

The Automatic Stay: Even Pre-Petition Seizures May Be Covered

July 1, 2019

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Earlier this year, we issued a client alert cautioning our clients to pay close attention to the requirements of the automatic stay provisions of the Bankruptcy code.

The Court of Appeals for the Seventh Circuit recently issued a decision which suggests that this issue may be headed for the United States Supreme Court. The Seventh Circuit's position, which is consistent with the majority rule, held by, among others, the Second Circuit, in which New York lies, represents a further split among Circuits.

The decision affirms appeals of four Chapter 13 bankruptcies (In re: Robbin L. Fulton, In re: Jason S. Howard; In re: George Peake; In re: Timothy Shannon). In each case, the City of Chicago had impounded the respective debtor's vehicle for failure to pay multiple traffic fines prior to the respective petition filing date. In taking possession of the vehicles, the City was invoking an amendment to the local law which allowed it to exercise a possessory lien in the amount required to release the vehicle. The real dispute arose when the City refused to return the vehicles to the Debtors following filing of their Chapter 13 case. The Seventh Circuit boiled the controversy down to one question: was the City obligated to return the debtor's vehicle upon filing of a Chapter 13 bankruptcy petition or is the City entitled to hold said vehicle until the debtor pays the fines and costs or otherwise obtains a court order requiring the City to return the vehicle?

The City proffered multiple arguments and actively requested that the Court overturn the seminal case of Thompson v. General Motors Acceptance Corp., 566 F.3d 699 (7th Cir. 2009), upon which the Court largely relied. The court declined to overturn Thompson and went to far as to say that the City's arguments ignored the purpose of bankruptcy – "to allow the debtor to regain his financial foothold and repay his creditors."

The City took the position that continued possession of the vehicle following what had been a lawful taking did not count as a creditor exercising control of property of the bankruptcy estate, which would violate 11 U.S.C. § 362(a)(3). The Court, in examining the purpose of a 1984 Congressional amendment to § 362(1)(3), determined that the automatic stay provision of the bankruptcy code includes the conduct of "creditors who seized an asset pre-petition" and concluded that the City's retention of the vehicle violated the automatic stay in § 362(a)(3). The City also tried to argue that the vehicle need not be turned over to the debtor unless and until the debtor brings a

turnover action and a resulting order directs same. The Court rejected this argument concluding that the automatic stay provision becomes effective immediately upon filing of the petition. Moreover, the court, citing to § 542(a), states that a creditor in possession of property of the estate shall deliver said property to the trustee and that such turnover of a seized asset is compulsory.

While the opinion is lengthy and may have been prepared for consideration by the Supreme Court in the event that it issues a Writ of Certiorari. A recent change in administration in the City of Chicago, which is expected to result in a more debtor-friendly approach to the handling of Chapter 13 petitions, makes it less likely that the City will petition for review by the Supreme Court.

Nonetheless, this decision is clearly sympathetic to Chapter 13 debtors. It notes that the spirit of the Chapter 13 provisions of the United States Bankruptcy code are to permit a successful re-organization by the debtor and provide a fresh start. This becomes difficult if not impossible if the individual consumer debtor's vehicle has been repossessed.

Given the potentially onerous penalties that can be imposed for violating the automatic stay or for refusing to return property of the estate, our clients are strongly encouraged to seek legal advice when presented with a demand for return.

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](tel:312.860.4230)

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