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Supreme Court Rules That "Mere Retention" of Property Does Not Violate Bankruptcy Code's Automatic Stay Provision

On January 14, 2021, the U.S. Supreme Court unanimously held that the City of Chicago did not violate section 362(a)(3) of the Bankruptcy Code, one of the many "automatic stay" provisions designed to protect debtors in bankruptcy, when it retained and refused to return the debtors' impounded motor vehicles following their bankruptcy filings. The Supreme Court's decision reversed a decision by the U.S. Court of Appeals for the Seventh Circuit, and resolved a long-standing circuit split on the issue.

The Court of Appeals held that the City of Chicago's practice of withholding debtors' impounded motor vehicles was an "exercise" of "control" over the vehicles that was "stayed" upon the debtors' bankruptcy filings. When the City refused to return the vehicles upon request, the Seventh Circuit found that the City violated Code section 362(a)(3), and imposed monetary sanctions. The effect of the ruling was to require creditors to automatically return a debtor's previously seized property upon a bankruptcy filing, even where, as in these cases, the debtor has not requested "turnover" using the Code provision that specifically addresses such matters, section 542(a).

Writing for an eight-justice Court (the case was argued before Justice Amy Coney Barrett took the bench), Justice Samuel Alito observed that the most logical reading of section 362(a)(3)'s "stay" of "acts" to "exercise control" over a debtor's property is to prohibit "affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed." Reading section 362(a)(3) to cover "mere retention of property" would create at least two serious problems. First, because Code section 542 already requires a creditor to "deliver" to the trustee and "account for" property of the debtor's estate, the Seventh Circuit's reading of section 362(a)(3) would render section 542(a) largely superfluous. Second, the Seventh Circuit's holding would render the commands of Code sections 362(a)(3) and 542(a) contradictory: the automatic turnover of property required by section 362(a)(3) could affect property that is expressly exempt from the turnover obligation under Code section 542(a). The Court expressly declined to address the meaning of other subsections in section 362(a).

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In a concurring opinion, Justice Sotomayor emphasized the limited nature of the Court's ruling—as Justice Alito acknowledged, other subsections of section 362(a) were not addressed—and suggested that the City's conduct may well violate one or more of these other provisions. She also called attention to the difficult circumstances many debtors face in such situations: debtors in bankruptcy need their vehicles to get to work, among other things, where they can earn money needed to pay their debts to creditors. Still, Justice Sotomayor emphasized that bankruptcy courts are not powerless to facilitate the return of impounded vehicles, noting section 542(a) in particular, and that Congress could pass legislation to assist debtors in these situations, or the Federal Rules of Bankruptcy Procedure might be changed to make "turnover" actions under section 542(a) less costly and time-consuming.

For additional information on this case, the automatic stay, or any of your insolvency-related needs, please contact Frank DiCastri, Sara McNamara or another member of Reinhart's bankruptcy and Insolvency Team.

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