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Rochelle's Daily Wire | ABI Exclusive

June 28, 2019

Second Circuit Opinion Raises Questions Left Open by *Taggart v. Lorenzen*

“ If a lower court buys an argument that’s clearly wrong, is the argument nonetheless ‘objectively reasonable’? And does *Taggart* apply to an automatic stay violation?”

If contempt proceedings were enjoined by the automatic stay, the non-bankruptcy court cannot proceed even if the contempt sanctions were not to be imposed until after conclusion of the bankruptcy, the Second Circuit ruled in a nonprecedential opinion.

Before bankruptcy, the district court entered a \$13.4 million judgment for compensatory damages against an individual for violating the Federal Trade Commission Act. Believing that the man had substantial assets but was not paying the judgment, the FTC filed a motion seeking coercive incarceration for contempt.

Shortly before the contempt hearing in district court, the man filed a chapter 7 petition and immediately filed a suggestion of bankruptcy. The district judge first ruled that the contempt proceedings were an exercise of police or regulatory power and thus not subject to the automatic stay in Section 362(a).

Next, the district judge entered a second order holding the debtor in contempt and ordering his coercive incarceration. At the FTC’s request, the district judge stayed enforcement of incarceration until after conclusion of the bankruptcy.

The debtor appealed and won in a *per curiam* opinion on June 26.

Reversing the district court, the appeals court cited Section 362(b)(4), which provides that the automatic stay does not apply to proceedings by a governmental unit to enforce police or regulatory powers, “including the enforcement of a judgment *other than a money judgment*. . . .” [Emphasis added.]

The circuit court said that the purpose of the contempt proceedings “was simply to enforce a money judgment that had already been entered” before the debtor’s bankruptcy. Even though the FTC had filed the contempt motion before bankruptcy, the appeals court said that “once the automatic stay was in place, the district court was prohibited from disposing of the request while [the debtor’s] bankruptcy remained pending.”

The appeals court therefore vacated the district court’s orders holding the debtor in contempt and ruling that the automatic stay did not apply.

A footnote may be the most important part of the opinion. The appeals court said that delaying enforcement of the contempt judgment until after bankruptcy makes “no difference in our analysis.” In other words, simply compelling a debtor to defend a proceeding violates the stay.

Questions

Will the debtor now seek damages from the FTC for willful violation of the automatic stay under Section 362(k)? If the debtor seeks a citation for contempt, a recent decision of the Supreme Court will come front and center. See *Taggart v. Lorenzen*, 139 S. Ct. 1795, 204 L. Ed. 2d 129 (June 3, 2019). For ABI’s discussion of *Taggart*, [click here](#).

Taggart held that the bankruptcy court “may impose civil contempt sanctions when there is *no objectively reasonable basis* for concluding that the creditor’s conduct might be lawful under the discharge order.” [Emphasis added.]

The first question is: What does the appeals court’s reversal say about “objectively reasonable basis”? Was the continuation of the contempt proceeding objectively reasonable as a matter of law, just because the district court (mistakenly) believed the stay did not apply?

[+] Feedback

The second question is: Does *Taggart*, dealing with contempt of the discharge injunction, also apply to violations of the automatic stay? Hint: Some smart people have said that *Taggart* does not apply when Section 362(k) is the standard for a contempt finding, rather than the nonstatutory contempt standard for Section 524 discharge violations.

If our readers have answers to the questions, please pass them along. With regard to the first question, keep this in mind: The district court's order holding the automatic stay to be inapplicable was a terse, handwritten memo endorsement that cited Section 362(b)(4) with no analysis. Does an incorrect conclusion by a judge with no analysis always mean that the moving party's position was objectively reasonable?

Opinion Link

PREVIEW

View Opinion

Case Details

Case Citation	Rensin v. Federal Trade Commission, 17-669 (2nd Cir. June 26, 2019).
Case Name	Rensin v. Federal Trade Commission
Case Type	Consumer
Court	2nd Circuit
Bankruptcy Tags	Automatic Stay Ethics Practice and Procedure Discharge/Dischargeability



Bill Rochelle
EDITOR-AT-LARGE, ABI
[@BillRochelle](#)

An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015. [Feedback](#)

Prior to his second career in journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP.

Consumer Corner

BY KEN SIOMOS

Denying Chapter 13 Discharges for Direct-Payment Defaults

There has never been uniform agreement on what defines “success” in a chapter 13 case.¹

Some debtors might see success as receiving a loan modification to keep their home; others as procuring the return of their vehicle to retain their ability to drive to work. Many are undoubtedly seeking the discharge injunction in the hopes that their debt problems will be solved.

These debtors might lose their home or car after stay relief during their case, but they continue making their chapter 13 plan payments to the trustee, expecting at the end to receive their discharge. However, that discharge might never be forthcoming. This article explores the basis for the interpretation leading to this rising trend,² a potential interpretative oversight in these recent decisions, and the potential national impact of these recent decisions.

Like chapters 11 and 12, chapter 13 requires the debtor to propose a plan that, once confirmed, sets out who will be paid and how much.³ Section 1328(a) of the Bankruptcy Code states that “after completion by the debtor of all payments under the plan ... the court shall grant the debtor a discharge of all debts.”⁴ Chapter 13 debtors can choose to pay some debts, most often mortgage or vehicle payments, directly to creditors, rather than using the chapter 13 trustee as a conduit.⁵ Doing so can reduce a debtor’s expenses because paying via the chapter 13 trustee requires an additional payment for the trustee’s percentage fee.⁶

In 2014, a bankruptcy court ruled that a debtor who failed to make the mortgage payments that they were to personally pay to the mortgage creditor — rather than through the trustee — was not entitled to a chapter 13 discharge.⁷ This decision relied heavily on a Fifth Circuit decision from 1982 that allowed debtors to make mortgage payments directly rather than requiring them to be paid by the trustee.⁸ The analysis was short, with some subsequent decisions following suit stating that the plain meaning of “under the plan” is clear, making analysis of similar

statutory provisions unnecessary.⁹ However, other decisions have looked to other Bankruptcy Code provisions to clarify the meaning of § 1328(a).¹⁰

One such potentially clarifying provision is § 1326, in which the Code is clear that “[e]xcept as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors *under the plan*.”¹¹ It is reasonable to interpret this provision as implying that an alternative to the trustee making payments to creditors “under the plan” is the debtor making payments to creditors “under the plan.”¹²

Interpreting the Bankruptcy Code, like all statutory interpretation, can be a “holistic endeavor.”¹³ Looking to § 1326(c) to help resolve the meaning of § 1328(a) is therefore appropriate,¹⁴ but once § 1326(a) is reviewed to inform the interpretation of § 1328(a), historical precedent and other relevant Code provisions should also be reviewed.

The U.S. Supreme Court has made clear that the Bankruptcy Code should not be interpreted so as to “erode past bankruptcy practice absent a clear indication that Congress intended such a departure.”¹⁵ The Code has not significantly changed in 80 years with respect to the chapter 13 discharge following completion of payments.¹⁶ Under the Chandler Act of 1938, a debtor under a “wage earners” plan was to be issued a discharge “[u]pon compliance by the debtor with the provisions of the plan and upon completion of all payments to be made thereunder.”¹⁷ The current iteration of the Code similarly states that the discharge shall be entered “after completion by the debtor of all payments under the plan.”¹⁸ Therefore, it came as a surprise to many when, 76 years after the Chandler Act, a court first held that a debtor was required to make all direct-pay mortgage payments during the term of the plan in order to receive a chapter 13 discharge.¹⁹

In addition to reading § 1326 to help inform the meaning of § 1328, and weighing that against the



Ken Siomos
Marsha L. Combs-Skinner, Chapter 13 Trustee; Newman, Ill.

Ken Siomos spent seven years as staff attorney for Chapter 13 Trustee John H. Germeraad in the Springfield division in the Central District of Illinois and is now staff attorney for Chapter 13 Trustee Marsha L. Combs-Skinner for the Urbana, Peoria and Springfield divisions of the Central District of Illinois.

1 Gordon Bermant, “What Is Success in Chapter 13 and Why Should We Care,” *ABI Journal*, September 2004, available at abi.org/abi-journal.

2 While this trend appears to have a majority of published opinions, it is not clear whether a majority of courts nationally are following the trend of these published decisions.

3 11 U.S.C. §§ 1321, 1322, 1325.

4 11 U.S.C. § 1328(a).

5 11 U.S.C. § 1326(c).

6 11 U.S.C. § 586(e).

7 *In re Heinzie*, 511 B.R. 69 (Bankr. W.D. Tex. 2014).

8 *In re Foster*, 670 F.2d 478 (5th Cir. 1982).

9 *In re Evans*, 543 B.R. 213, 220 (Bankr. E.D. Va. 2016); *In re Wehrman*, 2016 Bankr. Lexis 4712 (Bankr. D.S.C. 2016); *In re Finley*, 2018 Bankr. Lexis 2585 (Bankr. S.D. Ill. 2018).

10 *Heinzie* at 75-76.

11 11 U.S.C. § 1326(c) (emphasis added); *In re Foster*, 670 F.2d 478 (5th Cir. 1982).

12 11 U.S.C. § 1326(c); 11 U.S.C. § 1328(a).

13 *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988).

14 *Id.*

15 *Hamilton v. Lanning*, 560 U.S. 505, 517 (2010) (citing *Travelers Casualty & Surety Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 454).

16 Chandler Act of 1938, 52 Stat. 840 (1938).

17 Chandler Act of 1938, 52 Stat. 840, § 660 (1938).

18 11 U.S.C. § 1328(a).

19 *In re Heinzie*, 511 B.R. 69 (Bankr. W.D. Tex. 2014).

historical interpretation of the Bankruptcy Code to avoid the erosion of “past bankruptcy practice,” courts should look to another provision similar to § 1328. Section 1329 of the Bankruptcy Code addresses modification of a chapter 13 plan, allowing such modification in certain circumstances as long as it is “before the completion of payments *under such plan*.”²⁰ This language is substantively similar to the § 1328 language that a discharge be entered “as soon as practicable after completion by the debtor of all *payments under the plan*.”²¹ Despite one rule of statutory interpretation suggesting that different statutory phrasings should be given different statutory meanings, it would be absurd to interpret “under the plan” differently from “under such plan.” Granting different interpretations to these provisions would mean that a plan could be complete under one provision but not under another, thus creating a potentially disastrous legal limbo for many debtors. For this reason, interpretations of § 1329’s “under such plan” should be considered in making any conclusions about the meaning of § 1328’s “under the plan.”

Looking to § 1329, it is significant that even the Fifth Circuit, the source of this damaging § 1328(a) trend, once stated that if modification were allowed after “the debtor completes his or her payments to the trustee, the mandatory nature of the discharge provision [11 U.S.C. § 1328] would be eviscerated.”²² The *Heinzle* case, which started this trend, fails to recognize this Fifth Circuit case and found that the plan was not complete under § 1329. Further, the plan could not be modified because the case was past month 60, regardless of whether the debtors would seek to extend the plan term.²³

The Fifth Circuit is not alone in interpreting § 1329(a)’s limitation on modification as applying only to payments completed “to the trustee.”²⁴ In many courts, “a plan is ‘complete’ when the debtor makes all the payments to the trustee.”²⁵ Nonetheless, other than *Heinzle*, courts interpreting § 1328 rarely discuss § 1329.²⁶

In the author’s review of § 1329(a) case law on the timeliness of plan modification, courts never discuss whether debtors with direct-pay debts have made all the direct payments called for under the plan. Repeatedly, the question of whether payments “under such plan” have been completed to preclude modification all hinge on whether the debtor has paid the plan “base” or sufficient funds for the stated dividend to unsecured creditors.²⁷ Courts denying a debtor’s discharge for a failure to make direct payments need to be mindful of the long and well-established history under § 1329 that interpret completion of payments under the plan to mean completion of payments to the chapter 13 trustee.

Moreover, despite the *Gonzalez* court in 2015 indicating that there was no precedent in favor of excluding direct

payments from payments “under the plan” under § 1328, a 1988 decision stated that “[w]hile section 1328(a) does not specify whether ‘payments’ as used therein refers to the payment the debtor makes to the trustee or to the payments that the trustee or debtor makes to creditors, it is reasonable to construe the language to apply to the payments made by the debtor to the trustee.”²⁸ The court found that modification under § 1329 could not be allowed because payments “under the plan” were the same under §§ 1328(a) and 1329(a), and were completed when all payments were made “to the trustee.”²⁹ Thus, from 1938-2014, the only decision on this issue found that §§ 1328 and 1329 should be interpreted in the same manner, and that manner should be that payments made directly by the debtor were excluded.

Considering that the first of these denial-of-discharge decisions was only written in 2014, and at least with respect to published decisions they are not especially widespread, it is likely too early for any statistical analysis to conclude with any significance how these decisions are impacting rates of both filings and discharges. However, they add a new, and substantial, uncertainty nationwide, especially in light of the inability to litigate this matter at confirmation. Even if an attorney practices before a court that disagrees with this recent trend, bankruptcy judge terms are only 14 years, and at the end of a five-year plan a new judge, with a new § 1328(a) interpretation, could be on the bench.

Chapter 13 practitioners know that post-petition stay relief being granted during a case is not an uncommon situation; if each of those debtors who lose the home also end up losing their discharge, it undoubtedly would diminish that 33-to-36-percent discharge rate. The impact on the debtors who otherwise would file, and on those who have filed and nonetheless lost their home they were trying to save, needs to be considered in interpreting § 1328(a).

Some courts have started pushing back against this new, deeply harmful interpretation of § 1328(a). In Arizona, one bankruptcy court has held that § 1328(a), read in “the context of Chapter 13 as a whole,” should be interpreted as referring to payments to the trustee.³⁰ An Illinois court that allows debtors to receive a discharge despite a post-petition second mortgage default recognized that these decisions denying discharge based on a failure to make direct payments are of “recent vintage,” lacking any significantly on-point corollary from before 2014.³¹ In a decision that was not directly on point, a panel for the Eleventh Circuit Court of Appeals held that a direct pay mortgage was not “provided for” under § 1328(a).³²

The relative novelty of the new § 1328(a) interpretation has caused courts to inquire as to why this issue has suddenly come into focus nationwide.³³ The *Gibson* court speculated that the new interpretation may have arisen from Bankruptcy Rule 3002.1, which required at the end of a case that the trustee submit a notice of final cure and for mortgage

20 11 U.S.C. § 1329(a) (emphasis added).

21 11 U.S.C. § 1328(a) (emphasis added).

22 *In re Meza*, 467 F.3d 874 (5th Cir. 2006) (emphasis added).

23 *Heinzle*, 511 B.R. at 79.

24 *Id.*

25 *In re Sounakhene*, 249 B.R. 801 (Bankr. S.D. Cal. 2000); *In re Casper*, 154 B.R. 243 (Bankr. N.D. Ill. 1993).

26 See *In re Evans*, 543 B.R. 213 (cites § 1329 in single footnote but no discussion); *In re Wehrman*, 2016 Bankr. Lexis 4712 (no citation to § 1329); *In re Finley*, 2018 Bankr. Lexis 2585 (no citation to § 1329); *In re Kessler*, 655 Fed. App’x 242 (5th Cir. 2016) (no citation to § 1329); *In re Coughlin*, 568 B.R. 461 (Bankr. E.D.N.Y. 2017) (allowing modification to surrender but not discussing § 1329’s history in interpreting § 1328); *In re Gonzales*, 532 B.R. 828 (Bankr. D. Colo. 2015) (no citation to § 1329); *In re Thornton*, 572 B.R. 738 (Bankr. W.D. Mo. 2017) (no citation to § 1329).

27 See *Sounakhene*, 249 B.R. 801; *Casper*, 154 B.R. 243; *Refosco*, 2013 Bankr. Lexis 2776; *Moss*, 91 B.R. at 565.

28 *In re Moss*, 91 B.R. 563, 565 (Bankr. C.D. Cal. 1988).

29 *Id.*

30 *In re Rivera*, 2019 Bankr. Lexis 989 (Bankr. D. Ariz. 2019).

31 *In re Gibson*, 582 B.R. 15, 18 (Bankr. C.D. Ill. 2018).

32 *In re Dukes*, 909 F.3d 1306 (11th Cir. 2018).

33 See *In re Gibson*, 582 B.R. 15 (Bankr. C.D. Ill. 2018); *In re Rivera*, 2019 Bankr. Lexis. 989 (Bankr. D. Ariz. 2019).

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creditors to respond as to whether the debtor was current.³⁴ The *Gibson* court believed that courts and chapter 13 trustees may have lacked awareness of direct payment defaults before Bankruptcy Rule 3002.1 required mortgage creditors to file a statement at the end of the case specifying whether the debtor was still behind in payments.³⁵

However, although *Heinzle* and other decisions were spurred by mortgage creditors responding pursuant to Rule 3002.1, trustees and bankruptcy courts have long been aware of plan defaults on direct-pay debts by virtue of creditors filing motions for relief from the automatic stay seeking permission to foreclose or repossess.³⁶ To give credence to the Rule 3002.1 theory would suggest that the historical dearth of case law in support the new § 1328(a) interpretation was the result of courts being ignorant of the facts. The reality is that for decades, courts were aware when debtors defaulted on their chapter 13 mortgages or other direct payments, but never read § 1328(a) to mean that their discharge was lost as a result.

History is on the debtors' side. From 1938-2014, debtors were not losing their discharge when they failed to

make direct payments. Although Congress made no Code amendments suggesting that this be changed, one bankruptcy court in Texas has held otherwise, and did so by citing decisions with convenient excerpts but no directly-on-point decisions. Wholly ignoring the historical interpretation of § 1329(a), which contained a similar provision, additional courts found a lack of contrary § 1328 precedent and expanded the trend.

With respect to published decisions, the majority of courts are denying discharges for failing to make direct payments. Now, in parts of Texas, Colorado, Illinois, New York and Virginia, and potentially in the entire Fifth Circuit due to a nonprecedential decision,³⁷ a debtor who fails to make their house or car payment during their case is unable to receive a discharge. The author does not mean to give short shrift to the decisions behind the rising trend, but little can be said when the decisions state that the meaning is "plain" or that § 1328 "plainly embraces" their interpretation.³⁸ In light of the contradictory Code provisions, such a monumental shift from historical practice should only be effectuated by a clear act of Congress, not a "plain meaning" interpretation that had not been plain to any court for the previous 76 years. **abi**

³⁴ *Id.*

³⁵ *Id.*

³⁶ 11 U.S.C. § 362(d).

³⁷ *In re Kessler*, 655 Fed. App'x 242 (5th Cir. 2016).

³⁸ *Evans*, 543 B.R. at 220; *Gonzales*, 532 B.R. at 832.

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Rochelle's Daily Wire | ABI Exclusive

February 15, 2019

Another Court Strikes Down Higher U.S. Trustee Fees in Some Cases

“ A crisis befalls smaller companies that can't afford the huge increase in U.S. Trustee fees.

The increase in quarterly fees payable to the U.S. Trustee Program is unconstitutional if applied to chapter 11 debtors with plans confirmed before October 26, 2017, when the increase became effective, according to Bankruptcy Judge Ronald B. King of San Antonio, Texas.

The U.S. Trustee Program is intended to be self-funding, but a recent increase in fees could make chapter 11 too expensive for some mid-market companies and cause some debtors to default on confirmed plans. (The inherent expense of chapter 11 already makes some companies forgo bankruptcy reorganization.)

The new fee amounts to a 1% tax on a debtor's disbursements. Since "disbursements" is interpreted so broadly, the fee in substance is a 1% tax on revenue, given that everything a company takes in will be disbursed one way or another.

Because the fee is essentially a flat tax unrelated to a debtor's cash flow, some companies simply cannot afford the higher fee, especially those with high revenue and low margins.

With the fee capped at \$250,000 per quarter, the largest companies are immune from the increase, putting the onus of the increase on smaller companies.

The February 8 opinion by Judge King is an effort at ameliorating the crisis for some debtors until Congress fixes the mess it unthinkingly made.

The Amended Statute

To ensure that taxpayers do not finance the U.S. Trustee Program, Congress revised the U.S. Trustee fees as part of the Bankruptcy Judgeship Act of 2017. Codified at 27 U.S.C. § 1930(a)(6)(B), the fees are raised whenever the balance in the U.S. Trustee System Fund falls below \$200 million at the end of any fiscal year through 2022.

Since the fund balance was the threshold, the fees increased as of Oct. 27, 2017, when the amendment became effective. The section now provides that "the quarterly fee payable for a quarter in which disbursements equal or exceed \$1,000,000 shall be the lesser of 1 percent of such disbursements or \$250,000."

In other words, if the debtor disburses \$1 million a quarter, the quarterly fee is \$10,000, or \$40,000 a year. Under the prior fee schedule, the quarterly fee would have been \$4,785 if disbursements were \$999,999 in the quarter, or \$6,500 if the quarterly disbursements were \$1 million but less than \$2 million.

If quarterly disbursements are \$25 million or more, the fee is now \$250,000 a quarter. At \$25 million under the old schedule, the fee would have been \$20,000 a quarter. For a company with \$25 million in quarterly disbursements, the fee rose 1,250%

The word "disbursements" is not defined in the statute.

The Case at Bar

In the case before Judge King, the debtor had confirmed a plan in April 2017, before the amendment was adopted. In each of the first three quarters of 2018, the debtor's disbursements were approximately \$65 million. For each of the quarters, the U.S. Trustee asserted that the fee should be \$250,000.

Under the fee schedule in effect when the petition was filed and when the plan was confirmed, the quarterly fee would have been \$30,000. In other words, the increase was 833%, Judge King said.

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The confirmed debtor was operating more than 100 restaurants around the country. If the debtor were obligated to pay the higher fees, Judge King said that priority claimants “would be at risk of nonpayment” and “the plan’s feasibility would be compromised.”

The Debtor’s First Arguments

Given that “disbursements” is not defined in Section 1930, the debtor contended that the fee should only be applied to payments made to creditors under the plan. If that were true, the quarterly payment would be \$4,875, Judge King said.

Judge King said that the fees sought by the U.S. Trustee were “excessive and [in] certain situations may require a limitation on what constitutes a disbursement.” However, Judge King agreed with a majority of courts interpreting “disbursements to mean all transfers from the estate, including payments in the ordinary course of business.”

The debtor urged Judge King to follow Chief Bankruptcy Judge Catherine J. Furay of Madison, Wis., and her decision in *In re Cranberry Growers Cooperative*, 592 B.R. 325 (Bankr. W.D. Wis. 2018).

In *Cranberry Growers*, Judge Furay held that “disbursements” does not include payments under a revolving credit where the lender immediately readvances funds that were swept the prior day to pay down the loan. To read ABI’s discussion of *Cranberry Growers*, [click here](#). The decision is on direct appeal to the Seventh Circuit.

Judge King declined to follow *Cranberry Growers*, because “a narrow interpretation of disbursements that applies in the case of a revolving line of credit does not apply in this case.”

Constitutional Arguments Prevail

The debtor advanced three more arguments: the Uniformity and Due Process Clauses of the U.S. Constitution, and retroactivity. The debtor won on all counts.

Previously in the history of Section 1930, fees for the U.S. Trustee Program did not apply in the two districts that still employ Bankruptcy Administrators rather than U.S. Trustees. The Ninth Circuit therefore held in *St. Angelo v. Victoria Farms Inc.*, 38 F.3d 1525 (9th Cir. 1994), that a prior iteration of Section 1930 violated the Uniformity Clause because U.S. Trustee fees were not being charged in the two districts with Bankruptcy Administrators.

Following *St. Angelo*, Judge King held that the higher fees were unconstitutional until the increase was applied to administrator districts in October 2018. He therefore concluded that the debtor was only liable for \$30,000 in fees for the first three quarters of 2018.

The Uniformity Clause would not relieve the debtor of the obligation for higher fees beginning in October 2018. That’s where retroactivity comes into play.

Judge King recited the presumption against retroactivity. “Nothing in the statute or legislative history indicates that Congress intended the amendment to apply retroactively,” he said. Although the amendment applies to disbursements made after Jan. 1, 2018, he said the statute “does not specify its application to pending cases.”

Therefore, Judge King held that the higher fees “should not be applied to pending cases with a confirmed plan when the statute became effective on Oct. 26, 2017.”

But he wasn’t through. Judge King also found a violation of the Due Process Clause, because imposing “the fees retroactively in this case did not provide the Reorganized Debtors with sufficient notice of the increased fees prior to filing chapter 11 or confirmation of a plan.”

Some of the language in the concluding pages of the opinion suggests that Judge King’s analysis might also apply to chapter 11 filings before Oct. 26, 2017, even if confirmation did not occur until after the higher rates became effective. In that regard, Judge King said that knowledge of the higher fees might propel debtors into adopting prepackaged plans or restructuring debts outside of bankruptcy “to avoid the quarterly fees.”

For the first three quarters of 2018, Judge King ruled that the debtor was only liable for the \$30,000 quarterly maximum under the “old” schedule.

(Any opinions are those of the writer, not ABI.)

Opinion Link

 PREVIEW

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 View Opinion

Case Details

Judge Name	Ronald B. King
Case Citation	In re Buffets LLC, 16-50557 (Bankr. W.D. Tex. Feb. 8, 2019)
Case Name	In re Buffets LLC
Case Type	Business
Court	5th Circuit Texas Texas Western District
Bankruptcy Tags	Administrative Expense Claims Business Reorganization



Bill Rochelle
EDITOR-AT-LARGE, ABI
[@BillRochelle](#)

An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015.

Prior to his second career in journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP.

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Rochelle's Daily Wire | ABI Exclusive

June 21, 2019

Seventh Circuit Solidifies a Circuit Split on the Automatic Stay

“Disagreeing with the Tenth and D.C. Circuits and siding with four other circuits, the Seventh Circuit rules that passively holding estate property violates the automatic stay.”

Solidifying a split of circuits, the Seventh Circuit ruled that the City of Chicago must comply with the automatic stay by returning impounded cars immediately after being notified of a chapter 13 filing.

The decision lays the foundation for the Supreme Court to grant *certiorari* and decide whether violation of the automatic stay requires an affirmative action or whether inaction amounts to control over estate property and thus violates the stay.

The Second, Seventh, Eighth, Ninth and Eleventh Circuits hold that a secured creditor or owner must turn over repossessed property immediately or face a contempt citation. The Tenth and the District of Columbia Circuits have ruled 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), which prohibits “any act . . . to exercise control over property of the estate.”

The same issue was argued on May 23 in the Third Circuit, where the lower courts were siding with the minority. See *Denby-Peterson v. NU2U Auto World*, 18-3562 (3d Cir.). For ABI's report on *Denby*, [click here](#).

The Impounded Cars in Chicago

Four cases went to the circuit together. The facts were functionally identical.

The chapter 13 debtors owed between \$4,000 and \$20,000 on unpaid parking fines. Before bankruptcy, the city had impounded their cars. Absent bankruptcy, the city will not release impounded cars unless the fines are paid. If the cars are not redeemed by their owners, most of them are scrapped.

In 2016, Chicago passed an ordinance giving the city a possessory lien on impounded cars.

After filing their chapter 13 petitions, the debtors demanded the return of their autos. The city refused to release the cars unless the fines and other charges were paid in full.

The debtors mounted contempt proceedings in which four different bankruptcy judges held that the city was violating the automatic stay by refusing to return the autos. After being held in contempt, the city returned the cars but appealed.

In all four cases, the owners confirmed chapter 13 plans treating the city as holding unsecured claims. The city did not object to confirmation or appeal.

In the four cases, the city never sought adequate protection for its alleged security interests under Section 363(e).

Thompson Controls

Circuit Judge Joel M. Flaum was not writing on a clean slate in his June 19 opinion, given the circuit's controlling precedent in *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009). *Thompson*, he said, presented “a very similar factual situation.”

Although *Thompson* came down only 10 years ago, Judge Flaum nonetheless wrote a comprehensive, 27-page opinion, perhaps sensing that the case will go to the Supreme Court on *certiorari*.

In *Thompson*, Judge Flaum said, “we held that a creditor must comply with the automatic stay and return a debtor's vehicle upon her filing of a bankruptcy petition. We decline the City's request to overrule *Thompson*.” He also agreed with the bankruptcy courts “that none of the exceptions to the stay apply.”

[+] Feedback

Quoting extensively from *Thompson*, Judge Flaum said that the Seventh Circuit had already “rejected” the city’s contention that “passively holding the asset did not satisfy the Code’s definition of exercising control.” He noted that Congress amended Section 362 in 1984 by adding subsection (a)(3) and making the automatic stay “more inclusive by including conduct of ‘creditors who seized an asset pre-petition,’” citing *U.S. v. Whiting Pools Inc.*, 264 U.S. 198, 203-204 (1983).

Again citing *Whiting Pools*, Judge Flaum said that Section 362(a)(3) “becomes effective immediately upon the filing of the petition and is not dependent on the debtor first bringing a turnover action.” He added, the “creditor . . . has the burden of requesting protection of its interest in the asset under Section 363(e).”

Judge Flaum found support for his conclusion in Section 542(a). Again quoting *Thompson*, he said the section “‘indicates that turnover of a seized asset is compulsory.’” *Thompson, supra*, at 704.

“Applying *Thompson*,” Judge Flaum held “that the City violated the automatic stay . . . by retaining possession . . . after [the debtors] declared bankruptcy.” The city, he said, “was not passively abiding by the bankruptcy rules but actively resisting Section 542(a) to exercise control over the debtors’ vehicles.”

Telling Chicago how to proceed in the future, Judge Flaum said the city must turn over the car and may seek adequate protection on an expedited basis. The burden of seeking adequate protection, he said, “is not a reason to permit the City to ignore the automatic stay and hold captive property of the estate, in contravention of the Bankruptcy Code.”

In sum, Judge Flaum declined the city’s invitation to overrule *Thompson*. He said, “Our reasoning in *Thompson* continues to reflect the majority position and we believe it is the appropriate reading of the bankruptcy statutes.”

Exceptions to the Automatic Stay

Judge Flaum devoted the last third of his opinion to explaining why Chicago was not eligible for any of the exceptions to the automatic stay.

Section 362(b)(3), allowing acts to perfect or continue perfection of liens, does “not permit creditors to retain possession of debtors’ property,” Judge Flaum said. Rather, it allows creditors to file notices to continue or perfect a lien when bankruptcy has intervened. The city, he said, could perfect its possessory lien by a filing with the Secretary of State.

Judge Flaum cited Illinois decisions holding that giving up possession involuntarily does not destroy a possessory lien. The notion that turning over cars would abrogate the possessory lien was one of Chicago’s primary arguments on appeal.

Judge Flaum held that Section 362(b)(4), excepting police or regulatory powers from the automatic stay, did not apply. On balance, he said, the municipal machinery to impound cars “is an exercise of revenue collection more so than police power.”

Is *Certiorari* Next?

In the term that ends this month, the Supreme Court denied a petition for *certiorari* raising the same question. See *Davis v. Tyson Prepared Foods Inc.*, [18-941](#) (Sup. Ct.) (cert. denied May 20, 2019).

Davis, from the Tenth Circuit, was a challenge to the Tenth Circuit’s holding in *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017). In *Cowen*, the Tenth Circuit ruled 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.” To read ABI’s discussion of the denial of *certiorari*, [click here](#).

In this writer’s opinion, the Chicago parking ticket cases are a better vehicle for *certiorari* because they raise the issue more cleanly. *Davis* was a step or two removed from the question of whether overt action is required to violate the automatic stay.

Given the recent change in administration in Chicago, it is not certain that the city will pursue *certiorari*.

Eric Brunstad told ABI, “The issue is certainly not going away. I predict that eventually the Supreme Court will grant *certiorari* in a case involving the issue and resolve the conflict among the courts of appeals.” Brunstad represented the debtor who unsuccessfully sought Supreme Court review in *Davis*.

Opinion Link

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Case Details

Judge Name Joel M. Flaum

Case Citation In re Fulton, 18-2527
(7th Cir. June 10, 2019)

Case Name In re Fulton

Case Type [Consumer](#)

Court [7th Circuit](#)

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Bill Rochelle
EDITOR-AT-LARGE, ABI
[@BillRochelle](#)

An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015.

Prior to his second career in journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP.

By The Numbers

Total cases in system	1190
Business Cases	466
Consumer Cases	519
Circuit Splits Cases	47
Supreme Court Cases	75
Total Judges	641 <small>[+] Feedback</small>