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Automatic Stay Violators and Prepetition Seizures

November 15, 2019

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As many of our clients are well aware, our federal judicial system includes 13 Circuit Courts of Appeal to which lower court decisions may be brought for review. When there is a conflicting ruling between Circuits, the United States Supreme Court may be asked to resolve the conflict. Such a conflict exists today with 5-3 split among the Circuits as to whether refusal to return property seized prepetition constitutes a violation of the automatic stay.

While these cases frequently include situations where a Debtor's vehicle was seized by a lender or municipality, they may also include other kinds of property, including garnishments.

The first question assessed by courts is whether such property must be turned over to the Debtor automatically or upon its request pursuant to the automatic stay granted by Section 362. The second question assessed is whether refusal to turn over the property constitutes a willful violation of the automatic stay.

On several occasions earlier this year we have discussed this issue. In those discussions we referenced cases in the Second, Seventh and Sixth Circuits where courts have ruled that upon the filing of a petition under the bankruptcy code property seized prepetition must be returned. In some cases, failure to do so is deemed a willful violation of the automatic stay and penalties are imposed.

Recently, a decision by the Court of Appeals for the Third Circuit joined two other Circuits in taking the opposite view. [1]

In the Third Circuit, it is now the law that the Debtor must initiate an adversary proceeding or lawsuit under the bankruptcy code demanding the return of the property and only after a ruling by the bankruptcy court judge will the party in possession be required to turn over the property.[2]

The ruling by the Third Circuit, joining the 10th and District of Columbia Circuits would compel Debtors to undertake time-consuming and expensive litigation to recover prepetition seizures. That will be burdensome, but it could also act to limit frivolous filings in order to regain property.

This Ruling by the Third Circuit also seems to redefine the meaning of the word "shall" as contained in the bankruptcy code. While the plain language would make the turn over of prepetition seized property mandatory,

the Third Circuit established that the word “shall” will only have meaning after the bankruptcy court has ruled on the request by the Debtor through an adversary proceeding.[3] To us this seems like a strange interpretation of the meaning of the word in this context.

A Petition of Certiorari has been filed with the United States Supreme Court regarding a case out of the Seventh Circuit, *City of Chicago v. Fulton* addressing the same issue.[4] Should the Supreme Court choose to accept the petition, it will establish the law of the land on this issue. In the meantime, whether your Debtor files a bankruptcy petition in the Second Circuit or Third Circuit, a clear litigation strategy will need to be implemented to avoid potential pitfalls. As always, we encourage our clients to consult counsel to avoid unnecessary and costly proceedings.

[1] *In re Denby-Peterson*, 941 F.3d 115, 119 (3d Cir. 2019)

[2] *Denby-Peterson*, 941 F.3d at 129.

[3] *Denby-Peterson*, 941 F.3d at 131.

[4] *City of Chicago Illinois v. Robbin L. Fulton et al.*, No. 18-2527 (7th Cir. June 19, 2019); *City of Chicago, Illinois v. Robbin L. Fulton, et al.,* No. 19-357, 926 F.3d 916 (Docketing Petition for Cert. Sep 18, 2019)

Practices

- Bankruptcy and Creditors' Rights

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