Must Repossessed Vehicle Be Returned Immediately Upon Debtor's Filing for Bankruptcy?

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An all too common occurrence today is a debtor filing a Chapter 13 bankruptcy petition to regain possession of a vehicle that was repossessed pre-petition. *See* Ralph Brubaker, *Turnover, Adequate Protection, and the Automatic Stay: A Reply to Judge Wedoff*, 38 Bankr. L. Letter No. 11, at 1 (Nov. 2018) (calling this a "popular strategy"). This scenario applies to any collateral repossessed pre-petition, not just vehicles. Two important questions immediately arise in this scenario: (i) does the creditor have to return the vehicle at the debtor's request, and (ii) will the failure to return the vehicle expose the creditor to damages for violation of the automatic stay?

The answers to these important questions are different in New York and New Jersey. In New York and the Second Circuit, the creditor must return the vehicle or face sanctions for a willful violation of the automatic stay. *In re Weber*, 719 F.3d 72, 81, 83 (2d Cir. 2013). In New Jersey and the Third Circuit, retaining possession of the vehicle post-bankruptcy does not violate the stay. *In re Denby-Peterson*, 941 F.3d 115, 126 (3d Cir. 2019).

The majority of Circuit Courts considering the issue agree with the Second Circuit. *In re Fulton*, 926 F.3d 916, 924-25 (7th Cir. 2019); *In re Rozier*, 376 F.3d 1323, 1324 (11th Cir. 2004) (per curiam); *In re Del Mission Ltd*., 98 F.3d 1147, 1152 (9th Cir. 1996); *In re Knaus*, 889 F.2d 773, 774-75 (8th Cir. 1989).

On the other hand, the D.C. Circuit and the Tenth Circuit agree with the Third Circuit that retaining possession does not violate the automatic stay. *In re Cowen*, 849 F.3d 943, 959-50 (10th Cir. 2017); *United States v. Inslaw*, 932 F.2d 1467, 1474 (D.C. Cir. 1991).

The Supreme Court granted a petition for certiorari to resolve this split.

Under the Bankruptcy Code, the debtor retains an equitable interest in a repossessed vehicle or other collateral seized pre-petition until the creditor completes the process of transferring ownership to itself or a third party. When a debtor files a petition, Bankruptcy Code §541 provides that the debtor's equitable interest is "property of the estate." Bankruptcy Code §362(a)(3) provides, in relevant part, that the filing operates as a stay of "any act … to exercise control over property of the estate[.]" The Question Presented in the Supreme Court is, "[w]hether an entity that is passively retaining possession of property in which a bankruptcy estate has an interest has an affirmative obligation under the Bankruptcy Code's automatic stay, 11 U.S.C. §362, to return that property to the debtor or trustee immediately upon the filing of the bankruptcy petition." *Case Documents: Granted/Noted Cases List*, Supreme Court of the United States, http://www.supremecourt.gov/qp/19-00357qp.pdf (last visited Jan. 29, 2020). Stated

differently, the Supreme Court will decide whether passively retaining possession post-bankruptcy is an "act" to "exercise control" over a vehicle, such that §362(a)(3) requires the creditor to immediately return a repossessed vehicle to the debtor.

The Third Circuit, in holding that a creditor retaining possession of a vehicle post-bankruptcy does not violate the stay, considered the meaning of the words "stay" and "act," and the phrase "exercise control," and determined that §362(a)(3) prohibits only affirmative acts to exercise control over property of the estate. *In re Denby-Peterson*, 941 F.3d at 125-26. The passive retention of possession is not an affirmative act prohibited by §362(a)(3). The Third Circuit bolsters its conclusion by reference to the legislative purpose, finding it well-established that one of the automatic stay's primary purposes is "to maintain the status quo" between the debtor and creditors. *Id.* at 126. Passively retaining possession maintains the status quo. Further buttressing this reasoning is the recognition that the creditor's possessory interest in seized property is distinct from the debtor's equitable interest and is, therefore, not "property of the estate" subject to the automatic stay. The creditor's possessory interest in the vehicle does not become "property of the estate" until the creditor returns the vehicle to the debtor. Accordingly, the creditor who retains a possessory interest in the vehicle does not violate §362(a)(3) because the creditor is not exercising control over "property of the estate." *See* Brubaker, 38 Bankr. L. Letter No. 11, at 6-9; *In re Hall,* 502 B.R. 650, 667-69 (Bankr. D. D.C. 2014).

The majority of Circuit Courts, including the Second Circuit, which require a creditor to return a repossessed vehicle upon notice of a bankruptcy filing, find the affirmative "act" required by §362(a)(3) in the turnover provision of §542(a). Section 542(a) of the Bankruptcy Code provides that:

> [A]n entity … in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property … unless such property is of inconsequential value or benefit to the estate.

Significantly, §542(a) references "property," not the more limiting phrase, "property of the estate." These courts hold that §542(a) is self-executing and attribute non-compliance with §542(a) as the "act" violating the stay. *Fulton,* 926 F.3d at 924; *In re Weber*, 719 F.3d at 79.

> [T]he courts following the majority rule are not saying the stay imposed by section 362(a)(3) requires the creditor to turn the repossessed property over to the bankruptcy estate, but that section 542(a) does, and the creditor's affirmative decision not to comply with the obligation imposed by section 542(a) is the prohibited "act" to exercise control over property of the estate that violates section 362(a)(3).

5 Collier on Bankruptcy ¶543.03 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2019).

Although the question presented to the Supreme Court is framed in terms of the automatic stay, the real issue is whether §542(a) is self-executing; in other words, whether a creditor's obligation to turn over collateral to the debtor is automatic. If §542(a) is self-executing, then failing to comply may be the "act" that violates §362(a)(3). The courts holding that §542(a) is self-executing find the verb "shall" makes turnover mandatory, and rely upon the Supreme Court's

decision in *United States v. Whiting Pools*, 462 U.S. 198, 207 (1983), as implicitly supporting the proposition that the turnover provision is self-executing. *See Fulton,* 926 F.3d at 924. In *Whiting Pools* the creditor moved for stay relief to sell seized property, and the debtor counterclaimed for an order requiring turnover under §542(a). *Whiting Pools*, 462 U.S. 201. The bankruptcy court ordered turnover on the condition that the debtor provide adequate protection and the Supreme Court affirmed. *Id.* The Supreme Court, however, did not hold that §542(a) was self-executing because that issue was not before the court. *In re Denby-Peterson*, 941 F.3d at 130 n.76. The Second Circuit concedes that *Whiting Pools* does not resolve the issue. *In re Weber*, 719 F.3d at 78.

The Third Circuit and other courts that do not require a creditor to return a repossessed vehicle immediately upon notice of a bankruptcy filing reject the contention that §542(a) is self-executing. They note that under the Bankruptcy Rules, the debtor must bring a request for turnover in an adversary proceeding or motion before a Bankruptcy Court. *In re Denby-Peterson*, 941 F.3d at 128. Additionally, the plain language of the turnover provision does not require delivery of seized property to the debtor without condition. Rather, only property that is either (i) "property that the [debtor] may use, sell, or lease under section 363" or (ii) property "that the debtor may exempt under section 522," is subject to turnover. *Id.* The question of whether a debtor may use, sell or lease property under §363 is bound up with the question of whether the creditor is entitled to adequate protection under §363(e). For example, adequate protection routinely requires a debtor to maintain insurance. A creditor that returns a vehicle to a debtor without insurance risks immediate irreparable loss of the value of its lien if the vehicle is involved in an accident. Section 542(a) also explicitly limits the right to turnover to property that (i) is in the possession, custody or control of a creditor, and (ii) is not "of inconsequential value or benefit to the estate." *In re Denby-Peterson*, 941 F.3d at 129. These conditions must be satisfied before a creditor is required to turnover property. If §542(a) were self-executing, these defenses to turnover may be lost. *See In re Hall,* 502 B.R. at 662-64 (discussing why §542(a) cannot be self-executing).

The divergent approaches across jurisdictions are seemingly driven by policy considerations of who should bear the cost and burden involved in returning the vehicle to the debtor. In *Cowen*, the Tenth Circuit noted that the "majority rule" seems driven more by policy concerns than by "faithful adherence" to the statutory text. 849 F.3d at 949-50. The majority argues that §542(a) *should* be self-executing so the cost and burden of moving for relief falls on the creditor. Indeed, the Second Circuit has recognized that placing "on the debtor or trustee the burden of undertaking a series of adversary proceedings to pull together the bankruptcy estate, [will] … increase the costs of administering the estate and decrease the assets available to effect a successful reorganization." *In re Weber*, 719 F.3d at 80. While it may be better and cheaper for debtors if §542(a) is self-executing so that their vehicles and other repossessed property are automatically returned, the Supreme Court will have to decide whether this interpretation accords with the language of §§362(a)(3) and 542(a).

Finally, it should be noted that this discussion does not apply to bank accounts. In *Citizens Bank v. Strumpf*, the Supreme Court held that a bank does not violate the automatic stay by placing an administrative hold on a bank account in order to preserve the bank's right of setoff. 516 U.S. 16, 21 (1995). *Strumpf* dealt with a different turnover provision, §542(b), that is not at issue in the seizure cases discussed in this article.

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