SCOTUSblog
SUPREME COURT OF THE UNITED STATES BLOG

Case preview: Squaring impoundment with federal bankruptcy procedure

October 12th, 2020

Danielle D'Onfro

The Supreme Court will hear argument Tuesday in *City of Chicago v. Fulton*. The court originally scheduled *Fulton* for the April 2020 sitting but postponed the argument when the coronavirus pandemic closed the court. This case asks the court to resolve how impoundment interacts with bankruptcy procedure. As with so many of these consumer bankruptcy cases, the text of the U.S. Bankruptcy Code and the Federal Rules of Bankruptcy Procedure is difficult to square with bankruptcy's so-called fresh start policy: the idea that bankruptcy should provide borrowers with comprehensive relief from their debts. Beyond the familiar conflict between the Bankruptcy Code and bankruptcy policy, this case is a small window into "taxation by citation," the practice of municipalities filling budget gaps through fines and fees, usually imposed on the most vulnerable residents.

The case arises out of four separate bankruptcy cases that were consolidated on appeal before the U.S. Court of Appeals for the 7th Circuit. Each of these cases began with the city of Chicago impounding a car for non-payment of various fines and fees, many related to traffic and parking violations. After the city impounded each car, the vehicle owner filed for bankruptcy and sought to have Chicago return the car. Critically, the debtors all filed for bankruptcy protection before Chicago could sell the vehicles, meaning that they remained the owners of the cars although Chicago possessed the cars. The parties disagree about what the Bankruptcy Code required Chicago to do with the cars after it received notice of the bankruptcy filings.

Chicago's obligations to the debtors turn on how two provisions of the Bankruptcy Code interact. The first is the automatic stay in § 362, which pauses all collection activity against debtors to prevent creditors from racing to consume debtors' assets before any relief can occur. With a few exceptions, § 362 stays collection activity automatically when the debtor files for bankruptcy protection. Creditors who continue collection activity after the stay is in place risk sanctions.

Here, the debtors argue that § 362(a)(3) required Chicago to return the cars to them as soon as the stay went into effect. This provision bars two kinds of conduct: "any act" either to "obtain possession of property of the estate or of property from the estate" or to "exercise control over property of the estate." The debtors argue that passively retaining property impounded before bankruptcy is an "act" to "exercise control over property of the estate." The U.S. Courts of

Appeals for the 2nd, 8th, 9th, 11th and now the 7th Circuits have adopted this reading of § 362(a)(3).

The city argues that the analysis of its obligation to return the cars to the debtors cannot stop at § 362(a)(3). Instead, they argue that § 542(a) governs. Section 542(a) provides that "an entity … in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease … shall deliver to the trustee … such property or the value of such property unless such property is of inconsequential value or benefit to the estate."

The city argues that the "shall deliver" language is not self-executing. Rather, as the U.S. Courts of Appeals for the 10th and District of Columbia Circuits have held, it is an obligation to turn over the property if and when the trustee files an adversary proceeding seeking the property. The Federal Rules of Bankruptcy Procedure, which are the bankruptcy analog to the Federal Rules of Civil Procedure, explain that "a proceeding to recover money or property, other than a proceeding to compel the debtor to deliver property to the trustee," is an adversary proceeding governed by Rule 7001. The city and the United States — which filed a "friend of the court" brief supporting the city — argue that § 362 freezes the status quo — here, leaving the cars impounded — and then trustees must proceed under § 542 and Rule 7001 to recover the property.

Both the briefs of the city and federal government focus on the simple textualism of the kind that the Supreme Court often finds attractive. Both argue that the court must read the Bankruptcy Code as a statutory scheme. While it may be possible to read Chicago's continued possession of the debtors' cars as an "act" to "exercise control over property of the estate" in violation of the stay, doing so would render § 542 superfluous. In this larger scheme, they argue, § 542 must be separated from § 362 to preserve the various exceptions and defenses to turnover enshrined in the code.

Chicago and the United States emphasize that the Bankruptcy Code reflects a "balance" between providing relief for the debtor and honoring creditors' rights. One such exception is in § 542's provision that debtors need not turn over property "of inconsequential value or benefit to the estate." More importantly for creditors, they argue that because § 542(a) only applies to property that is either usable under § 363 or exempt from the reach of creditors under § 522, creditors can insist on adequate protection — objective assurance that collateral property will not depreciate while being used by the debtor or trustee — before turning over the property.

Moreover, the city and its amici contend that the court has already determined that § 542(a) permits creditors to remain in possession of debtors' property notwithstanding § 362 in the bankruptcy chestnut *United States v. Whiting Pools, Inc.* In *Whiting Pools*, the IRS seized the debtors' property to satisfy a tax lien. The debtor responded by seeking bankruptcy protection and relying on § 542 to force the IRS to return the property before it could proceed with a tax sale. In holding that § 542 mandated that the IRS turn over the property, the court at no point contemplated that the IRS had already violated the automatic stay by not returning the property upon the commencement of the bankruptcy case. The debtors in this case, and their amici, have an opposite interpretation of *Whiting Pools*, arguing that it shows that § 542 is self-executing.

Chicago argues that the court reaffirmed the view that § 362 does not govern § 542 in Citizens Bank of Maryland v. Strumpf. In *Strumpf*, the debtor argued that a creditor bank violated the automatic stay when it placed an administrative hold on its account after the debtor filed for bankruptcy. There, § 542(b) compelled the bank to "pay" the trustee any "debt that is property of the estate and that is matured, payable on demand, or payable on order … except to the extent that such debt may be offset under section 553." Section 553 governs setoff. The Supreme Court concluded that "it would be foolish to take the § 553(a) 'except' clause as indicating that § 362(a)(7) requires immediate payment of a debt subject to setoff." Despite the debtors' efforts here, it is difficult to imagine the current court distinguishing the facts of these cases from *Strumpf*.

The United States goes one step further than the city and argues that even if the "shall deliver" language in § 542 is self-executing, it need not also be a violation of § 362. The remedy for violating § 542 is contempt, while the remedy for violating § 362 is monetary. Indeed, § 342(g) explicitly provides that "[a] monetary penalty may not be imposed on a creditor for a violation of a stay in effect under section 362(a) (including a monetary penalty imposed under section 362(k)) or for failure to comply with section 542 or 543 unless the conduct that is the basis of such violation or of such failure occurs after such creditor receives notice effective under this section of the order for relief." The United States explains that the use of the disjunctive shows that § 542 does not rely on § 362 for enforcement.

Represented by a well-respected retired bankruptcy judge, Eugene Wedoff, the debtors also begin their argument in the text of the statute. Relying on the word "shall" in § 542(a), they explain that § 362 enforces the mandates in § 542. In their view, Congress could have inserted something like "after entry of a court order" into § 542 if its use of the word "shall" was not meant to be self-executing.

Next, their argument turns on the failure to do something being an "act" within the meaning of § 362. In arguing that retaining property is an act, the debtors have several strong amici to bolster their arguments. Professors John Pottow and Jay Westbrook, two experts on bankruptcy law, put it best when they explain that "*the City's conduct — refusing to take action until the debtor's debt is repaid — is literally a textbook example of an automatic stay violation*. It is 'an act to collect, assess, or recover a claim'" (emphasis in the original). They caution that distinguishing between active and passive conduct for automatic stay violations would yield ridiculous results. Pottow and Westbrook also make the case that reading Chicago's retention of the cars as a stay violation does not render § 542(a) superfluous. The key, they argue, is that § 542(a) imposes a duty to account for the debtors' property. Thus, even if the creditor abandoned the property without violating the stay, § 542 would make the creditor liable to the estate for the value of the property.

Bankruptcy policy and common sense likely favor the debtors. Making trustees file law adversary proceedings as a condition for recovering property to which they are entitled is wasteful. As Pottow and Westbrook point out, "Every burden placed on panel trustees means delay and expense for the unsecured creditors within a limited-resource bankruptcy estate where, by definition, there is not enough money to go around." The weight of the amici echoes this

point. The bankruptcy is likely better served by returning the property to the trustee and allowing the creditor to file a routine motion to lift the stay — which Pottow and Westbrook call "the bread and butter of bankruptcy court litigation" — if they question whether their property is adequately protected.

An amicus brief in support of the debtors from diverse groups such as the American Civil Liberties Union, the Cato Institute, the Fines and Fees Justice Center, and the Institute for Justice, among others, situates this case in the moment. There is an ugly history of municipalities raising revenue from their poorest residents through aggressive fines and fees with little credible nexus to public safety. According to amici, in 2018, 11% of Chicago's general budget came from fines and fees. As the brief explains, "Chicago levies exorbitant fees for impounding, towing, and storing vehicles, and refuses to return vehicles to their owners without full payment of all money owed." Never mind that Chicagoans may need their vehicle to work for the wages that might pay the fines. In this context, returning the vehicle to the borrower without extra hoops and delay is all the more urgent. Compelling policy notwithstanding, this case looks like another narrow, statutory fight.