CARLTON FIELDS

Can Doing Nothing as a Creditor Get You Sanctioned – In re Fulton Part II

January 22, 2021

In a prior post, we discussed the *In re Fulton* case — in which the Seventh Circuit Court of Appeals ruled that creditors that seize debtors' property prior to the debtor filing bankruptcy are required to return the property after the bankruptcy filing — and that the Supreme Court granted certiorari to review the case. The Supreme Court recently entered its opinion overturning the Seventh Circuit and holding that merely retaining property of a debtor's bankruptcy estate does not, itself, violate the automatic stay imposed by Section 362 of the Bankruptcy Code. *Fulton* arose from a consolidation of four similar cases in which soon-to-be-debtors' cars were impounded by the city of Chicago for unpaid traffic/parking citations. The debtors eventually filed bankruptcy and sought the return of their cars. After the city refused, the debtors argued that the automatic stay imposed by Section 362 required the city to return the cars, and they sought sanctions against the city for failing to do so. It is well accepted that, once a debtor files bankruptcy, the automatic stay generally precludes various post-petition actions to recover debt. However, less clear was whether a creditor that seizes a debtor's property before the debtor files bankruptcy is required to release or return that property once the debtor files bankruptcy and whether the creditor can be sanctioned if the creditor fails or refuses to do so. In fact, there was a significant split among the federal circuit courts on this issue. In *Fulton*, the debtors relied on the Seventh Circuit's prior decision in *Thompson v. General Motors Acceptance Corp.*, in which the court held that a creditor must return a debtor's vehicle seized prepetition upon the filing of a bankruptcy petition. The Seventh Circuit, following its prior precedent, concluded that the city's primary objective in retaining possession of the vehicles was not ownership of the vehicles, "but to put pressure on the debtors to pay their tickets ... precisely what the stay is intended to prevent" and thus that the city, in retaining the cars post-petition, violated the automatic stay. The Supreme Court disagreed. The court found that the most natural reading of Section 362 is that it prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed. The court found that mere retention of property is a passive act that merely maintains the status quo. The court pointed to the legislative history of the section and the fact that Congress, when it added the phrase "or to exercise control

over property of the estate," failed to include any direct mention of an affirmative turnover obligation. The court also noted that reading an affirmative turnover duty in Section 362 would render certain portions of Section 542 of the Bankruptcy Code, which requires that an entity in possession of certain estate property "shall deliver to the trustee ... such property," superfluous. The court further noted that finding otherwise could render the commands of Section 362(a)(3) and Section 542 contradictory because an entity would be required to turn over property even if that property were exempt from turnover under Section 542. The Supreme Court's opinion is noteworthy for both what it resolves and what it does not. While the decision provides important guidance for actions that creditors may wish to take or not take post-petition, it does not answer other questions regarding the application of the seized property or preclude other potential remedies for debtors to seek return, post-petition, of property seized prepetition, or to seek sanctions when creditors fail to comply. Pre-*Fulton*, issues regarding the seizure and retention of property from a prospective debtor required careful consideration. Post-*Fulton*, that remains the case.

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