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7th Circ. Misinterprets 'Active Resistance' In Ch. 13 Stays

By **Frank DiCastri and Lindsey Greenawald** (August 27, 2019, 4:03 PM EDT)

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Section 362(a)(3) of the Bankruptcy Code provides that a bankruptcy petition "operates as a stay, applicable to all entities, of ... any act ... to exercise control over property of the estate."

For decades, the federal circuit courts have struggled to interpret this automatic stay provision when it is applied to a creditor that arguably takes no affirmative steps to "exercise control" over property of the estate, but rather simply refuses to deliver such property on demand.

The issue has arisen most frequently with car repossessions or impoundments, but as a practical matter can arise any time the creditor commits no new "act" upon the filing of a bankruptcy petition but instead maintains the same "position of refusal" that it held before the bankruptcy filing. The resulting circuit split has produced much debate, from scholarly analysis to running commentary, and litigation continues unabated, even when the relevant circuit court appears to have decided the issue.

So it was in In re Fulton, consolidated cases recently decided by the U.S. Court of Appeals for the Seventh Circuit.[1] While defending its practice of impounding motor vehicles for unpaid parking tickets or other violations of law, the city of Chicago asked the Seventh Circuit to overrule its decade-old decision in Thompson v. General Motors Acceptance Corp., which established the rule that "the act of passively holding onto an asset constitutes 'exercising control' over it, and such action violates Section 362(a)(3) of the Bankruptcy Code."[2]

The Seventh Circuit refused to overrule Thompson, but instead reaffirmed it in every respect while concluding, like the bankruptcy courts below, that the city violated Section 362(a)(3), and should be sanctioned, for refusing to return previously seized motor vehicles.

The Seventh Circuit's holding, while not changing the law in that circuit, added to the growing list of appellate decisions that are in conflict, most notably with the U.S. Court of Appeals for the Tenth Circuit's recent decision in WD Equipment LLC v. Cowen (In re Cowen), where the Tenth Circuit found that a creditor does not violate Section 362(a)(3) by refusing to return previously seized property.[3]

So the decision in Fulton is less remarkable for its result, which is consistent with Thompson, and more for its rationale, particularly coming on the heels of Cowen and the Seventh Circuit's recent pronouncements concerning a court's duty to interpret the words of a statute in context.

In this article, the authors explore the Seventh Circuit's use of accepted principles of statutory interpretation to interpret Section 362(a)(3), and conclude that when all of Section 362's relevant words and phrases are considered, as they must be, there is good reason to doubt the rationale in Fulton, if not its outcome.

Parking Tickets, Petitions and Sanctions

Chicago's municipal laws authorize the city to impound a motor vehicle for multiple determinations of municipal liability, including parking and speeding violations, and once impounded, the vehicle is subject to a statutory possessory lien in favor of the city in the amount of the unpaid fines.

All four Chapter 13 debtors in Fulton had their vehicles impounded shortly before they filed bankruptcy, and in each case, the bankruptcy court found that, by not returning a vehicle to the debtor upon post-petition request, the city violated Section 362(a)(3) and should be sanctioned for its obstinacy. In none of the cases did the city file a motion for adequate protection of its interest under Section 363(e).

The Second City Appeals to the Seventh Circuit

The city appealed the bankruptcy courts' orders, and the Seventh Circuit issued its decision on June 19. Framing the issue before it as "whether the city is obligated to return a debtor's vehicle upon her filing of a Chapter 13 bankruptcy petition, or whether the city is entitled to hold the debtor's vehicle until she pays the fines and costs or until she obtains a court order requiring the city to turn over the vehicle," the Seventh Circuit immediately launched into a discussion about the meaning of the phrase "exercise control."[4]

The Seventh Circuit held (as have other circuits holding the "majority" view), relying heavily on its decision in Thompson, that refusing to return property of the estate constitutes an exercise of control over that property.[5] In the eyes of the Seventh Circuit, this meant victory for the debtors: the city violated Section 362(a)(3) and sanctions were appropriate.

The Seventh Circuit bolstered its conclusion by citing "bankruptcy's purpose" ("to group all of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts") and by analyzing the legislative history of Section 362.[6]

The Seventh Circuit also concluded that Section 362(a)(3) is effective immediately upon the filing of a bankruptcy petition, and does not require a debtor to first bring a turnover action under Section 542. Because the burden is on the creditor to seek adequate protection under Section 363(e), and Section 542 makes turnover mandatory, the latter works "in conjunction with" Section 362(a) to draw back into the estate a right of possession:

> [t]hus, contrary to the City's argument, the status quo in bankruptcy is the return of the debtor's property to the estate. In refusing to return the vehicles to their respective estates, the City was not passively abiding by the bankruptcy rules but actively resisting [Section]542(a) to exercise control over debtors' vehicles.[7]

Does Section 362 Plus Section 542 Equal Automatic Turnover?

If there is one thing to remember about the bankruptcy courts' rulings, and the Seventh Circuit's decision on appeal, it is this: the city was found to have violated Section 362(a)(3) and was sanctioned for it.

In other words, these were not Section 542 cases because no turnover actions were filed.[8] Nor were they Section 363(e) cases, because the city never sought adequate protection of its interests. So, arguably, the only questions to be answered on appeal were: (1) Did the city violate Section 362(a)(3); And (2), if so, should the city be sanctioned for it?

To be clear, the facts in Fulton called for a thorough analysis of Section 362(a)(3); only months before, in an en banc decision, the Seventh Circuit clarified its duty to interpret the words of a statute in context:

> time and again the [U.S.] Supreme Court has instructed that statutory interpretation requires reading a text as a whole, and here that requires that we refrain from isolating two words when the language surrounding those two words supplies essential meaning and resolves the question before us.[9]

Yet in Fulton, a three-judge panel of the Seventh Circuit chose to focus on two words, "exercise control," to the exclusion of "stay" and "act." As the Tenth Circuit did in Cowen, the Seventh Circuit should have determined the meaning of "stay" and "act" because each is found in the same sentence as, and each influences the meaning of, "exercise control": "a petition ... operates as a stay, applicable to all entities, of ... any act ... to exercise control over property of the estate."

Read in isolation (which is contrary to established principles of statutory interpretation), "exercise control" sounds broad enough to include continued possession, but the question facing the Seventh Circuit was whether that continued possession is an "act" that is "stayed" by Section 362. When all three of these words and phrases are read together — "stay," "act" and "exercise control" — the Seventh Circuit's conclusion appears more difficult to justify.

The concept of a "stay" is built on a foundation of "restraint."[10] Inherently, a "stay" (as used in this context) prevents or suspends an event, in this case temporarily.[11] The Tenth Circuit found that the automatic stay serves as a restraint only — "stay means stay, not go."[12]

"Act" typically means to "do something."[13] The analysis could stop there, as the Tenth Circuit did in Cowen, on grounds that passively holding onto an asset is not "doing something." But for the sake of argument, let us assume that refusing to do something is itself an "act" — that by refusing to accede to the debtors' demands for their vehicles, the city engaged in "acts" to "exercise control" over those vehicles.

Nevertheless, if "stay" means "restrain" and an "act" includes passively holding onto an asset, it logically follows that Section 362(a)(3) restrains a creditor from continuing to possess a debtor's property. In other words, Section 362(a)(3)'s true meaning is this: the creditor must return property of the estate to the debtor.

But a "stay" of an "act" to "exercise control" is an unusually awkward way for Congress to say that a creditor must "automatically turn over" property, particularly when there is a separate statute to

address turnover (Section 542), and a separate mechanism to enforce that statute (Section 105). Such an interpretation is, in a real sense, reading a double negative into Section 362: "You are restrained (or stayed, or prohibited) from refusing to give me what I want."

So the Seventh Circuit appears to have violated its and the Supreme Court's rules of statutory interpretation by not scrutinizing all of the relevant words and phrases in Section 362(a)(3), but it may have compounded the error by not analyzing other sections of the code.

Perhaps the Seventh Circuit should have considered Sections 362(a)(1) and (a)(8), which provide for a stay of the "continuation" of certain proceedings against the debtor. Clearly Congress anticipated that a creditor would "continue" creditor-like behavior initiated before the bankruptcy filing, but it chose not to use any variation of the word "continue" in Section 362(a)(3).[14]

Then there is the concept of "withholding," as in withholding property of the debtor's estate. Here Section 362 has a lot to say, but only in respect of exceptions to the general stay rules. A bankruptcy petition does not act as a stay of the "withholding" of income for payment of a domestic support obligation (Section 362(b)(2)(C)), or the "withholding" or even "restriction" of a driver's license (Section 362(b)(2)(D)), or the "withholding" of wages for a pension plan (Section 362(b)(19)). Did Congress intend to prevent the withholding of estate property in Section 362(a)(3) without using the obvious word?

In the end, none of these comparisons yields dispositive evidence of the meaning of Section 362(a)(3), but the point is that Congress had much easier ways to require "automatic turnover," if that were the intent, than the clumsy combination of "stay," "act" and "exercise control."

Behold Section 542, where Congress explicitly mandated "turnover," "deliver[y]" and "account[ing]" for property of the debtor.[15] The Seventh Circuit tries to bridge the language gap between Sections 362 and 542 by declaring that Section 362 must be read together with Section 542, even though there is no express statutory link between the two sections.[16]

In the words of the Seventh Circuit, the city "actively resist[ed] Section 542(a) to exercise control over debtors' vehicles."[17]

Debtors have clear statutory authority to file a turnover action pursuant to Section 542, and the turnover is mandatory. In turn, the creditor may seek adequate protection of its interest pursuant to Section 363(e). But this sequence of events produces a result that is unpalatable to some, including the Seventh Circuit, perhaps because it places the burden on the debtor to spend the time and money necessary to retrieve its property.

According to the Seventh Circuit, the creditor with possession has "no incentive" to seek protection of its interests under Section 363(e) even though it has the burden to do so under that section. For Section 363(e) to "have meaning," so the argument goes, the asset must be returned first, and the creditor can ask questions later.[18]

But again, whether the creditor or the debtor is required to act first under Sections 363 and 542 would appear to say little about whether the creditor violated Section 362(a)(3), the only statute that was truly implicated in Fulton.

Conclusion

The Seventh Circuit rightly could be criticized for failing to adhere faithfully to the Supreme Court's canons of statutory interpretation. Is the failure deliberate, in order to achieve an outcome perceived to be consistent with the "purpose of bankruptcy"?

If so, the Supreme Court recently rejected such judicial aspirations with a broad admonition: "The Code of course aims to make reorganizations possible. But it does not permit anything and everything that might advance that goal."[19] And if there is an imbalance of power, Congress could simply amend Section 362(a)(3).

For now, and until the Supreme Court resolves the circuit split, the concept of "active resistance" lives on in the Seventh Circuit.

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[1] 926 F.3d 916 (7th Cir. 2019).

[2] 566 F.3d 699, 703 (7th Cir. 2009).

[3] 849 F.3d 943 (10th Cir. 2017).

[4] Fulton, 926 F.3d at 923.

[5] See also In re Weber, 719 F.3d 72 (2d Cir. 2013); In re Knaus, 889 F.2d 773 (8th Cir. 1989); In re Del Mission Ltd., 98 F.3d 1147 (9th Cir. 1996).

[6] Fulton, 926 F.3d at 923. The Seventh Circuit examined legislative history in both Thompson and Fulton without first concluding that the statute is ambiguous. This oversight appears to violate an accepted rule of statutory interpretation. See, e.g., Five Points Rd. Joint Venture v. Johanns, 542 F.3d 1121, 1128 (7th Cir. 2008).

[7] Fulton, 926 F.3d at 924-25. The Seventh Circuit also concluded that none of the exceptions to the automatic stay applied.

[8] In several of the bankruptcy cases below, the debtors did request "turnover," but typically as a remedy for violations of the automatic stay. None of the debtors appears to have filed a turnover action pursuant to §542.

[9] Kleber v. CareFusion Corp., 914 F.3d 480, 483 (7th Cir. 2019).

[10] See, e.g., Webster's Third New Intn'l. Dictionary at 2231 (1981) ("Stay" is to "stop doing something" or to "stop the progress or advance of" something).

[11] See 11 U.S.C. §362(c) (providing that bankruptcy stays are temporary).

[12] Cowen, 849 F.3d at 949. See also United States v. Inslaw, Inc., 932 F.2d 1467, 1474 (D.C. Cir. 1991) ("The automatic stay, as its name suggests, serves as a restraint only on acts to gain possession or control over property of the estate.")

[13] See, e.g., Cowen, 849 F.3d at 949.

[14] See also 11 U.S.C. §§362(b)(1), (2), (3), (4), (12), (13), (22), (25) (all utilizing the concept of "continuation").

[15] One might say the Seventh Circuit renders §542 meaningless with its interpretation of §362(a)(3), which would violate yet another accepted rule of statutory interpretation. See, e.g., Kawaauhau v. Geiger, 523 U.S. 57, 62 (1998).

[16] So noted the Tenth Circuit in Cowen, 849 F.3d at 950 ("Even if the turnover provision were "self-executing" (which we do not decide), there is still no textual link between §542 and §362.").

[17] Fulton, 926 F.3d at 925.

[18] Fulton, 926 F.3d at 924.

[19] Mission Product Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652, 1665 (2019).