

Lessor Repossession Of Property on Eve Of Lessee Bankruptcy: Voluntary Turnover Or Face Contempt

By Theresa A. Driscoll

Lessors who repossess property immediately prior to a lessee bankruptcy filing may be required to return such property or face sanctions by the bankruptcy court. Federal courts are currently split on the issue of whether the lessor must voluntarily surrender property seized pre-petition or may hold such property until such time as the debtor seeks, and obtains, an order of turnover. In June, the U.S. Court of Appeals for the Seventh Circuit weighed in and decided four appeals involving chapter 13 debtor filings following the City of Chicago's seizure of vehicles based on unpaid fines. *See, In re Fulton*, 2019 U.S. App.

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LEXIS 18393 (7th Cir. 2019). In *Fulton*, the Seventh Circuit ruled that the City of Chicago must comply with the automatic stay by returning impounded cars immediately after being notified of a chapter 13 filing. (The *Fulton* decision is not the first time the Seventh Circuit decided the issues presented. In 2009, the court held that a creditor must comply with the automatic stay and return a debtor's vehicle upon her filing of a bankruptcy petition. *See, Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009)).

The Seventh Circuit's holding in *Fulton* is consistent with decisions from the Second, Eighth, and Ninth Circuits, each of which hold that a secured creditor or owner must turn over repossessed property immediately or face a contempt citation. *See, Weber v. SEFCU (In re Weber)*, 719 F.3d 72 (2d Cir. 2013); *Cal. Emp't Dev. Dep't v. Taxel (In re Del Mission)*, 98 F.3d 1147 (9th Cir. 1996); *Knaus v. Concordia*

Lumber Co. (In re Knaus), 889 F.2d 773 (8th Cir. 1989). A minority of the circuits disagree. Specifically, the Tenth and the District of Columbia Circuits and the District Court for the District of Delaware have ruled that holding property of the estate seized prepetition does not violate the automatic stay in Section 362(a)(3) because such section applies prospectively and prohibits "any [postpetition] act ... to exercise control over property of the estate." *WD Equip., LLC v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. 2017); *United States v. Inslaw, Inc.*, 932 F.2d 1467 (D.C. Cir. 1991); *Denby-Peterson v. Nu2u Auto World*, 595 B.R. 18 (D.N.J. 2018).

A lessee's chapter 13 filing invokes the broad protections of the automatic stay. Section 362(a)(3) of the Bankruptcy Code provides that a chapter 13 petition "operates as a stay applicable to all entities, of ... 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.” 11 U.S.C. §362(a)(3). The concept of property of the estate is likewise broad and is defined in the Bankruptcy Code to include “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. §541(a)(1). To the extent that a lessee has a right of redemption under applicable state law, the debtor has an interest in property repossessed as of the petition date. The split among federal courts focuses on the extent to which the lessor has an affirmative obligation to return property repossessed on the eve of a bankruptcy filing as opposed to requiring the debtor to affirmatively seek turnover of such property. The majority of courts hold that a lessor’s holding onto property upon a bankruptcy filing is “exercising control” over such property within the meaning of the automatic stay section 362 of the Bankruptcy Code. These courts also rely on the turnover section of the Bankruptcy Code which effectively requires that any entity in possession of property of the estate as of a bankruptcy filing is required to turnover such property to the trustee. 11 U.S.C. §542(a) (“an 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 ... shall deliver to the trustee, and account for, such property”).

Individual debtors injured by a lessor’s willful violations of the automatic stay may recover actual damages, including costs and attorneys’ fees as well as, in some instances, punitive damages. 11 U.S.C. §362(k). A lessor that repossesses an individual’s personal property prior to a bankruptcy filing may face sanctions if such property is not voluntarily returned to the debtor upon the lessor’s learning of the filing. Actual notice of the bankruptcy filing should be provided to all creditors of the debtor. Notwithstanding that lessors should receive actual notice of their lessee’s bankruptcy filings, active monitoring of lessee accounts for bankruptcy filing activity is prudent. Lessors may obtain access to the public database for details on all bankruptcy filings throughout the United States by registering with PACER. *See*, <http://bit.ly/2NKzEUK>.

While the issue of whether property repossessed on the eve of a lessee bankruptcy filing must be returned by the lessor is left unsettled pending a possible U.S. Supreme Court review, lessors should proceed with caution. The best practice for lessors is to be proactive upon a lessee’s bankruptcy filing and

either voluntarily return property seized (to the extent the debtor has an interest in such property by way of a right of redemption or otherwise) or promptly seek relief from the bankruptcy court to otherwise approve the lessor’s retention of such property.

