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City's Retention of Impounded Vehicle Not Violation of Automatic Stay

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Introduction

Upon the filing of a petition under title 11 of the United States Code (the "Bankruptcy Code"), creditors and other parties in interest are generally automatically stayed from taking any action against a debtor or property of the estate.¹ The estate includes "all legal or equitable interests of the debtor in property as the commencement of the case," with some exceptions.² The automatic stay is "one of the most important protections and powerful tools available to a debtor in a bankruptcy."³

It is well established that a creditor cannot take affirmative steps against a debtor or estate property. Prior to the United States Supreme Court's ruling in *City of Chicago v. Fulton* (herein "*Fulton*"), the courts were split as to whether refraining from returning property of the estate seized prior to a bankruptcy filing violated the automatic stay.⁴ In *Fulton*, the Supreme Court held that the city was not required to turn over property of the estate to the debtor in a case where property of the estate, such as a vehicle, had been impounded or repossessed by the city prior to

¹ See 11 U.S.C. §362 (2018).

² See 11 U.S.C. §541(a) (2018).

³ Practical Law Bankruptcy & Restructuring and Practical Law Finance, 'Practice Note: Automatic Stay Overview (2021) <Practical Law> accessed 7 March 2021.

⁴ 141 S.Ct. 585, 585 (2021).

the bankruptcy filing.⁵ “Mere retention of estate property after the filing of a bankruptcy petition does not violate §362(a)(3) of the Bankruptcy Code.”⁶

This memorandum discusses the circuit split that existed prior to the recent Supreme Court’s decision in *City of Chicago v. Fulton*, and the decision itself. Additionally, this memorandum explores what qualifies as a violation of the automatic stay and what remedies are available to those who have suffered from a willful violation of the stay.

I. The Automatic Stay is Not an Affirmative Turnover Obligation

A. The Circuit Split Prior to January 2021

Until January 2021, the circuits were split on whether the failure to act or return estate property violated the automatic stay.⁷ The Second, Seventh, Eighth, Ninth, and Eleventh Circuits supported the majority view that passive conduct violated the automatic stay because the party was exercising control over the property by refusing to return it.⁸ In *In re Fulton*, the Seventh Circuit reasoned that Congress’s inclusion of the language “to obtain possession . . . or to exercise control” hints that control applies to property of the estate that was not in possession of the debtor.⁹ The court also noted that for §363(e) of the Bankruptcy Code to have meaning, an asset that was possessed prior to a bankruptcy filing must be returned to the estate prior to the creditor seeking protection of its interest.¹⁰ The court similarly found that §542(a) indicates that

⁵ *Id.* at 380, 92.

⁶ *Id.* at 392.

⁷ See Practical Law Bankruptcy & Restructuring, ‘Practice Note: Splits of Authority Among Circuit, District, and Bankruptcy Courts Tracker’ (2021) <Practical Law> accessed 7 March 2021.

⁸ *Id.* See e.g., *In re Fulton*, 926 F.3d 916 (7th Cir. 2019), *California Emp’t Dev. Dept. v. Taxel*, 98 F.3d 1147, 1151 (9th Cir. 1996), *Knaus v. Concordia Lumber Co., Inc.*, 889 F.2d 773, 775 (8th Cir. 1989), *Weber v. SEFCU*, 719 F. 3d 72, 81 (2d Cir. 2013).

⁹ 926 F.3d at 923.

¹⁰ *Id.* at 924.

the turnover of a seized asset is compulsory, and to maintain possession of the asset is a violation of the stay.¹¹

The minority view, held by the Third, Tenth, and D.C. Circuits, maintained the use of the word “act” in §362(a) requires an affirmative act, rather than passive retention.¹² The minority view was that failure to return property did not violate the automatic stay.¹³ In *In re Denby-Peterson*, the Third Circuit rejected the Seventh Circuit’s view and looked at the ordinary meaning of the terms “stay,” “act,” and “exercise control,” as used in §362(a)(3).¹⁴ The court determined that §362(a)(3) prohibits creditors from taking affirmative actions to exercise control over property of the estate after a bankruptcy filing.¹⁵ The court held that pre-petition possession and control over a debtor’s asset does not count as a violation of the automatic stay.¹⁶

B. The Supreme Court’s Textual Analysis of §362(a)

This Circuit split was resolved by the Supreme Court in *City of Chicago v. Fulton*.¹⁷ The opinion, authored by Justice Samuel Alito, made the minority view binding law.¹⁸ There, the facts were relatively straightforward. The City of Chicago impounded the vehicles of several individuals for failure to pay fines for vehicle infractions.¹⁹ After filing for Chapter 13 bankruptcy, each individual requested that the City return his or her vehicle.²⁰ In each case, the

¹¹ *Id.*

¹² *Id.* See e.g. *In re Denby-Peterson*, 941 F.3d 115, 126-28 (3d Cir. 2019), *WD Equip., LLC v. Cowen*, 849 F.3d 943, 948 (10th Cir. 2017); *US v. Inslaw*, 932 F.2d 1467, 1474 (D.C. Cir. 1991).

¹³ *Id.*

¹⁴ 941 F.3d at 125.

¹⁵ *Id.*

¹⁶ *Id.* at 126.

¹⁷ 141 S.Ct. 585.

¹⁸ *Id.* at 587.

¹⁹ *Id.* at 589.

²⁰ *Id.*

City refused, and a bankruptcy court held that the City’s refusal violated the automatic stay.²¹ The City appealed in each case and the Seventh Circuit consolidated the cases for purposes of the appeal.²² The Seventh Circuit affirmed the lower courts, and the Supreme Court granted certiorari.²³

Justice Alito’s analysis primarily focused on the language of §362(a), which suggested that “merely retaining possession of estate property does not violate an automatic stay.”²⁴ According to the Court’s analysis of §362(a)(3), the most natural reading of the terms “stay,” “act,” and “exercise control” is that affirmative acts are prohibited. The Court also noted that the term “control” can mean “to have power over,” and omissions can qualify as acts in certain contexts.²⁵ However, the inclusion of the word “act” in the section indicates that Congress intended that exercising power would be an affirmative action rather than merely having a power over something.²⁶ This supports the reasoning that §362(a)(3) implies that “something more than merely retaining power is required to violate the [] provision.”²⁷

Justice Alito resolved any ambiguity in the text of §362(a)(3) in the City’s favor by pointing to §542, which expressly governs the turnover of estate property.²⁸ The Justice noted that reading §362(a) to cover mere retention of property would render the central command of §542 superfluous because §542 is intended to govern turnover of property over to the estate, where §362 governs affirmative actions of removing property from the estate.²⁹ Additionally,

²¹ *See id.*

²² *Id.* at 586.

²³ *Id.*

²⁴ *Id.* at 590.

²⁵ *Id.* (quoting *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699, 702).

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.* at 591.

Justice Alito explained that §542's carve out exception would be inoperable under a reading of §362(a) that would command turnover of precisely what §542 excuses. The Supreme Court concluded that retention of estate property does not violate §362(a)(3) when the property was a collected prior to the filing of a Chapter 13 bankruptcy.

Justice Sonya Sotomayor concurred in the decision and rationale but wrote separately to emphasize that the Court had “not decided whether and when §362(a)'s other provisions may require a creditor to return a debtor's property.”³⁰ Additionally, Justice Sotomayor opined that regardless of whether the City's policy of refusing to return the impounded vehicles satisfied the Bankruptcy Code, it “hardly comports with its spirit.”³¹ For a Chapter 13 bankruptcy to succeed, the debtor must be able to continue earning an income so that the creditors can be compensated, and for many, having a car is essential to maintaining employment.³²

II. Violations of the Automatic Stay

A violation of an automatic stay must be an affirmative action against a debtor, such as the filing of litigation or continuing to litigate against the debtor, obtaining possession or control over estate property, enforcing a lien against the property of the estate or debtor, and any act to collect, recover, or assess a claim against the debtor that arose prepetition.³³ Under the Supreme Court's ruling in *Fulton*, inaction, or failure to return property of the estate to the debtor that was acquired prior to the bankruptcy filing, is not a violation of the automatic stay.³⁴

³⁰ *Id.* at 592.

³¹ *Id.* at 592–93.

³² *Id.* at 593.

³³ Practical Law Bankruptcy & Restructuring and Practical Law Finance, ‘Practice Note: Automatic Stay Overview (2021) <Practical Law> accessed 7 March 2021.

³⁴ 141 S.Ct. at 587.

To establish a prima facie case for damages due to a violation of the automatic stay, the debtor must establish four things.³⁵ First, that they are an “individual” rather than an entity within the meaning of §362(k).³⁶ Second, that the creditor received actual or constructive notice of the debtor’s bankruptcy petition.³⁷ Third, that the creditor intended to carry out the underlying misconduct that violated the stay.³⁸ Fourth, the defendant’s actions caused the plaintiff to suffer a significant resulting injury.³⁹ Once a debtor has successfully shown they suffered an injury, the debtor has the burden of proving the violation was willful.⁴⁰

A. *Willful Violations*

Congress established that when a debtor’s automatic stay is violated, they are able to recover as long as the violation is “willful.”⁴¹ Under §362(k)(1), an individual “injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys’ fees, and in appropriate circumstances, may recover punitive damages.”⁴² A willful violation need not be an act done with specific intent, rather, a willful violation is an act committed intentionally, with knowledge of the automatic stay.⁴³ Violations that are sufficiently willful include a creditor taking “questionable action despite being aware of a pending bankruptcy proceeding.”⁴⁴

³⁵ James L. Buschwalter, J.D., ‘Causes of Action Second Series: 61 Causes of Action 2d 131’ (2020) accessed 7 March 2021.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *See* 11 U.S.C. §362(k)(1) (2018).

⁴² *Id.*

⁴³ Bankruptcy Service, Lawyers Edition, ‘2B Bankruptcy Service L. Ed. §19:1165’ (2021) accessed 7 March 2021.

⁴⁴ *In re Rice*, 613 B.R. 690, 690 (Bankr. N.D. Ill. 2020).

A human clerical or computer error resulting from intentional creditor action is a willful violation of an automatic stay.⁴⁵ Courts have also found that sending a billing statement to a debtor was a willful violation of the stay.⁴⁶ Initiating a collection lawsuit is also a willful violation of the stay and can result in sanctions.⁴⁷ Willfulness requires real or constructive knowledge of a bankruptcy filing, and action on part of the creditor.⁴⁸

III. Remedies and Damages for Violations of the Automatic Stay Provisions

A debtor injured by any willful violation of the automatic stay is entitled to recover compensatory damages, including costs and attorney's fees, injunctive and declaratory relief, and in appropriate circumstances may recover punitive, and emotional damages.⁴⁹ For example, in *In re Harrison*, a lienholder willfully violated an automatic stay by taking steps to finalize a foreclosure sale with the knowledge of the debtor's Chapter 13 filing.⁵⁰ Once the pro-se debtor brought the issue to the Bankruptcy courts attention, the debtor was awarded to out-of-pocket damages consisting of money it would cost to change the locks on the home and on landscaping costs to correct issues that occurred when she was wrongly denied access to the property.⁵¹ A homeowners' association's egregious violation of an automatic stay resulted in \$100,000 in

⁴⁵ See *In re Sciortino*, 561 B.R. 260 (Bankr. N.D. Ga. 2016).

⁴⁶ See 23 A.L.R. Fed. 2d 339, see also *In re Harris*, 374 B.R. 611 (Bankr. N.D. Ohio 2007) (creditor willfully violated stay by sending two billing statements for medical services provided prepetition after receiving notice of debtors filing).

⁴⁷ See *id.* See also *In re Premier Sports Tours*, 283 B.R. 598 (Bankr. M.D. Fla. 2002) (creditor's suit against trustee relating to property of the estate was a willful violation).

⁴⁸ Bankruptcy Service, Lawyers Edition, '2B Bankruptcy Service L. Ed. §19:1165' (2021) accessed 7 March 2021.

⁴⁹ James L. Buschwalter, J.D., 'Causes of Action Second Series: 61 Causes of Action 2d 131' (2020) accessed 7 March 2021.

⁵⁰ 599 B.R. 173 (Bankr. N.D. FL 2019).

⁵¹ See *id.*

emotional distress damages and \$100,000 in punitive damages, along with other compensatory damages.⁵²

An award of damages is not appropriate for a creditor's willful violation of an automatic stay if the debtor did not suffer any out-of-pocket losses or lost income.⁵³ In *In re Morgan*, the lack of evidence of a financial injury destroyed the debtor's prima facie case of a stay violation. "Once a willful violation of the automatic stay is demonstrated that caused harm to the debtor, an entitlement to damages is mandatory as debtors have an 'unequivocal statutory right' to prove actual damages after a willful violation of automatic stay, including the recovery of costs and attorney's fees."⁵⁴

Conclusion

The automatic stay has a "twofold" purpose: " (1) to protect the debtor, by stopping all collection efforts, harassment, and foreclosure actions, thereby giving the debtor a respite from creditors and a chance 'to attempt a repayment or reorganization plan or simply be relieved of the financial pressures that drove him [or her] into bankruptcy;' and (2) to protect 'creditors by preventing particular creditors from acting unilaterally in self-interest to obtain payment from a debtor to the detriment of other creditors.'⁵⁵ To violate the stay, the violator must have actual or constructive knowledge of the bankruptcy petition and act anyways.⁵⁶ Affirmative action, like seizing a vehicle post-bankruptcy filing, would violate the automatic stay. In contrast, inaction,

⁵² See *In re Rivera*, 511 B.R. 6 (Bankr. D. P.R. 2014).

⁵³ *In re Morgan*, 547 B.R. 185 (Bankr. W.D. Va. 2016).

⁵⁴ James L. Buschwalter, J.D., 'Causes of Action Second Series: 61 Causes of Action 2d 131' (2020) accessed 7 March 2021, citing *In re Vazquez Laboy*, 647 F.3d 367 (1st Cir. 2011).

⁵⁵ *In re Denby-Peterson*, 941 F.3d at 122.

⁵⁶ Bankruptcy Service, Lawyers Edition, '2B Bankruptcy Service L. Ed. §19:1165' (2021) accessed 7 March 2021.

like retaining an impounded vehicle of a debtor that was seized prior to the bankruptcy filing, would not violate the automatic stay.⁵⁷

⁵⁷ City of Chicago v. Fulton, 141 S.Ct. at 589.