of the normal timetables for full-blown all-out litigation, such as 30 days to answer the complaint, etc., which obviously is *not* conducive to an expedited resolution of the adequate protec-

tion issue, which is essentially the only contested issue to be litigated. If the secured creditor must initiate proceedings in the bankruptcy court, however (under the majority interpretation of § 362(a)(3)), the secured creditor *can* proceed by motion requesting relief from the automatic stay/adequate protection under Bankruptcy Rule 4001(a), and under that scenario, the Bankruptcy Code itself directs expedited resolution of the adequate protection issue under the hearing timetable mandated by Code § 362(e).

Expeditious resolution of a turnover order (and corollary adequate protection determination) is indeed appropriate as a matter of course. The Bankruptcy Rules, however, do *not* provide an appropriate process therefor if the minority interpretation of § 362(a)(3) prevails—thus, the compelling impetus for the majority interpretation and the pervasive instinct that the negotiating leverage the minority interpretation affords the secured creditor is legitimately regarded as “unfair.”

The majority courts' highly questionable interpretation of § 362(a)(3), therefore, may well be attributable principally to the curious decision of the drafters of the 1973 Bankruptcy Rules to require that turnover be sought via an adversary proceeding. That decision effected a marked departure from the “summary” nature of turnover proceedings under the 1898 Act, pursuant to which “[t]he procedure for exercising summary turnover jurisdiction was by written petition . . . with notice to the respondent by an order to show cause.”⁵⁶

The 1973 Bankruptcy Rules and then the 1978 Bankruptcy Code initiated an (as yet unsuccessful⁵⁷) effort to “relegate[] the differences between summary proceedings and plenary suits” inherited from English bankruptcy practice “to a place of minor historical significance.”⁵⁸ In the process, though, some of the accumulated wisdom embodied in that distinction may have been discarded and now forgotten, and a “summary” process for obtaining turnover relief (and corollary adequate protection determinations) appears to be one such casualty. Indeed, in 1983 the Advisory Committee reversed the 1973 decision to require an adversary proceeding for stay relief (and corollary adequate protection) requests,⁵⁹ and in 1987, they did the same with respect to a

trustee's turnover proceedings against a debtor.⁶⁰ The 1973 decision to require an adversary proceeding for all other turnover requests, however, remains unchanged, but perhaps warrants renewed attention from the Bankruptcy Rules Advisory Committee. If nothing else, the way in which the competing procedural regimes seem to be distorting the interpretation of § 362(a)(3) is cause for concern.

ENDNOTES:

¹In re Weber, 719 F.3d 72 (2d Cir. 2013).

²See *Thompson v. General Motors Acceptance Corp., LLC*, 566 F.3d 699, 61 Collier Bankr. Cas. 2d (MB) 1611, Bankr. L. Rep. (CCH) P 81490 (7th Cir. 2009); In re Knaus, 889 F.2d 773, 19 Bankr. Ct. Dec. (CRR) 1691, Bankr. L. Rep. (CCH) P 73117 (8th Cir. 1989); In re Yates, 332 B.R. 1, 54 Collier Bankr. Cas. 2d (MB) 1901, 8 A.L.R. Fed. 2d 837 (B.A.P. 10th Cir. 2005); In re Sharon, 234 B.R. 676, 1999 FED App. 0009P (B.A.P. 6th Cir. 1999); In re Abrams, 127 B.R. 239, 21 Bankr. Ct. Dec. (CRR) 1283, 25 Collier Bankr. Cas. 2d (MB) 15, Bankr. L. Rep. (CCH) P 74023 (B.A.P. 9th Cir. 1991).

³Judges Teel, Spector, and Stosberg have written particularly thoughtful opinions challenging the majority approach. See In re Sharon, 234 B.R. 676, 688, 1999 FED App. 0009P (B.A.P. 6th Cir. 1999) (Stosberg, J., dissenting); In re Bernstein, 252 B.R. 846, 36 Bankr. Ct. Dec. (CRR) 211, 45 Collier Bankr. Cas. 2d (MB) 297 (Bankr. D. D.C. 2000) (Teel, B.J.); In re Barringer, 244 B.R. 402, 43 Collier Bankr. Cas. 2d (MB) 1615 (Bankr. E.D. Mich. 1999) (Spector, B.J.); In re Young, 193 B.R. 620 (Bankr. D. D.C. 1996) (Teel, B.J.). Accord Charles J. Tabb, *The Law of Bankruptcy* § 3.6, at 262-64 & § 5.13, at 442 n.4, 444 (2d ed. 2009); Ralph Brubaker, *Which Comes First: the Turnover or the Adequate Protection?*, 20 Bankr. L. Letter No. 12, at 1 (Dec. 2000); Thomas E. Plank, *The Outer Boundaries of the Bankruptcy Estate*, 47 Emory L.J. 1194, 1267-71 (1998).

The Eleventh Circuit's case law on the subject, while also departing from the majority approach, is badly misguided, as this contributing author has argued in a previous issue of *Bankruptcy Law Letter*. Ralph Brubaker, *Turnover Rights Revisited (or Repudiated Sub Silentio?): Who “Owns” Collateral Repossessed by a Secured Creditor?*, 22 Bankr. L. Letter No. 8, at 1 (Aug. 2002). See also Stephen J. Ware, *Security Interests, Repossessed Collateral, and Turnover of Property to the Bankruptcy Estate*, 2002 Utah L. Rev. 775.

⁴Young, 193 B.R. at 626 (quoting In re R. Purbeck & Assocs., 12 B.R. 406, 408 (Bankr. D. Conn. 1981)).

⁵Sharon, 234 B.R. at 682.

⁶Knaus, 889 F.2d at 775.

⁷Sharon, 234 B.R. at 684.

⁸Dewsnup v. Timm, 502 U.S. 410, 419 (1992) (citations omitted).

⁹See Thompson, 566 F.3d at 705-06.

¹⁰The contention that, “at a minimum, it appears that bankruptcy courts approved of differing practices concerning adequate protection” pre-1984, relies upon two entirely inapt bankruptcy court decisions. Thompson, 566 F.3d at 706 (quoting In re Sharon, 200 B.R. 181, 190, Bankr. L. Rep. (CCH) P 77101 (Bankr. S.D. Ohio 1996), aff’d, 234 B.R. 676, 1999 FED App. 0009P (B.A.P. 6th Cir. 1999)). In one, the bankruptcy court ordered turnover without any provision for adequate protection because the repossessing creditor’s security interest was unperfected and thus *invalid* in bankruptcy! See In re R. Purbeck & Associates, Ltd., 12 B.R. 406 (Bankr. D. Conn. 1981). In the other, the creditor refusing return of the collateral had repossessed *postpetition* in violation of the automatic stay! See Matter of Endres, 12 B.R. 404 (Bankr. E.D. Wis. 1981).

¹¹United States v. Inslaw, 932 F.2d 1467, 1473 (D.C. Cir. 1996) (citation omitted).

¹²In explaining the clause prohibiting any “act to obtain possession . . . of property from the estate,” both the House and Senate Reports described this provision as designed to protect “property over which the estate has control or possession.” S. Rep. No. 95-989, at 50 (1978) (emphasis added); H.R. Rep. No. 95-595, at 341 (1977) (emphasis added).

¹³Inslaw, 932 F.2d at 1474.

¹⁴Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 21, 116 S. Ct. 286, 133 L. Ed. 2d 258, 28 Bankr. Ct. Dec. (CRR) 97, 33 Collier Bankr. Cas. 2d (MB) 869, Bankr. L. Rep. (CCH) P 76666A (1995).

¹⁵See, e.g., In re Computer Communications, Inc., 824 F.2d 725, 16 Bankr. Ct. Dec. (CRR) 615, 17 Collier Bankr. Cas. 2d (MB) 556, Bankr. L. Rep. (CCH) P 71933 (9th Cir. 1987).

¹⁶See generally Ralph Brubaker, Piercing the Corporate Veil of a Bankruptcy Debtor: Distinguishing the Bankruptcy Estate’s Distinctive Roles as Successor to the Debtor and as “Super Creditor,” 25 Bankr. L. Letter No. 9, at 1, 3 (Sept. 2005).

¹⁷Inslaw, 932 F.2d at 1473.

¹⁸U.S. v. Whiting Pools, Inc., 1983-2 C.B. 239, 462 U.S. 198, 206, 103 S. Ct. 2309, 76 L. Ed. 2d 515, 10 Bankr. Ct. Dec. (CRR) 705, 8 Collier Bankr. Cas. 2d (MB) 710, Bankr. L. Rep. (CCH) P 69207, 83-1 U.S. Tax Cas. (CCH) P 9394, 52 A.F.T.R.2d 83-5121 (1983).

¹⁹See 11 U.S.C.A. § 554(a)-(b) (providing for court-ordered abandonment, “after notice and a hearing,” of “any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate”).

²⁰Weber, 719 F.3d at 79 (emphasis added).

²¹Tabb, Bankruptcy § 3.6, at 263.

²²Plank, 47 Emory L.J. at 1194, 1209, 1213.

²³Plank, 47 Emory L.J. at 1221.

²⁴“Interests in the seized property that could have been exercised by the debtor . . . are already part of the estate by virtue of § 541(a)(1).” U.S. v. Whiting Pools, Inc., 462 U.S. 198, 207 n. 15, 103 S. Ct. 2309, 76 L. Ed. 2d 515, 10 Bankr. Ct. Dec. (CRR) 705, 8 Collier Bankr. Cas. 2d (MB) 710, Bankr. L. Rep. (CCH) P 69207, 83-1 U.S. Tax Cas. (CCH) P 9394, 52 A.F.T.R.2d 83-5121 (1983). Section 542(a), though, “grants to the estate a possessory interest . . . that was *not* held by the debtor at the commencement of” the bankruptcy case. 462 U.S. at 207.

²⁵Whiting Pools, 462 U.S. at 206 & n.12.

²⁶11 U.S.C.A. § 363(e) (emphasis added).

²⁷Whiting Pools, 462 U.S. at 205.

²⁸See Whiting Pools, 462 U.S. at 207 & n.15.

²⁹Whiting Pools, 462 U.S. at 205.

³⁰In re Colonial Realty Co., 980 F.2d 125, 131, 23 Bankr. Ct. Dec. (CRR) 1143, 28 Collier Bankr. Cas. 2d (MB) 28, Bankr. L. Rep. (CCH) P 75283 (2d Cir. 1992) (emphasis added). Accord Rajala v. Gardner, 709 F.3d 1031, 1037-39, 57 Bankr. Ct. Dec. (CRR) 188, 69 Collier Bankr. Cas. 2d (MB) 403, Bankr. L. Rep. (CCH) P 82441 (10th Cir. 2013), petition for cert. filed, 81 U.S.L.W. 3704 (U.S. June 10, 2013). But see In re MortgageAmerica Corp., 714 F.2d 1266, 1275-76, 12 Bankr. Ct. Dec. (CRR) 151, 9 Collier Bankr. Cas. 2d (MB) 603 (5th Cir. 1983) (relying upon the *Whiting Pools* statement to the contrary).

³¹Thompson, 566 F.3d at 703 (quoting Sharon, 234 B.R. at 682) (emphasis added).

³²Weber, 719 F.3d at 79. See also Sharon, 234 B.R. at 682 (under “*Whiting Pools*, possession of the Debtor’s car was part of the bundle of rights that became ‘property of the estate’ at the Chapter 13 petition”).

³³Weber, 719 F.3d at 79.

³⁴See also Thompson, 566 F.3d at 703 (“GMAC exercised control over Thompson’s vehicle when it refused to return it to the bankruptcy estate upon request”).

³⁵Whiting Pools, 462 U.S. at 206.

³⁶Whiting Pools, 462 U.S. at 206.

³⁷Whiting Pools, 462 U.S. at 207.

³⁸See, e.g., In re Colortran, Inc., 210 B.R. 823, 38 Collier Bankr. Cas. 2d (MB) 862 (B.A.P. 9th Cir. 1997), aff’d in part, vacated in part, 165 F.3d 35 (9th Cir. 1998) (table decision). **no consideration of 362(b)**

³⁹See, e.g., In re Bernstein, 252 B.R. 846, 36 Bankr. Ct. Dec. (CRR) 211, 45 Collier Bankr. Cas. 2d (MB) 297 (Bankr. D. D.C. 2000).

⁴⁰See, e.g., In re WEB2B Payment Solutions,

Inc., 488 B.R. 387, 57 Bankr. Ct. Dec. (CRR) 202, Bankr. L. Rep. (CCH) P 82449 (B.A.P. 8th Cir. 2013).

⁴¹Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 116 S. Ct. 286, 133 L. Ed. 2d 258, 28 Bankr. Ct. Dec. (CRR) 97, 33 Collier Bankr. Cas. 2d (MB) 869, Bankr. L. Rep. (CCH) P 76666A (1995).

⁴²Bernstein, 252 B.R. at 851.

⁴³In re WEB2B Payment Solutions, Inc., 488 B.R. 387, 57 Bankr. Ct. Dec. (CRR) 202, Bankr. L. Rep. (CCH) P 82449 (B.A.P. 8th Cir. 2013).

⁴⁴In re Knaus, 889 F.2d 773, 19 Bankr. Ct. Dec. (CRR) 1691, Bankr. L. Rep. (CCH) P 73117 (8th Cir. 1989).

⁴⁵WEB2B, 488 B.R. at 393.

⁴⁶Weber, 719 F.3d at 79.

⁴⁷Sharon, 234 B.R. at 683 (emphasis added).

⁴⁸Thompson, 566 F.3d at 707 (quoting Colortran, 210 B.R. at 827-28).

⁴⁹Bernstein, 252 B.R. at 851.

⁵⁰Thompson, 566 F.3d at 703, 706.

⁵¹Weber, 719 F.3d at 80.

⁵²Thompson, 566 F.3d at 707.

⁵³Barringer, 244 B.R. at 409.

⁵⁴See 11 U.S.C.A. §§ 362(g)(2), 363(p)(1).

⁵⁵Young, 193 B.R. at 627.

⁵⁶In re Riding, 44 B.R. 846, 850, 12 Bankr. Ct. Dec. (CRR) 635, 11 Collier Bankr. Cas. 2d (MB) 859, Bankr. L. Rep. (CCH) P 70173 (Bankr. D. Utah 1984). Judge Allen's *Riding* opinion contains a very useful and extremely exhaustive history of the evolution of procedural requirements for turnover relief. See id. at 849-57.

⁵⁷"[S]ubtle influence[s] of the more limited English concept of [summary in rem] bankruptcy jurisdiction continue[] to linger" in unexpected places, and perhaps always will. Ralph Brubaker, On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory, 41 Wm. & Mary L. Rev. 743, 939 (2000).

⁵⁸Riding, 44 B.R. at 854.

⁵⁹"The formalities of the adversary proceeding process and the time for serving pleadings are not well suited to the expedited schedule" necessary for stay relief/adequate protection determinations. 1983 Advisory Committee Note to Bankruptcy Rule 7001.

⁶⁰See Advisory Committee Note to the 1987 Amendment to Bankruptcy Rule 7001.

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Opinions Regarding the City of Chicago and Vehicle Immobilization

By Nathan Delman*

Introduction

In late 2016 the City of Chicago amended its municipal code 9-92-080(f), stating that “Any vehicle impounded by the City or its designee shall be subject to a possessory lien in favor of the City in the amount required to obtain release of the vehicle.” Shortly thereafter, the City commenced a policy of not releasing impounded vehicles to debtors upon the filing of a Chapter 13. All the opinions below share a similar fact pattern, the debtor in each case accrued numerous nonmoving violations with the City of Chicago, causing the City to immobilize and impound the debtors’ vehicles. Subsequent to impoundment, each debtor filed a Chapter 13 bankruptcy, sought release of the vehicle, and the City refused to turn over the vehicles. The opinions are notable as they contain numerous and distinct legal issues in support of their decisions. The opinions are listed chronologically by date of issuance in an attempt to evince the uneven and organic evolution of arguments from both the City and the debtors, and a deepening in contemplation and analysis in the holdings from the bench. For each summary, “City” refers to the City of Chicago, and “Code” refers to the Bankruptcy Code.

3/21/2017

In re Avila, 566 BR 558 - Bankr. Court, ND Illinois 2017

The first opinion to examine the City’s ability to retain an impounded vehicle post-petition was initiated by the City’s emergency declaratory motion seeking confirmation that it was not in violation of the stay. Judge Cassling granted the motion and issued an opinion in favor of the City. In reaching its holding, the Court distinguished *Thompson v. General Motors Acceptance Corp. LLC*, 566 F.3d 699 (7th Cir. 2009) (“*Thompson*”) on the premise that *Thompson* did not directly address the exception to the automatic stay pursuant to § 362(b)(3), which the City relied on in arguing that the automatic stay did not apply to them. Finding the exception to the stay applicable, the Court emphasized the City’s municipal code constituted generally applicable law under § 546(b) and absent possession of the impounded vehicle, the City’s lien would terminate. The Court also rejected arguments concerning the validity of the lien itself and the municipal code being used to circumvent bankruptcy law.

2/8/2018

In re Walker, Bankr. Court, ND Illinois 2018

Approximately ten months after *Avila*, the same issue was brought before Judge Schmetterer who issued an opinion finding the City in violation of the automatic stay. The opinion, however, was withdrawn as the City and Debtor reached an agreement resolving the matter hours before the opinion was issued rendering it moot. Nevertheless, the Court declined to follow *Avila*, holding that passive retention of a vehicle post-petition did not constitute an “act” under §362(b)(3). The Court further emphasized the necessity of following the clear procedural guidelines set forth by *Thompson* and *Whiting Pools* for creditors, including the City, who feared surrendering collateral would irreparably harm them, namely the filing of a motion for relief.

3/22/2018

Baines v. City of Chicago, 584 BR 723 - Dist. Court, ND Illinois 2018

Shortly after the withdrawn *Walker* opinion, the District Court weighed in for the first time. *Baines* is a narrow opinion holding the City’s newly enacted municipal ordinance does not violate the Supremacy Clause of the Constitution. In *Baines*, the United States District Court granted the City’s motion to dismiss the complaint for failure to state a claim upon which relief can be granted. Debtor averred the newly amended municipal ordinance pertaining to the City’s possessory lien on immobilized vehicles was preempted by federal bankruptcy law due to the ordinance obstructing the fresh start of bankruptcy and frustrating the purpose of the Code. Specifically, the Debtor identified the City engaging in conflict preemption by using the ordinance to stand “as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” The District Court, unpersuaded, noted that since no specific provision of the Code expressly forbids the practice of the City, the vehicle immobilization practice was valid “even if it violates the fresh start principle.” Furthermore, the City’s practice constituted a property interest created by state law and fundamental bankruptcy principles supported maintaining the City’s rights.

4/19/2018

In re Howard, 584 BR 252 - Bankr. Court, ND Illinois 2018

Judge Cox revisited the City’s policy. Here, the court denies Debtor’s post-confirmation motion to modify and enters rule to show cause against the City for failure to release the Debtor’s vehicle. The Debtor filed a chapter 13 plan treating the City’s claim as unsecured. The City filed a claim but did not object to confirmation and the plan was confirmed with monthly payment of \$100, paying the City’s allowed claim at a minimum of 10%. Two months after confirmation the Debtor still had not regained possession of his vehicle, and in an attempt to obtain possession filed a motion to modify the confirmed plan paying the City in full as a secured creditor. The Court finds the City’s possessory lien to be invalid, due to the City not fitting into the

statutory definition of possessory lien under Illinois law and rules that the City is overstepping its authority. The Court does not rule if the City is subject to the automatic stay exception §362(b)(4), regarding the continuation of a governmental unit to enforce police and regulatory powers, because the Court finds that the City had an affirmative duty under *Thompson* to initiate a proceeding to determine adequate protection. The Court also rejects the City's contention that it meets the exception to automatic stay under §362(b)(3), stating even if it did have a valid lien, "perfection of liens encompasses recording notes and mortgages, not possession of collateral." This line of reasoning will be revisited and developed in later opinions.

5/4/2018

City of Chicago v. Kennedy, Dist. Court, ND Illinois 2018

The District Court reviews an order from the Bankruptcy Court ordering turnover pursuant to confirmation of plan. Here, the District Court vacates the turnover order, and remands for adequate protection inquiry. This opinion declares the City gave itself new powers by amending their municipal code to get around Bankruptcy Court protection. In this case, the plan proposed by the Debtor would require the City to release the vehicle upon plan confirmation, since the plan treated the City's claim as secured and proposed to pay the full balance. The bankruptcy court confirmed the plan and ordered the release of the vehicle.

Notably, here the Debtor consents that the City's possession of the immobilized vehicle fits the stay exception of §362(b)(3), rendering analysis of the stay exception issue superficial and unnecessary by the District Court. Debtor unsuccessfully raises due process concerns and argues that he is entitled to a hearing before the City can place a lien on his vehicle. The District Court is not convinced and finds the municipal law to be consistent with due process requirements. Debtor also raises the supremacy clause issues raised in *Baines*. Although the Court is suspect of the City's motives behind the new ordinance, once again the District Court finds no conflict in the revised ordinance and the Code. The Court also finds *Thompson* inapplicable due to the invocation of the §362(b)(3) automatic stay exception. The Court does find that the City may indeed be required to turnover the Debtor's vehicle, notwithstanding the City's assertion that turnover would extinguish its lien. However, the Court holds that Debtor can only obtain a turnover through an adversary proceeding. Accordingly, the District Court vacates the Bankruptcy Court's turnover order and remands to the Bankruptcy Court to determine adequate protection of the City's lien.

5/25/2018

In Re Fulton, Bankr. Court, ND Illinois 2018

Judge Schmetterer returns, this time being able to issue his opinion without the need to withdraw it. At the time of writing this summary, this matter is current

pending appeal to the Seventh Circuit. Here, the Court grants Debtor's motion for sanctions against the City for the City's continued possession of Debtor's vehicle and sustains in part the Debtor's objection to the City's secured claim. The Court explains *Thompson* places an affirmative duty on creditors to initiate a hearing in bankruptcy court in order to not be bound by *Thompson's* holding mandating turnover. The Court finds the City is both coercing debtors into paying the traffic fines faster than required and improperly avoiding the court filing fee for motions for relief from the automatic stay.

The Court rules that the City's act of maintaining possession does not fit the §362(b)(3) exception to the automatic stay. Even if the city were to have a valid lien, *Thompson* still requires the city to assert this exception in court in order to not deliver the vehicle to the debtor. The Court declines to follow *Avila*, first stating that §362(b)(3) only covers acts and not omissions to act, meaning passive retention is not an act. Also, requiring the City to file a motion to lift stay and demand adequate protection only alters the City's procedural rights and does not alter its substantive rights, and that a replacement lien in bankruptcy would comport with adequate protection. Moreover, the Court finds the City's assertion of a possessory lien to be invalid under Illinois State Law. The Court follows the *Howard* opinion, notwithstanding the City's objection to *Howard's* reliance on a UCC corollary for its definition of possessory lien. Here the Court finds that the City is exceeding its home rule authority, violating the supremacy clause and the City is bound by *Thompson*. Disregarding the District Court in *Kennedy*, which holds that an adversary is required for turnover, the Court finds that an order for turnover can be included in a larger motion for sanctions. The Court did allow the City's amended claim in the full amount, albeit as an unsecured claim.

5/31/2018

In re Cross; Cross v. City of Chicago and Carmax Business Solutions Bankr. Court,
ND Illinois 2018

On the heels of his *Fulton* opinion, Judge Schmetterer issues another opinion, this time denying the City's motion to dismiss an adversary proceeding and granting the Debtor's motion for a preliminary injunction enjoining the City to turnover Debtor's vehicle. The Court rules that exception to the automatic stay in §362(b)(4) is not met because the City does not establish that retaining the vehicle is nonpecuniary in nature or that the vehicle is being kept off the roads as a matter of public safety. The Court finds that determining if public safety is being threatened from traffic violations requires a factual inquiry, which did not occur in this case. The stay exception in §362(b)(3) is also not met for two reasons. First, the Court rules that passive retention is not an act under §362(b)(3). More importantly, the Court follows *Howard*, finding the City to not have a valid possessory lien under Illinois law. Again, the Court notes that *Thompson* imposes an affirmative duty and procedural burden on the creditor to file an emergency motion for stay relief to not

return the vehicle upon filing. The Court reasons the exception to the stay in §362(b)(3) has a far narrower scope than the mandates of §362(a)(3), warranting a narrower reading of the phrase “any act.” The Court likewise finds no support in the contention that no replacement lien will suffice, citing *Whiting Pools* explanation of Congress using the Code to adequately protect and replace a possessory interest of an affected creditor.

The Court also grants the Debtor’s motion for a preliminary injunction. The Debtor not having her vehicle for her commute to work constitutes irreparable harm, and a review of the law shows a substantial likelihood the Debtor will succeed over the City under the Seventh Circuit’s *Thompson* opinion, the Supreme Court in *Whiting Pools*, and the Bankruptcy Court in the *Howard* decision.

8/15/2018

In Re Peake, Bankr. Court, ND Illinois 2018

In an in-depth opinion, Judge Thorne grants the Debtor’s motion for turnover of his vehicle. At the time of writing this summary, this matter is current pending appeal to the Seventh Circuit. The City first asks the Court to overturn *Thompson*. Although there now exists a circuit split on §362(a)(3), the Court declines to take this extraordinary measure. The Court also rejects the Debtor’s assertion from *Walker* and *Fulton* that the City has exceeded its Home Rule authority rendering the lien invalid, and instead finds the ordinances to comply with the authority granted to it by the State of Illinois. The Court then in great detail examines the procedures employed by the City before immobilizing vehicles, ultimately concluding the City has a property interest at the time of immobilization and has a valid lien. Furthermore, the Court finds that the City had the same interest even before the November 2016 amendment to its municipal code. The Court also follows the District Court in *Baines* that the Supremacy Clause is not violated. The Debtor argues that the City would not lose its lien in the context of a turnover pursuant to a Chapter 13 filing under the reasoning that involuntary turnover does not extinguish liens. The Court rejects this argument as well, stating that possession is necessary for perfection of the City’s lien. But, the Court follows *Fulton* in finding that passive retention does not constitute an “act” under §362(b)(3). This conclusion is reached by a careful analysis of the statutory text, including its references to §546 and §547.

The Court also subscribes to a narrow reading of “any act” under §362(b)(3) instead of the broader reading of “any act” under §362(a)(3), and bolsters this finding by putting the phrase in its full context. §546(b)(1)(B) is not satisfied because the passive retention does not occur on a “date” as contemplated by the statute, but is continuous and without a fixed date. The same problem occurs with §362(b)(3)’s reference to §547(e)(2)(A), which also contemplates a fixed date. The Court finds the underlying purpose of §362(b)(3) is to allow a creditor to follow procedures such as

filing continuation statements, or holding status hearings, which would enable the creditor to maintain its lien under state law. These acts do occur at specific times, and do not disrupt a debtor's performance under a reorganization plan. Retention of the debtor's vehicle is a stark contrast to filing a continuation statement, and not releasing a vehicle is found to not comport with the history and purpose of §362(b)(3). The end result is that the City does not meet the stay exception of §362(b)(3) and, without an emergency motion for relief from stay, is compelled to turnover the vehicle by §362(a)(3).

9/7/2018

In Re Shannon, Bankr. Court, ND Illinois, 2018

In the most recent opinion issued on this matter, Judge Doyle holds that the City's retention of the Debtor's vehicle is not permitted and violates the automatic stay in multiple ways. As in *Howard*, the Debtor confirmed a plan treating the City as a general unsecured creditor and sought return of the vehicle post-confirmation. The City declined to release the vehicle due to the plan not paying its claim in full. The City also amended its claim post-confirmation, increasing the claim from \$3,160 to \$5,600 and altering it from unsecured to secured. The Debtor in turn filed a motion for sanctions against the City for violation of the automatic stay. The Court grants the motion and orders the City to release the Debtor's vehicle.

The Court again is not persuaded to overturn *Thompson*, and rejects a novel argument that the Seventh Circuit recently undercut *Thompson* in its 2018 decision *In Re Thorpe*. The City argues that since the Seventh Circuit has a recent ruling regarding ownership rights not being expanded at the commencement of a bankruptcy, the Debtor cannot gain an ownership right in its vehicle it doesn't have. But, the Court finds that the Debtor did have an ownership and the City had merely a lien right in the Debtor's vehicle, and nothing in *Thorne* addresses the automatic stay.

The Court goes on to hold that the City's post-petition retention of the vehicle does not meet the exceptions to the automatic stay in §362(b)(3) or §362(b)(4), and accordingly it has violated the automatic stay under §362(a)(3), §362(a)(4), and §362(a)(6), and also that it is bound by the terms of the confirmed plan. The Court examines the scope of the stay exception under §362(b)(3) by looking at its references to the avoidance powers of the trustee under §546(b). Since the City has already perfected its lien pre-petition, §546(b)(1)(A) is inapplicable, since the underlying purpose of the stay exception is to permit a creditor to perfect its lien rights post-petition. Secondly, §546(b)(1)(B) is inapplicable because the City's ordinance is silent about continuation or maintenance of perfection. Furthermore, since the trustee cannot avoid the lien, retention of the vehicle is not necessary. The Court reads §362(b)(3) strictly to only protect acts of the creditor which would defeat the trustee's

avoiding powers. The Court also finds that involuntary turnover of the vehicle due to a bankruptcy filing preserves the City's lien.

Again, the City's assertion that the §362(b)(4) exception applies is rejected due to the pecuniary nature of the City's lien. The City is holding the vehicle to obtain payment from a money judgment.

In addition to other opinions' holdings that the City has violated §362(a)(3) by exercising control over property of the estate, the Court also finds the City in violation of §362(a)(4) and (6). Section 362(a)(4) is necessarily violated if no stay exceptions apply, because the city is performing an act to enforce a lien. Section 362(a)(6) is violated by the City requiring direct payments from the Debtor post-petition to obtain the vehicle.

*The author graciously acknowledges the help of colleague John Wonais in the preparation of these summaries

***Chicago v. Moore* and *Chicago v. Marshall*: Important Questions on
the Structure of Chapter 13**

By Craig Goldblatt*

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The Seventh Circuit heard oral argument on September 12, 2018 in these consolidated appeals, which raise important and unresolved issues regarding the structure of Chapter 13 of the Bankruptcy Code.

Background

Section 1327(b) of the Bankruptcy Code provides that “[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all property of the estate in the debtor.” In a 1996 opinion, the Bankruptcy Court for the Northern District of Illinois held that Section 1306(a)’s “conflicting” language prevailed over the requirements of 1327(b), such that (even in the absence of plan language) the debtor’s property would remain property of the estate throughout the period of the debtor’s repayment plan. *In re Fisher*, 198 B.R. 721, 733 (Bankr. N.D. Ill. 1996).

On appeal, the district court reversed that determination, concluding that the language of Section 1327(b) controlled and that (in the absence of contrary language in the plan or confirmation order) the confirmation of a plan re-vests estate property in the debtor. *In re Fisher*, 203 B.R. 958 (N.D. Ill. 1997). After the district court decision, the bankruptcy court adopted its form plan and confirmation order, providing that property of the estate shall remain property of the estate throughout the debtor’s repayment period.

The rationale in support of the Northern District of Illinois’ form plan is likely best expressed by the original bankruptcy court decision in *Fisher*, which explained that retaining property in the estate was beneficial because, when the property is owned by the bankruptcy estate, “post-petition creditors, like the City of Chicago,” will not “be free to enforce claims against [that] property.” This, in turn, permits the property to “serve as a reserve source for [pre-petition] creditor payments” in the event the debtor otherwise has difficulty meeting her obligations under the plan. In addition, by keeping the debtor’s property within the bankruptcy estate, the debtor remains subject to the bankruptcy court’s protection and supervision after confirmation, rather than being “emancipated” and “free to treat property of the estate as if no bankruptcy had ever occurred,” as a post-confirmation Chapter 11 debtor operates. *See also* Keith M. Lundin, *Lundin on Chapter 13* § 113.11 (online ed. 2018), available at www.lundinonchapter13.com (advancing similar arguments).

It bears note that roughly contemporaneously with the Northern District of Illinois Bankruptcy Court’s adoption of the form plan and confirmation order, the Seventh Circuit’s rejected one of its premises: the notion that property should remain in the bankruptcy estate to ensure the role of the bankruptcy court in supervising the affairs of the post-confirmation debtor. *See In re Heath*, 115 F.3d 521, 523 (7th Cir. 1997) (finding that no subject-matter jurisdiction existed over a chapter 13 trustee’s challenge to \$50 garnishment fee charged by the debtor’s employer and suggesting, in dicta, that property could only be kept in the bankruptcy estate if it was necessary to fulfillment of the plan so that the bankruptcy court not become the arbiter of a debtor’s “dispute with the corner grocer”). That said, Section 1327(b) of the Bankruptcy Code does provide that property reverts in the debtor “[e]xcept as otherwise provided in the plan or the order confirming the plan,” a statutory provision that could be understood as a broad grant of discretion to the debtor and the bankruptcy court to adopt whichever practice they deem best suited for their particular circumstance. Perhaps for that reason, the practice of the Bankruptcy

Court for the Northern District of Illinois to employ its model form and plan appears to have gone unchallenged for more than 20 years.

That changed, however, when the City of Chicago, after having lost several cases in which it sought administrative claim treatment for parking tickets incurred by vehicles owned, after confirmation, by a debtor's bankruptcy estate, opposed confirmation of a chapter 13 plan that, per the form plan and confirmation order, sought to maintain all of debtor's property as property of the estate. The bankruptcy court entered the form confirmation order over the City's objection. See *In re Moore*, Bankr. N.D. Ill. No. 17-2387. The City then sought and obtained certification of a direct appeal from the confirmation order to the Seventh Circuit.

The Seventh Circuit consolidated the *Moore* appeal with various appeals from orders denying administrative claim treatment to traffic and parking fines incurred by chapter 13 debtors using vehicles that remained property of their bankruptcy estates. See *In re Steenes*, Bankr. N.D. Ill. No. 14-16692. In these cases, the City's argument has been that insofar as the vehicle remains property of the estate, post-petition liability that non-bankruptcy law would impose upon the owner of the vehicle is an administrative claim. In support of that argument, the City relies heavily on the Supreme Court's decision in *Reading v. Brown*, 391 U.S. 471 (1968). *Reading* arose under the predecessor to Chapter 11. A fire at the debtor's premises, resulting from the receiver's negligence, damaged a nearby building. The Court held that the claim of the injured parties were entitled to administrative claim status in bankruptcy, as costs incident to operating the debtor's business. In response, the debtors and the chapter 13 trustee have argued that *Reading* is inapplicable to cases under Chapter 13. In particular, the debtors argued on appeal that the sole recourse for a post-petition claimant is the assertion of a claim under Section 1305, which permits the holders of claims for taxes and certain consumer debts to file a proof of claim, which is then treated under the plan as if it were a prepetition claim. The debtors have contended that if post-petition creditors could be treated as administrative creditors, Section 1305 would have no meaning. And the debtors rely on the Supreme Court's decision in *Hall v. United States*, 566 U.S. 506 (2012), where the Court relied on Section 1305 in holding that certain post-petition taxes were not administrative claims (and thus not dischargeable) in a chapter 12 case. In response, the City contends that Section 1305 provides a means of collecting a liability that runs against the *debtor*, but that it does not address the question of liability that would be imposed, under non-bankruptcy law, on the *estate*.

A panel of the Seventh Circuit (Judges Easterbrook, Rovner and Hamilton) heard argument in the consolidated appeals on September 12, 2018.

Seventh Circuit Argument

The Seventh Circuit panel was extremely well prepared and peppered counsel on both sides with challenging questions. Predicting the outcome of an appeal based on the questions the court asks during oral argument is of course perilous. I offer no such prediction here. Instead, the following is intended merely as a summary of the arguments themselves.

The City of Chicago's Argument

For the City of Chicago, Danielle Spinelli argued that Section 1327(b) of the Bankruptcy Code provides a default rule that property re-vests in the debtor, and that while courts have discretion to vary that default rule, as an ordinary matter of statutory construction such a variance requires a case-specific reason. It cannot be based simply on the bankruptcy court's preference for a different policy. And shielding property from post-petition creditors, Ms. Spinelli contended, simply reflected a policy judgment that is at odds with the one embodied in the Bankruptcy Code.

Judge Easterbrook, noting that the bankruptcy court here had not provided an explanation for flipping the statutory presumption, asked Ms. Spinelli if she was aware of a case in which such an explanation was provided. When Ms. Spinelli explained that the clearest explanation for the Northern District of Illinois' practice was set out in the bankruptcy court's opinion in *Fisher*, Judge Easterbrook commented that the *Fisher* rationale "sounds like a reason for enacting a different statute," rather than a reason for entering the form order "given the current statute."

Judge Rovner, on the other hand, suggested that a vehicle may well be necessary for the debtor to get to work and earn wages necessary to make the payments required by the plan. In response, Ms. Spinelli suggested that against the statutory backdrop, property could only be maintained in the estate if the property is going to be used to satisfy plan obligations. In response to a question from Judge Rovner about how frequently this issue arises, Ms. Spinelli noted that there are now approximately 60,000 outstanding parking tickets issued by the City of Chicago to Chapter 13 debtors. She added that she was not aware of cases in which the City has sought stay relief or moved to dismiss the bankruptcy cases, contending that such relief should not be necessary in light of the structure of the Bankruptcy Code.

Judge Hamilton observed that a number of bankruptcy judges and practitioners are "unhappy with" the statutory presumption that property reverts in the debtor that they have "found a means to avoid complying with it." He asked, however, what type of remedy would be appropriate in view of the statutory grant of discretion to the bankruptcy court. Ms. Spinelli responded that the court should hold that property should be kept in the estate only when it is necessary to the plan, and that when it is kept in the estate, creditors who suffer injuries arising out of the use of that property are entitled to administrative expense treatment. When pressed further by Judge Hamilton on what "necessary to the plan" entails, Ms. Spinelli responded by noting that it should mean that the court's finding that the plan is feasible depends on keeping the property in the estate. She added, in response to further questions, that the debtor's need for the vehicle for commuting should not be sufficient, since the debtor would be free to use the vehicle for commuting even if it reverted in the debtor.

Judge Hamilton also pressed on the administrative claim issue, asking whether the reasoning of *Reading* had ever been held to apply in a Chapter 13 case. Ms. Spinelli acknowledged that she was not aware of such a case, but that the specific issue here is a function of the rather novel practices in the Northern District of Illinois. Judge Hamilton commented, however, that the circumstances of *Reading*, where a building was destroyed in a fire, seem more compelling, from the perspective of fundamental fairness, than those in a case in which a parking meter expires but "no harm is done."

Judge Rovner added that she thought the City's positions in the two cases was "contradictory" because in the cases challenging the form order, the City does not believe it necessary to keep the car in the estate, whereas in the administrative expense appeal, "suddenly, fines related to the cars are necessary to preserve the estate." Ms. Spinelli responded that it should be "one or the other" and that the City should not "lose both ways." Judge Rovner added that "the way I see it, the City's argument seems contrary to the goals of the bankruptcy statute" and would allow the City to "jump the line." "You are trying to balance your bankrupt budget on the backs of bankrupt citizens," she observed. In response, Ms. Spinelli observed that the City was not "jumping the line," since the Bankruptcy Code does not provide for subordinating post-petition creditors to pre-petition creditors.

Judge Rovner, however, noted that the Bankruptcy Court for the Northern District of Illinois adopted the form order "presumably because it was the most efficient order for the Court. Why shouldn't it be incumbent on the City to object to the form order?" Ms. Spinelli responded that in the cases on appeal, the City did object to the entry of the form order.

The Moore Debtors' Argument

The Court then heard argument from Nathan Curtis, who represents the debtors in the *Moore* appeal. He began the argument asserting that the statutory language is clear, and that it grants the bankruptcy court discretion to deny revesting of estate property.

Judge Easterbrook observed that while he could “easily understand a ruling that particular assets” not revest, but that he had “trouble seeing how a district court could just contradict a statute” by providing, on a blanket basis, that property would not revest. Mr. Curtis responded that the model order did not contradict the statute because a debtor could provide, in any particular case, that property would revest.

Judge Hamilton pressed Mr. Curtis on whether there were limits to the bankruptcy court’s discretion to deny revesting. Mr. Curtis responded that no discretion is “unlimited.” Judge Easterbrook then interjected that “there need to be reasons for the exercise of discretion” other than “I think the Bankruptcy Code makes the wrong presumption.” When Judge Easterbrook asked Mr. Curtis whether the bankruptcy court had given reasons for the decision, he responded: “not to my knowledge.” Judge Rovner then added that “the problem is how do we review the exercise of discretion?,” asking “what is the individualized justification here?”

Mr. Curtis responded that a bankruptcy court’s ruling can be reviewed for abuse of discretion, which requires a showing that the decision was based on an incorrect legal ruling or a clearly erroneous fact finding. Judge Easterbrook, however, noted that when a party objects to the confirmation of a plan, the bankruptcy court must give a reason for rejecting the objection. “The statement, ‘I haven’t read your documents, your request is denied’ is not a reason.”

Judge Hamilton asked “what good reasons are there” for denying revesting other than “selling it quickly or stiffing post-petition creditors.” Mr. Curtis noted that the debtor should be permitted to retain possession of a vehicle in order earn the necessary income to repay creditors. Judge Hamilton, however, noted that a debtor can use a car even if it reverts.

Judge Easterbrook commented that it is the “payment of post-petition debts” that permits a debtor to retain a vehicle. “Suppose that what a debtor in bankruptcy does is take the car and drive on the Tri-State Tollway and goes straight through the automatic payment section but doesn’t have a transponder. And when challenged, the debtor says ‘you can’t force me to pay, I am a debtor in bankruptcy. Since I need my car to fulfill the plan, I have the privilege of driving without paying the toll for five years.’” Judge Easterbrook asked: “is that the way a plan should be structured?” Mr. Curtis responded that a post-petition creditor in that situation could seek relief from the automatic stay. Noting that the cost of filing a motion would be prohibitive in many cases, Judge Easterbrook questioned whether it is “sensible to use the cost of filing motions to give the debtor an opportunity not to pay legitimate and honest debts.”

The Steenes Debtors' Argument

Retired Judge Wedoff then argued on behalf of the debtors in the *Steenes* case, one of the consolidated cases. In response to questions from Judge Easterbrook whether reasons have been given in support of the form order, Judge Wedoff noted that there have been “enormous discussions among the bankruptcy judges of the Northern District of Illinois regarding the form order.” “The rationale for the form order,” Judge Wedoff added, is a desire to protect the assets of the debtor. “The problem with that,” Judge Easterbrook observed, is “that’s just disagreement with the statute.” Judge Wedoff responded that he “did not see it that way.” Rather, “I see the statute as simply providing a default,” Judge Wedoff added.

Judge Hamilton asked about the application of *Reading* to chapter 13 cases, asking whether a victim injured in a traffic accident with a vehicle owned by the bankruptcy estate is entitled to administrative expense treatment. Judge Wedoff answered that the victim would not be, because that case “is governed by Section 1305” because it is “a consumer claim” that “can only be assessed against a debtor’s disposable income if conditions are met.” Judge Wedoff added that such a creditor could wait until the case is over and pursue their non-bankruptcy remedies or seek relief from stay and pursue those remedies immediately. In response to questions from Judge Easterbrook, Judge Wedoff added that Section 1305 would have no meaning if this type of claim were given administrative expense status. Relying on the Supreme Court decision in *Hall v. United States*, 566 U.S. 506 (2012), Judge Wedoff argued that where a post-petition claim is personal to a debtor, it is governed by Section 1305, and is not an administrative claim.

The Marshall Trustee's Argument

Finally, the Court heard argument from Anthony Olivadoti, representing the Chapter 13 Trustee in the *Marshall* case. Mr. Olivadoti argued that the administrative claim issue was the “biggest issue in the case” and that it would not be appropriate for the City to become an administrative claimant because fines and tickets are not “beneficial to the estate.” Judge Hamilton asked, however, how that language applies to involuntary creditors. Mr. Olivadoti observed that while debtors are expected to pay post-petition debts in chapter 13, allowing the City an administrative claim would “open the door” to any post-petition creditor becoming an administrative claimant. Judge Hamilton, however, noted that the City’s proposed rule would apply only to creditors who are injured by property that the plan provided would stay in the bankruptcy estate.

In response to further questioning from Judge Hamilton about why the property should stay in the estate, Mr. Olivadoti commented that it had the effect of ensuring that that the bankruptcy judge would be overseeing the debtor’s affairs. Judge Hamilton commented that this approach “seems pretty hard to reconcile with the approach we took in *Heath*, where we rejected the idea that there was some kind of wardship [over the debtor] after confirmation.” Mr. Olivadoti responded that “bankruptcy judges see that these cases don’t work without someone holding the hand of the debtor.”

Like Judge Wedoff, Mr. Olivadoti responded to questions from Judge Hamilton by saying that a post-petition accident victim should be required to seek stay relief in order to pursue a remedy against the debtor's post-petition assets, rather than "jump up above everyone else" and receive administrative status. To that, Judge Easterbrook responded "I still don't understand this 'jump up above everybody else.' Paying ongoing debts as they are incurred is the norm in bankruptcy.... Pre-bankruptcy debts are the ones that are written down. And post-bankruptcy debts are supposed to be paid on a current basis. That is the statutory scheme." Mr. Olivadoti responded that "debtors are expected to pay their post-petition expenses," but "as we know, it is not a perfect world."

The Court then took the case under advisement.