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Automatic Stay Violators and Prepetition Seizures

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For corporate entities, as well as individuals, the United States Bankruptcy Code provides an excellent tool to prevent property seizure when one is trying to re-organize their financial affairs. Section 362 of the Bankruptcy Code is the provision for an automatic stay. The stay commences at the time of the filing of a case and it prevents creditors from proceeding against the debtor or the debtor's assets by any means outside of the bankruptcy proceeding.

This injunction enables the re-organization or liquidation process to proceed in an orderly manner and is fundamental to the concept of "fresh start". Over the course of the past year and a half, we have issued alerts to our clients on the topic of the automatic stay, its effects and the impact of violations of the stay – which may lead to serious sanctions.

Most recently, we have focused on the question of whether prepetition seizures are also covered by the automatic stay [Prior legal alerts are available at: The Automatic Stay: Even Pre-Petition Seizures May Be Covered, July 1, 2019; Automatic Stay Violators and Prepetition Seizures, November 15, 2019; Supreme Court to Decide Whether Creditor's Inaction Violates the Automatic Stay, December 31, 2019].

As our readers may recall, the leading case involving seizures of automobiles by the City of Chicago, In re Fulton, 926 F.3d 916 (7th Cir. 2019), was appealed to the United States Supreme Court which issued its decision January 14, 2021 reversing the decision of the bankruptcy court and the Court of Appeals for the Seventh Circuit, holding that the mere retention of property seized prepetition does not violate § 362(a)(3) of the Bankruptcy Code. See City of Chicago, Illinois v. Fulton, No. 19-357, 2021 WL 125106 (Jan. 14, 2021).

While many chapter 13 debtors have been similarly affected, the Fulton case involves four such chapter 13 debtors. After the debtors' automobiles were seized for failure to pay parking fines, each debtor filed a Chapter 13 case and demanded the return of the automobiles under the provisions of the automatic stay. The City of Chicago refused to release the vehicles back to the debtors and the debtors brought an action to find the city in violation of the stay provision of § 362(a)(3).

In an earlier client alert issued by our firm, we addressed a decision in Michigan which involved a pre-petition garnishment of a bank account. [Prior legal alert available at: Recent Bankruptcy Court Decisions of Statutory Interpretation Reiterate the Importance of Equitable Consideration in Bankruptcy Cases, December 18, 2020]. The same principle applies.

A unanimous court, absent Justice Barrett who had not yet been appointed at the time of oral argument, issued an opinion which turned on whether the applicable section prohibits affirmative acts or something more, such as refusal to turn over property. Applying the principle of plain meaning of the law, they found there was no such violation.

However, the Court left open the question of whether other provisions of the automatic stay might have been used to argue the debtor's position. Moreover, the Court did not address whether using another section of the Bankruptcy Code which provides for turnover of assets, § 542, might have worked better for the debtors.

Justice Sotomayor chose to write a separate concurring opinion highlighting the difference between the letter of the law and the spirit by addressing the turnover provisions of § 542. She also acknowledged the restricted usefulness of § 542 turnover proceedings, since they are time consuming, and suggested that legislatures might want to review that provision so as to do justice for debtors in this position.

Not mentioned within the four corners of the recent opinion is another interesting observation. Other unrelated cases in other courts [e.g., In re Neubert, No. 20-30771-jda, 2020 WL 6950396 (Bankr. E.D. Mich. Nov. 25, 2020)] decided quite recently before the Supreme Court arguments on the Fulton case may have come out differently if final disposition had occurred after the Supreme Court ruled. Clients and their counsel should take note that keeping their cases open through use of appeal when they know certiorari has been granted as to the same issues might be good practice.

Please note that this is a general overview of developments in the law and does not constitute legal advice. Nothing herein creates an attorney-client relationship between the sender and recipient. If you have questions regarding these provisions, or any other aspect of bankruptcy law, please contact Michael Traison at 312.860.4230

Practices

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