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Cordova v. City of Chicago: Another Round for the Second City

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By now we know, or should know, what the U.S. Supreme Court said in *City of Chicago v. Fulton*.[1] The Court concluded that the most natural reading of the terms "stay," "act" and "exercise control" is that § 362(a)(3) of the Bankruptcy Code "prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed."[2] Saying that a person engages in an "act" to "exercise" his/her power over a thing communicates more than merely "having" that power, so something more than merely retaining power is required to violate the automatic stay imposed by § 362(a)(3).[3]

The Court held that any ambiguity in the text is "resolved decidedly in the City's favor" by the existence of the turnover provision, § 542(a). Reading § 362(a)(3) to cover mere retention of property would render the "central command of § 542 largely superfluous" by making § 362(a)(3) a "blanket turnover provision." It would further render the commands of both sections "contradictory" because § 542(a) excepts turnover of property that is "of inconsequential value or benefit to the estate," but § 362(a)(3) would command turnover all the same.[4]

We also know what the Court did not say in *Fulton*. Most notably, it did not address the other subsections of § 362(a): "Nor do we settle the meaning of other subsections of § 362(a)."[5] Do we need circuit-level or Supreme Court decisions for each of the other subsections of § 362(a) to find our way? Let's hope not, as there are seven of them. However, the recent decision in *Cordova v. City of Chicago (In re Cordova)* suggests that the automatic stay/turnover litigation is only just beginning.[6] For the City of Chicago, there must be a feeling of *déjà vu*.

Vehicle Impoundments in Chicago: Here We Go Again

Like the debtors in *Fulton*, the plaintiffs in *Cordova* (a putative class-action proceeding) had their vehicles impounded by the City of Chicago for unpaid municipal fines, each filed a chapter 13 case afterward, and each demanded return of his/her vehicle. The city did not refuse outright, but attempted to condition return of the vehicles on the payment of money and the treatment of its claims as fully secured. This may sound like an "act to collect" or an act to "enforce" a lien in violation of § 362(a)(4) or (6), but the city argued that it was merely demanding adequate protection of its interests, a right afforded by § 363(e).

The U.S. Bankruptcy Court for the Northern District of Illinois held that the plaintiffs had sufficiently pleaded claims for violations of §§ 362(a)(4) and (6) and 542(a) and actual damages arising therefrom, notwithstanding the Supreme Court's decision in *Fulton*.[7] The court rejected the city's argument that *Fulton*'s § 362(a)(3) rationale controls the outcome, as a matter of law, under § 362(a)(4) or (6).[8] The court further held that plaintiffs' claims for violations of § 542(a) survive motions to dismiss, leaving for another day the question of whether a chapter 13 debtor is authorized to enforce § 542(a) in the first instance.[9] Although the final outcome in *Cordova* remains to be determined, there are several preliminary observations worthy of discussion.

How Far Does the Rationale in *Fulton* Extend?

Several courts have addressed *Fulton*'s impact on claims for violations of § 362(a)(4) and (6). For example, in *In re Stuart*, the Ninth Circuit Bankruptcy Appellate Panel held that a creditor did not violate any of § 362(a)'s subsections by declining to vacate a pre-petition attachment.[10] A similar conclusion was reached in *Margavitch v. Southlake Holdings LLC (In re Margavitch)*.[11] For the most part, these courts addressed the statutory language head-on.

1 141 S. Ct. 585 (2021).
2 Section 362(a)(3) stays "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."
3 141 S. Ct. at 590.
4 *Id.* at 590-91. Section 542(a) requires that an entity in possession of "property that the trustee may use, sell, or lease under section 363 ... shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate."
5 *Id.* at 592.
6 No. 19-AP-684, 2021 WL 5774400 (Bankr. N.D. Ill. Dec. 6, 2021).
7 The *Cordova* plaintiffs requested actual damages, attorneys' fees, costs of litigation, accounting for the value of plaintiffs' loss of property, and punitive damages of $5 million. *Cordova*, 2021 WL 5774400, at *5.
8 Section 362(a)(4) stays "any act to create, perfect, or enforce any lien against property of the estate." Section 362(a)(6) stays "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title."
9 The bankruptcy court also held that § 106(a)(3) of the Bankruptcy Code barred plaintiffs' request for punitive damages against the city, and dismissed plaintiffs' claim for alleged violations of § 362(a)(7) without prejudice. *Cordova*, 2021 WL 5774400, at *20-21, 23. Section 362(a)(7) stays "the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor."
10 632 B.R. 531 (B.A.P. 9th Cir. 2021).
11 No. 5:20-00014, 2021 WL 4597760 (Bankr. M.D. Pa. Oct. 6, 2021).

In *Cordova*, the court declined to do a "deep dive" on the similarities and differences between the statute at issue in *Fulton*, § 362(a)(3), and the statutes utilized by the *Cordova* plaintiffs, at least in part because the litigation had only reached the motion-to-dismiss stage. The court observed that the phrase "exercise control," found in § 362(a)(3) and addressed in *Fulton*, does not appear in § 362(a)(4) or (6). Beyond this rather obvious distinction, the court would only conclude that there are "plausible readings" of § 362(a)'s other subsections "that do not preclude [the] Plaintiffs' Complaint," and that there are "grounds upon which relief may be granted."[12] What those "plausible readings" are, or the "grounds" upon which relief may be granted, the court did not expressly say. However, the court suggested channeling Justice Sonia Sotomayor's concurring opinion in *Fulton* and her citation to *In re Kuehn*, a college transcript case, that the facts in *Cordova* may eventually reveal the city's *motive* in withholding the impounded vehicles.[13]

The implication is that a creditor's motive should be considered to determine whether the creditor has taken an "act" to enforce a lien or an "act" to collect. Here, the bankruptcy court might have discussed the Supreme Court's reading of the words "stay" and "act" in *Fulton*. The Supreme Court interpreted § 362(a)'s "stay" of an "act" to prohibit an "affirmative" act that would "disturb the status quo." Subsections (a)(4) and (6) use the same words — "stay" and "act" — so it begs the question of whether a creditor has engaged in an affirmative act that disturbs the status quo when it refuses to return previously seized property, even if the motive is to enforce a lien or collect a debt.

The bankruptcy court may ultimately conclude that failing to return a debtor's property is itself an "affirmative" act to enforce a lien or collect a debt, and perhaps the "status quo" will appear less relevant when the motive is clear. However, the court should have clarified, at a minimum, that a request for adequate protection does not, by itself, constitute an "act" to collect a debt or to enforce a lien in violation of § 362(a)(4) or (6).

Turnover Without Protection?

In *Cordova*, the court did not much like the city's § 542 argument, labeling it "specious" and admonishing the city in that it "can and should do better."[14] The city argued that it was not obligated to return the debtors' vehicles absent an adversary proceeding to compel turnover, and that it was enough to raise adequate protection as an affirmative defense to the complaint.

The latter argument presents an interesting question under § 363(e), which requires that a creditor seeking adequate protection of an interest in the debtor's property actually "request" that protection.[15] Is it enough to make that "request" in the form of an affirmative defense? Rule 4001(a)(1) of the Federal Rules of Bankruptcy Procedure suggests otherwise: "[A] motion to prohibit or condition the use, sale, or lease of property pursuant to § 363(e) shall be made in accordance with Rule 9014." If an affirmative defense were enough, it would exacerbate the perceived problem of a delayed remedy under § 542: Adversary proceedings will likely delay the return of debtors' vehicles and increase litigation costs. This appears to be the plaintiffs' complaint in *Cordova*: "The Plaintiffs argue that the City intentionally and strategically refuses to file a motion for relief from the automatic stay or a motion for adequate protection so that chapter 13 debtors fail to complete their plans and the City may then proceed to collect the entire debt owed to it."[16] (Interestingly, when the city raised its adequate-protection defense in its motion to dismiss, the court declined to reach the issue, stating that the city raised the issue "prematurely.")[17]

The city's former argument presents a question that was also briefed in *Fulton*: Is § 542(a) "self-executing," as many claim? If so, what does that mean? To be sure, § 542(a) requires that an entity in possession of estate property "shall" deliver that property to the debtor unless it is of inconsequential value to the estate. However, when an entity requests adequate protection of its interest, and no such protection is provided, is the creditor required to return the property first and seek relief later? In *Cordova*, the court seemed to think so, stating that it is "tautological" that compliance with § 542(a) is required even absent a court order, and listing the parade of horribles that would follow if a party compelled to act by a statute "could avoid its statutory duties until ordered to comply."[18]

Although it is clear that adequate protection is the intended bankruptcy substitute for the creditor's nonbankruptcy right of possession, neither the Bankruptcy Code nor Rules expressly state which party is required to act first in the game of "chicken" that ensues when the creditor seeks adequate protection of its interest.[19] Still, it hardly seems "tautological" that a creditor is required to relinquish possession without protection when the plain language of § 363(e) is considered. Section 542(a) explicitly references § 363, and § 363(e) states that the court "shall" prohibit or condition the use, sale or lease of property that is "used, sold or leased, or *proposed* to be used, sold or leased," by the debtor "as is necessary to provide adequate protection of such interest."[20]

Logically, a debtor who does not possess property when a bankruptcy case is filed can only "propose" to use that property; it cannot actually "use" it without first obtaining possession. This might suggest the proper ordering of the available rights and remedies: A debtor demands the property's return (proposing to use it), a creditor requests adequate protection (seeking to prohibit or condition the proposed use), and the court decides, either by creditor's motion or debtor's adversary complaint. By all accounts, it would be better to decide the adequate-protection issue promptly, especially when a debtor's vehicle has been impounded.

12 2021 WL 5774400, at *15-16.
13 *Id.* at *10, *15.
14 *Id.* at *21-22.
15 Section 363(e) provides that, "on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest."
16 2021 WL 5774400, at *5.
17 *Id.* at *22.
18 *Id.* at *22, *21 ("Debtors would be free to fail to file the documents required under section 521. Creditors would be free to act in violation of the automatic stay. Taxpayers could avoid paying their taxes.").
19 *U.S. v. Whiting Pools Inc.*, 462 U.S. 198, 204, 207 (1983) ("The Bankruptcy Code provides secured creditors various rights, including the right to adequate protection, and these rights replace the protection afforded by possession.").
20 11 U.S.C. § 363(e) (emphasis added).

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Does Either § 362(a) or 542(a) Provide Debtors an Immediate Remedy?

The bankruptcy court may have avoided a thorough analysis of *Fulton* for the time being, but it had plenty to say about the potential problems that § 362(a) presents for debtors. An entire section of its opinion explains how the city's interpretation of § 362(a)(4) and (6) "leaves debtors with virtually no immediate remedy" and "removes the simplest and most direct method of compelling recalcitrant creditors to comply with their statutory duties."[21] Actions under § 542(a) "will result in delay in comparison to an action under section 362," and the result advocated by the city "does not comport with the spirit of the Bankruptcy Code."[22]

The bankruptcy court admitted that "the ultimate fix to these issues is a legislative one," but declared that it is "not so naïve as to assume that any such fix will be implemented soon, if at all. There are clear errors in the Bankruptcy Code that Congress has yet to fix despite being known for decades."[23] "What the court can do," it explains, is "refuse to adopt in the context of a motion to dismiss a reading of *Fulton* that is so expansive that it eliminates clear and obvious remedies against recalcitrant creditors."[24]

The court's concerns may be understandable, particularly where a debtor's means of transportation is at stake, but recall that many courts and litigants expressed similar concerns when applying § 362(a)(3) before *Fulton*. Yet in *Fulton* the Supreme Court applied the Code's plain language to conclude that § 542(a) — not § 362(a)(3) — is the proper means for obtaining turnover of estate property. Even Justice Sotomayor, who wrote the lone concurrence expressing concern about the delays caused by turnover proceedings, concluded that "any gap left by the Court's ruling today is best addressed by rule drafters and policymakers, not bankruptcy judges."[25]

More to Come

The bankruptcy court's comments in *Cordova* highlight the continuing perception that § 542(a) does not do enough for debtors when they are confronted with a creditor that refuses to return previously seized property. Is this a tacit admission that, as drafted, § 362(a)(4) and (6) are similarly inadequate? Stay tuned for the final word on *Cordova*. In the meantime, it appears that the City of Chicago will be litigating these issues for the foreseeable future. abi

21 2021 WL 5774400, at *16.
22 *Id.* at *16, *18.
23 *Id.* at *18.
24 *Id.*
25 141 S. Ct. at 595. Justice Sotomayor noted that it is "up to the Advisory Committee on Rules of Bankruptcy Procedure" to consider amendments to the Rules, and that "Congress, too, could offer a statutory fix." *Id.*