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Consumer Track

All Things Motor Vehicles in Bankruptcy

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CONCURRENT SESSION

2019

Automobile Claims in Chapter 13 Bankruptcy:
Can The Debtor Protect A Non-Filing Codebtor?
by: Holly N. Lankster, Esq.[1]

When a debtor files a chapter 13 petition, the debtor must disclose on Schedule H the names of any codebtors or "people or entities who are also liable for any debts [the debtor] may have." *See* Bankr. Form B-106H. It is common for debtors to disclose codebtors on automobile loans. A typical scenario involves a mother that cosigns a car loan for her daughter. The daughter files a chapter 13 petition and wants to keep the car because it is her primary source of transportation. The daughter is protected by the automatic stay, but her mother is not. To what extent can the debtor daughter protect her codebtor mother?

Section 1301 creates a codebtor stay that prevents a creditor from collecting against a non-filing codebtor. But the protection of the codebtor stay is limited. The debtor can only protect her codebtor if she proposes a plan that will pay the secured creditor's claim in full. Such plan proposals can be difficult to confirm without unfairly discriminating against other creditors. The protection of the codebtor stay is also finite. The debtor's ability to protect her codebtor ends with entry of the order of discharge. The secured creditor is then entitled to enforce its *in rem* rights to the extent its lien was not avoided. The secured creditor can also seek a personal judgment for the full amount of the debt against the codebtor pursuant to state law even though it is barred from attempting to collect from the debtor.

I. What is a Codebtor?

The term "codebtor" is not defined in the Bankruptcy Code. It is generally understood to mean an individual that signs as an obligor on a debt but does not receive consideration for the claim. *In re Bigalk*, 75 B.R. 561, 565 (Bankr. D. Minn. 1987). A codebtor is typically necessary for the primary obligor because of the codebtor's creditworthiness. *Id.*

The definition of codebtor is broad. It extends to cosigners, joint obligors, guarantors, sureties, and others who pledge property to secure a joint debt.

II. Certain Non-Filing Codebtors are Protected by the Codebtor Stay.

The automatic stay goes into effect when the petition is filed to protect the debtor from actions against her and her property. 11 U.S.C. § 362(a). The automatic stay only applies to the debtor and property of the debtor. *Id.* It does not extend to a non-filing codebtor. *Id.*

Certain non-filing codebtors are protected from collection actions by the codebtor stay. Section 1301 provides:

> (a) Except as provided in subsections (b) and (c) of this section, after the order for relief under this chapter, a creditor may not act, or commence or continue any

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[1] Holly N. Lankster is a law clerk for the Hon. Gregory R. Schaaf, United States Bankruptcy Court, Eastern District of Kentucky. The following analysis is not intended to express the opinions of the Court, but merely to outline the issues and arguments raised by various courts and commentators.

> civil action, to collect all or any part of a consumer debt of the debtor from any individual that is liable on such debt with the debtor, or that secured such debt, unless—
>
> > (1) such individual became liable on or secured such debt in the ordinary course of such individual's business; or
> >
> > (2) the case is closed, dismissed, or converted to a case under chapter 7 or 11 of this title.

11 U.S.C. § 1301.

The codebtor stay does not apply in all situations. Section 1301 is limited to civil actions. 11 U.S.C. § 1301(a). It applies only to codebtors liable on "consumer debts." Consumer debt is defined as "debt incurred by an individual primarily for a personal, family or household purpose." 11 U.S.C. § 101(8).

The codebtor stay is not applicable to corporate codebtors. *Dugan v. U.S. Bank (In re Dugan)*, Case No. 4:11-bk-13039, AP No. 4:11-ap-1267, 2012 Bankr. LEXIS 3383 at *7 (Bankr. E.D. Ark. June 20, 2012). The codebtor stay does not apply if the individual became liable in the ordinary course of the individual's business. 11 U.S.C. § 1301(a)(1). Thus, commercial sureties are excluded from its protection too. *In re Penn*, No. 09-14624-WHD, 2010 WL 9445533, at * 4 (Bankr. N.D. Ga. April 2, 2010).

It does not matter whether the debtor or the non-filing codebtor is the principal obligor on the debt. The non-filing codebtor is protected until stay relief is granted. *In re Patti*, No. 98-17719DWS, 2001 WL 1188218, at * 6 (Bankr. E.D. Pa. Sept. 14, 2001) (unpublished). Further, unlike the limitations in § 362(a), the codebtor stay applies to both *in personam* and *in rem* actions against the codebtor. *In re Jones*, 106 B.R. 33, 35 (Bankr. W.D.N.Y. 1989).

The codebtor stay only incidentally protects non-filing codebtors. Its primary function is to protect chapter 13 debtors from indirect pressure through co-workers, friends, and relatives who are obligated with the debtor. *In re Lemma*, 394 B.R. 315, 320 (Bankr. E.D.N.Y. 2008). The codebtor stay does not change the substantive rights of the creditor to ultimately collect its entire claim from the cosigner. As explained in the legislative history,

> [t]he [codebtor stay] does not prevent the creditor from receiving full payment, including any costs and interests, of his claim. It does not affect his substantive rights. It merely requires him to wait along with all other creditors for that portion of the debt that the debtor will repay under the plan.

H.R. Rep. No. 95-595, at 122-123 (1977).

A creditor is entitled to stay relief if the codebtor dishonors the agreement with the creditor. 11 U.S.C. § 1301(b). Stay relief is also appropriate if the debtor did not receive full consideration for the claim. 11 U.S.C. § 1301(c)(1); *In re Motes*, 166 B.R. 147, 149 (Bankr. E.D. Mo. 1994). A court should grant stay relief if a creditor shows that it would be irreparably

harmed by continuation of the codebtor stay. 11 U.S.C. § 1301(c)(3); *In re Williams*, 374 B.R. 713, 715 (Bankr. W.D. Mo. 2007).

Stay relief is also appropriate if the debtor's chapter 13 plan does not propose to pay the claim in full. 11 U.S.C. § 1301(c)(2); *In re Schaffrath,* 214 B.R. 153, 155 (B.A.P. 6th Cir. 1997). Paying the claim in full may require payment of postpetition interest. *Compare Southeastern Bank v. Brown*, 266 B.R. 900, 906 (S.D. Ga. 2001) (stay relief is appropriate where plan does not provide for payment of postpetition interest), *with In re Janssen*, 220 B.R. 639, 645-46 (Bankr. N.D. Iowa 1998) (stay relief inappropriate where plan does not provide for payment of postpetition interest because postpetition interest is not part of the claim).

Many chapter 13 debtors propose to separately classify these claims. Section 1322(b)(1) allows the debtor to separately classify claims for consumer debt if an individual is liable on such consumer debt with the debtor. 11 U.S.C. § 1322(b).

Chapter 13 trustees often object to these provisions as unfairly discriminating against other unsecured creditors. There is substantial disagreement among courts as to whether the unfair discrimination test applies to separate classification of debts with a non-filing codebtor. A majority of courts apply the unfair discrimination standard to plans that separately classify cosigned consumer debts. *See, e.g., Ramirez v. Bracher (In re Ramirez)*, 204 F.3d 595, 601 (5th Cir. 2000) (declining to confirm a plan proposing to pay consumer debt in full as unfairly discriminating); *In re Applegarth*, 221 B.R. 914, 915 (Bankr. M.D. Fla. 1998) (finding the better view is to apply the unfair discrimination test to separately classified codebtor claims). Others have declined to consider the unfair discrimination requirement for separately classified cosigned debts. *See, e.g., Carrion v. Rivera (In re Rivera),* 490 B.R. 130, 141 (B.A.P. 1st Cir. 2013) (plan proposing to separately classify and pay cosigned debt in full while proposing only 4.51 percent to unsecured creditors does not unfairly discriminate); *In re Monroe*, 281 B.R. 398, 400-02 (Bankr. N.D. Ga. 2002) (separate classification of cosigned debt is not subject to unfair discrimination test). The unfair discrimination test is a substantial barrier to application of the codebtor stay for the duration of the bankruptcy.

III. Non-Filing Codebtors are Subject to Collection When the Codebtor Stay Terminates.

The codebtor stay requires creditors to wait to collect from codebtors while the bankruptcy is pending or until stay relief is granted. But when the discharge order is entered, the codebtor stay terminates and the codebtor is subject to collection for the full amount of the debt pursuant to non-bankruptcy law.

Section 524(a) protects a debtor from any action to collect against the debtor personally. 11 U.S.C. § 524. The discharge does not apply to the non-filing codebtor. 11 U.S.C. § 524(e).

If the debtor does not pay the secured creditor's claim in full, the creditor's lien rides though the chapter 13 bankruptcy unless disallowed or avoided. *Johnson v. Home State Bank*, 501 U.S. 78, 84-85 (1991). The creditor has no obligation to release its lien upon entry of the discharge order and can collect the entire amount due from the non-filing codebtor. *See In re*

Ryel, No. 5:15-bk-70290, 2015 WL 13776223, at *3 (Bankr. W.D. Ark. July 19, 2015); *Faulkner v. CEFCU (In re Faulkner)*, Bankr. No. 07-81412, Adv. No. 12-08069, 2013 WL 2154790, at *5 (Bankr. C.D. Ill. May 17, 2013); *In re Jackson*, No. 12-10757-JDW, 2012 WL 6623497, at *3-4 (Bankr. M.D. Ga. Dec. 18, 2012); *Brooks v. General Motors Acceptance Corp. (In re Brooks)*, 340 B.R. 648, 654 (Bankr. D. Me. 2006); *In re Leonard*, 307 B.R. 611, 614 (Bankr. E.D. Tenn. 2004); *In re Harris*, 199 B.R. 434, 438 (Bankr. D.N.H. 1996). A debtor that does not confirm a plan that pays the claim in full can potentially undermine her desire to retain the vehicle and saddle her codebtor with all the remaining debt.

IV. The Secured Creditor Can Repossess the Vehicle and Collect from the Non-Filing Codebtor Pursuant to Non-Bankruptcy Law.

The Uniform Commercial Code controls how a secured creditor may recover on its claim postdischarge. For example, in Florida, if a debtor defaults on a loan with a secured creditor, the secured party may reduce its claim to judgment, foreclose or otherwise enforce the claim by any available judicial procedure. FLA. STAT. ANN. § 679.601. The secured party has the right to take possession of the collateral pursuant to judicial process or without judicial process if it can do so without a breach of the peace. FLA. STAT. ANN. § 679.609. After default, the secured party may sell, license, or otherwise dispose of collateral in a commercially reasonable manner. FLA. STAT. ANN. § 679.610. Any obligor or co-obligor is required to pay any deficiency following disposition of the collateral. FLA. STAT. ANN. § 679.608.

The manner in which a secured creditor repossesses a vehicle postdischarge is not grounds for contempt for violating the discharge injunction. *See Champagne v. Equitable Credit Union (In re Champagne)*, 145 B.R. 122, 124 (Bankr. D.R.I. 1992). Whether repossession is a breach of the peace is an issue of state law. *Id. See also Almond v. Ford Motor Credit Co. (In re Almond)*, Bankr. No. B-06-50324C-7W, Adv. No. 06-6089W, 2007 WL 1345224, at *6 (Bankr. M.D.N.C. May 7, 2007).

The owner and any co-obligor on the debt retains certain rights, such as the right to notice before disposing of the collateral (West's F.S.A. § 679.611), the right to redeem the vehicle (FLA. STAT. ANN. § 679.623), and the right to any surplus from the sale of the collateral (FLA. STAT. ANN. § 679.608). The debtor may also take steps to protect her codebtor post-discharge by voluntarily curing any default despite her discharge. *See In re Leonard*, 307 B.R. at 614 (noting that if the codebtor does not pay, "there is nothing preventing [the debtor] from voluntarily doing so in order to receive the title to the [vehicle]."). But voluntarily curing a default to protect the codebtor undermines the debtor's fresh start. The only sure way to retain the vehicle and protect the debtor and codebtor is to pay the claim in full through the chapter 13 plan.

PostPetition Turnover of Repossessed Vehicles

by: Holly N. Lankster, Esq.[1]

Individuals need automobiles for transportation to work, medical appointments, and other family obligations. Therefore, repossession of a vehicle is often the catalyst for filing a chapter 13 bankruptcy petition. The debtor will quickly seek turnover of the vehicle under 11 U.S.C. § 542(a) because his chance of reorganization is unlikely without it.

The secured creditor does not want to turn over the vehicle and lose its primary leverage. The majority of courts hold that § 541, § 542, and § 362 require a creditor to immediately turnover the vehicle upon the bankruptcy filing. Any delay results in sanctions for violation of the automatic stay. A few courts have allowed passive retention of the repossessed vehicle until the debtor's turnover action is decided.

The majority position is presently under scrutiny in an appeal to the Seventh Circuit. The Seventh Circuit follows the majority of cases for consensual liens and will soon decide whether to extend the majority position to creditors with an involuntary possessory lien on a debtor's vehicle.

I. The Majority Position.

A creditor in the First, Second, Sixth, Seventh, Eighth, Ninth, and Eleventh Circuits must voluntarily and unconditionally turnover a vehicle repossessed prepetition pursuant to § 542(a). Continued retention of the debtor's property is a violation of the automatic stay under § 362(a).

A. The Basis for the Majority Position.

The basis for the majority's position is the interaction of § 541, § 542, and § 362 and the United States Supreme Court decision in *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 103 S. Ct. 2309, 76 L.Ed.2d 515 (1983).

1. The Interaction Between § 541, § 542, and § 362.

Section 541 creates a bankruptcy estate that includes "all legal or equitable interests of the debtor." 11 U.S.C. § 541(a)(1). This section brings into the estate all interests in property "wherever located and by whomever held." 11 U.S.C. § 541(a).

Section 542 helps assemble the bankruptcy estate. It requires that an entity "in possession, custody, or control" of property of the estate "shall deliver" such property to the trustee "unless such property is of inconsequential value or benefit to the estate." 11 U.S.C. § 542(a). The property at issue is property the trustee "may use, sell or lease under section 363 of this title" or that the debtor may exempt. *Id.* In a chapter 13 case, the debtor possesses all

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property in the estate and acts as a trustee under § 542(a) unless the chapter 13 plan provides otherwise. 11 U.S.C. § 1306(b).

Section 362(a) stays action affecting estate property once the petition is filed. It prevents, among other things, "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). It also prevents "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case..." 11 U.S.C. § 362(a)(6).

The majority interprets § 541, § 542, and § 362 as working in tandem to "shelter the debtor's estate from action by creditors, enabling the debtor to get the relief and fresh start that are among the goals of the bankruptcy regime." *In re Weber*, 719 F.3d 72, 76 (2d Cir. 2013). Under the majority view, a creditor must immediately turnover collateral repossessed prepetition or risk sanctions for violating the automatic stay. *Id.* at 81; *Thompson v. Gen. Motors Acceptance Corp., LLC*, 566 F.3d 699, 703 (7th Cir. 2009); *Motors Acceptance Corp. v. Rozier (In re Rozier)*, 376 F.3d 1323, 1324 (11th Cir. 2003); *State of Cal. Employ. Dev. Dept. v. Taxel (In re Del Mission Ltd.)*, 98 F.3d 1147, 1152 (9th Cir. 1996); *Knaus v. Concordia Lumber Co., Inc. (In re Knaus)*, 889 F.2d 773, 775 (8th Cir. 1989); *TranSouth Fin. Corp. v. Sharon (In re Sharon)*, 234 B.R. 676, 686 (B.A.P. 6th Cir. 1999); *STMIMA Corp. v. Carrigg (In re Carrigg)*, 216 B.R. 303, 305 (B.A.P. 1st Cir. 1998); *Abrams v. Southwest Leasing and Rental Inc. (In re Abrams)*, 127 B.R. 239, 242 (B.A.P. 9th Cir. 1991).

2. The Impact of *United States v. Whiting Pools, Inc.*

The majority also relies on the Supreme Court's decision in *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983). According to the Second Circuit, "*Whiting Pools* teaches that, upon [the debtor's] filing of the bankruptcy petition, [the debtor's] equitable interest under state law gave the bankruptcy estate a possessory right in the secured property...that took precedence over the state law possessory right of [the creditor]." *In re Weber*, 719 F.3d at 78.

The issue in *Whiting Pools* was whether the Internal Revenue Service ("IRS") was required to turnover personal property seized prepetition. After the bankruptcy filing, the IRS filed a motion for relief from stay to seek permission to sell the property. The debtor counterclaimed and successfully sought an order from the bankruptcy court that required the IRS to return the property to the estate under § 542. *Whiting Pools*, at 199, 201.

The Supreme Court affirmed the bankruptcy court's turnover order. It explained that § 542(a) grants the estate a possessory interest in property not in the debtor's possession at the time the petition is filed, *id.* at 207, and "requires an entity ... holding any property of the debtor that the trustee can use under § 363 to turn that property over to the trustee." *Id.* at 205-06.[2]

[2] *Whiting Pools* involved a chapter 11 reorganization. The Supreme Court expressly reserved judgment on whether its decision applies to a chapter 13 reorganization. *Whiting Pools*, 462 U.S. at 208 n. 17. The courts that have addressed this distinction do not believe it is relevant because § 541, § 542, and § 362 apply to the "estate" and not just the "reorganization estate." *In re Weber*, 719 F.3d at 78; *Thompson*, 566 F.3d at 705-06.

B. The Obligation to Turnover is Not Conditional.

The majority also holds that § 542 is self-executing and unconditional. *In re Weber*, 719 F.3d at 79; *In re Thompson*, 566 F.3d at 700; *In re Rozier*, 376 F.3d at 1324. Thus, the creditor must surrender the property before it can seek adequate protection. 11 U.S.C. § 362(d), § 363(e); *see also In re Sharon*, 234 B.R. at 683-684. A creditor can seek expedited relief under § 362(f) if the creditor is concerned that adequate protection is immediately at risk. 11 U.S.C. § 362(f); *In re Sharon*, 234 B.R. at 685.

This position is bolstered by the Supreme Court's comments in *Whiting Pools* that the Code requires a creditor holding estate property to turn that property over to the trustee. *Whiting Pools*, 462 U.S. at 205. The Supreme Court discussed three exceptions to § 542, and none of the exceptions recognized lack of adequate protection. *Id.* at 206 n.12. In addition, the Supreme Court noted that the burden is on the creditor, not the debtor, to seek relief. *Id.* at 204; *see also In re Thompson*, 566 F.3d at 706.

Policy considerations further support this conclusion. The purpose of reorganization is to allow the debtor to "regain his financial foothold and repay his creditors." *In re Thompson*, 566 F.3d at 706. A debtor cannot effectively do so if the creditor retains his property. Allowing the creditor to retain possession "unfairly tips the bargaining power in favor of the creditor." *Id.* at 707. In addition, requiring the debtor to bear the costs of seeking relief decreases the value of the bankruptcy estate. *Id.*

C. Failure to Immediately Turnover Repossessed Property Violates the Automatic Stay.

The failure to immediately turnover the vehicle to the debtor is a violation of the automatic stay under § 362(a)(3). Section 362(a)(3) prevents an entity from exercising "control" over property of the estate. 11 U.S.C. § 362(a)(3). Under the majority position, control includes affirmative acts and passive conduct. *In re Weber*, 719 F.3d at 79; *In re Thompson*, 566 F.3d at 703; *In re Sharon*, 234 B.R. at 682; *In re Knaus*, 889 F.2d at 241-243; *In re Carrigg*, 216 B.R. at 304-305; *In re Del Mission Ltd.*, 98 F.3d at 1152; *In re Abrams*, 127 B.R. at 242.

The majority holds that any conclusion otherwise would unfairly place the burden on the debtor or trustee to undertake a series of adversary proceedings to gather the bankruptcy estate. This increases the costs of administrating the estate while decreasing assets available for reorganization. *In re Weber*, 719 F3d. at 780. Further, if a creditor is allowed to retain possession, then its burden to request adequate protection under § 363(e) is meaningless because the creditor has no incentive to seek protection of an asset in its possession. *In re Thompson*, 566 F.3d at 704.

II. The Minority Position.

A few courts have rejected the majority's position. *See In re Cowen*, 849 F.3d 943, 949-950 (10th Cir. 2017); *In re Hall*, 502 B.R. 650, 653 (Bankr. D.C. 2014). These courts conclude that § 542 is conditional and not self-executing, so passive retention of property is not a violation of § 362(a).

A. Section 542(a) Is Conditional and Not Self-Executing.

The most in-depth discussion of the minority position is in the case of *In re Hall*, 502 B.R. 650 (Bankr. D.D.C. 2014). *Hall* rejects the majority view primarily because it rests on an erroneous conclusion that § 542(a) is self-executing and unconditional.

According to *Hall*, § 542(a) permits an entity in possession of property of the estate to voluntarily turn over that property to the trustee rather than the debtor. 502 B.R. at 655-656. But a creditor is not required to turnover its collateral until the debtor provides adequate protection. *Id.* at 656.

Hall rejects the idea that § 542(a) is unconditional. It recognizes that § 542(a) includes certain conditions to turnover, such as when property is "of inconsequential value or benefit to the estate," or "property that the trustee may use, sell, or lease under section 363 of this title," or property that the debtor may exempt. Turnover is also an equitable claim that is subject to defenses. *Id.* at 662-663.

Contrary to the majority, *Hall* focuses on prejudice to the creditor. One concern is that the creditor will lose the value of its lien if required to turnover an uninsured vehicle to the debtor and the vehicle is subsequently destroyed. Another concern raised by *Hall* relates to a possessory, rather than consensual, lien. A lien perfected by possession is lost when possession is relinquished. *Id.* at 660-661. This is the problem at issue in an appeal before the Seventh Circuit, which tests the majority position and is discussed further below.

B. Passive Retention of Repossessed Property Does Not Violate the Stay.

Hall looks at the plain language of § 362(a)(3) to conclude that the word "act" in the phrase "any act to obtain possession of property" requires affirmative action. *Hall*, 502 B.R. at 664-65. *Hall* criticizes the majority for ignoring basic principles of statutory interpretation and argues the majority's conclusion leads to an absurd result because a creditor with a valid defense to turnover may violate the automatic stay. *Id.* at 666. The Tenth Circuit in *Cowen* reached the same conclusion on similar grounds. 849 F.3d at 949.

Hall also rejects a view that the repossessed property is property of the estate at the outset of the filing. The court focuses on language in § 541(a)(1) pertaining to "all legal or equitable interests of the debtor in property *as of the commencement of the case*." 11 U.S.C. § 541(a) (emphasis added). It notes that § 541(a)(3) and § 541(a)(7) are the provisions that include a possessory interest in property recovered pursuant to § 542, § 543, § 547, and § 548, and "they do not purport to make possession of the recovered property an interest of the estate in property until there is an actual recovery." *Id.* at 668. *Hall* thus concludes that even if a passive act is an "act to obtain possession of property," then "it is not an exercise of control over a present possessory interest that is property of the estate, and thus does not violate the automatic stay." *Hall*, 502 B.R. at 669.

III. The Majority Position Challenged: Is *Thompson* Correct and Does the Stay Apply to Possessory Liens?

The majority position is being tested in the Seventh Circuit, where *Thompson* is controlling. This challenge arises out of a recent line of cases issued by bankruptcy courts in Illinois. The city of Chicago enacted a local municipal ordinance that grants the city a possessory lien on vehicles impounded for parking-related debt. This practice forces many debtors to file for chapter 13 relief and seek return of their vehicles. The debtors argue that retention of their repossessed vehicles is a stay violation under *Thompson*. The city refuses to return the vehicles without adequate protection and argues *Thompson* is incorrectly decided. It believes the stay does not apply because possession of the vehicle is an act to maintain perfection of its lien under § 362(b)(3) or an action taken pursuant to its police power under § 362(b)(4). See EUGENE R. WEDOFF, *Return of Vehicles Seized Before a Chapter 13 Filing: Does the Debtor Have to File a Turnover Motion?*, AM. BANKR. INST. J., April 2019, at 14.

Five bankruptcy courts have addressed these issues. The first court to take up the issue recognized the validity of the city's possessory lien. *In re Avila*, 566 B.R. 558, 560-61 (Bankr. N.D. Ill. 2017). The *Avila* court distinguished *Thompson* on the grounds that it addressed consensual security interests and held that continued possession of the vehicle was not a stay violation because it was an act to maintain perfection of the city's possessory lien under § 362(b)(3). *Id.* at 561-62.

The next court rejected the city's contention that it had a possessory lien and determined that the city willfully violated the automatic stay. *In re Howard*, 584 B.R. 252, 258 (Bankr. N.D. Ill. 2018). The third court agreed with the decision in *Howard* and held there is no reason for the city to refuse turnover because the city could be granted a replacement lien that satisfies its right to payment. *In re Fulton*, Case No. 18-BK-02860, 2018 WL 2570109, at *6 (Bankr. N.D. Ill. May 31, 2018).

The fourth court held the city had a right under Illinois law to impound and possess the vehicle. *In re Peake*, 588 B.R. 811, 823 (Bankr. N.D. Ill. 2018). Even so, the bankruptcy court held that passively retaining the vehicle did not qualify for protection from the stay under § 362(b)(3). *Id.* at 830-32. The *Peake* court further concluded that the city's retention was an attempt to enforce a monetary judgment and did not qualify for the police power exception under § 362(b)(4). *Id.* at 832-33.

Finally, *In re Shannon* recognized the city's possessory lien but held its conditional retention of the vehicle was a violation of the automatic stay. 590 B.R. 467 (Bankr. N.D. Ill. 2018). It determined the city did not qualify for either exception under § 362(b)(3) or (b)(4). *Id.* at 480-90. It also concluded that the city did not have to possess the vehicle to maintain its possessory lien under state law. *Id.*

The city appealed the four decisions finding a violation of the stay and the Seventh Circuit consolidated the cases for a direct appeal on October 10, 2018, under the case of *City of Chicago v. Shannon,* Case No. 18-3023. WEDOFF, at 14.

The city makes three main arguments that the stay does not apply. WEDOFF, at 94. The city first relies on the minority decisions that hold § 542 requires debtors to obtain a court order before creditors must turnover seized property. *Id.* The contrary argument is that this interpretation is inconsistent with the text of § 542. *Id.*

The city argues in favor of the minority's conclusion that § 362(a)(3) requires an affirmative act to violate the stay. *Id.* at 95. The challenge to this argument is that a refusal to return estate property is the equivalent of a creditor actively preventing a debtor from gaining possession. *Id.*

The city also focuses on the extraordinary burden on the creditor if required to return its collateral without adequate protection. *Id.* The contrary argument is that this is no different than the situation faced by any creditor whose collateral is not adequately protected when the bankruptcy is filed. *Id.* Further, the remedy is to seek a court order for stay relief on an expedited basis. *Id.*

Oral arguments were scheduled for May 14, 2019. The Seventh Circuit must decide whether to deviate from the majority position in *Thompson*. If the Seventh Circuit follows its prior precedent, it then must address whether the majority position is limited to consensual liens or if it extends to possessory liens. If the majority position extends to possessory liens, the question then is whether the exception under § 362(a)(3) applies. Regardless of what the Seventh Circuit decides, its decision is certain to have an effect on chapter 13 practice.

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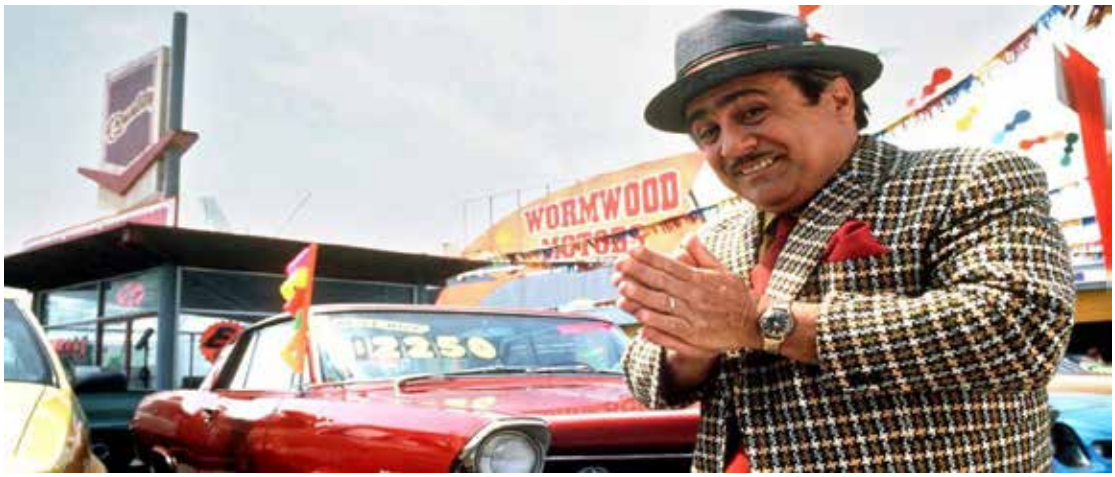
July 19, 2019

(Almost) Everyone Needs a Car

- Geography
- Mass Transit Limitations
- Age/health
- Children's Activities

(Almost) Everyone Needs a Loan



Remember This?

Bob Clayton shows an example of a completed rebus

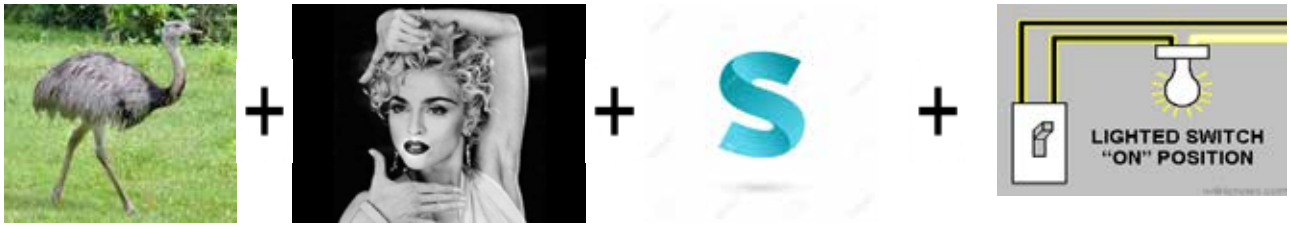
"earn" + "nest" + "hem" + "ink" + "weigh" = Ernest Hemingway

Not Everyone Pays The Loan When Due

- What Happens?

Not Everyone Pays The Loan When Due

- What Happens Then? **REPOSSESSION**



Rhea (strike the) Pose Ess On

What to Do? What Happens?

File Chapter 13 And Get Immediate

Majority Position

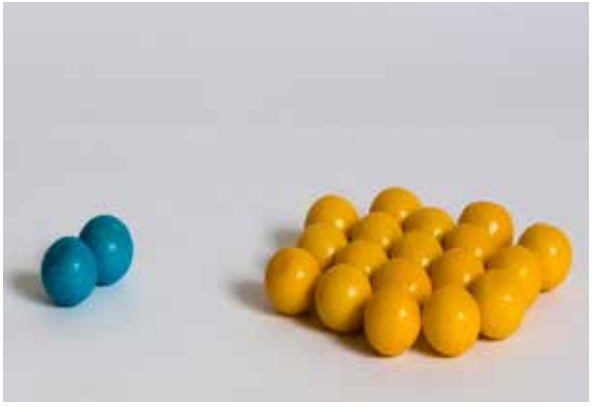
Voluntary, Immediate Turnover - At Least in:

- Circuits: 2nd, 7th, 8th, 9th, & 11th
- BAPs: 1st & 6th

Minority Position

But Not in:

- Circuit: 10th
- Lower Courts: DC Cir.; 3rd BCts



How To Get to the Majority Position

§ 541 – Property of the Estate

How is Section 541 Interpreted by Courts?

How To Get to the Majority Position

§ 541 – Property of the Estate

How is Section 541 Interpreted by Courts? **BROADLY**

B(ee) Road Lee

How To Get to the Majority Position

§ 542 – Person in Possession Turns Over Possession to the Trustee

- Exception – more later – Unless of Inconsequential Value

Trustee: "*Give it back*"

C'or: "*Okay, here you go.*"

How To Get to the Majority Positio

§ 362(a)(3) – Prohibits Acts to **Exercise Control**

- § 362(a)(4) – No perfection for prepetition claim
- § 362(a)(6) – No collection on prepetition claims

How To Get to the Majority Position

What Is the Next Best Thing after Statutes?

How To Get to the Majority Position

Case law: U.S. v.

+ ING

How To Get to the Majority Position

Case law: U.S. v. Whiting Pools, 462 U.S. 198 (1983)

+ ING

Question: Is the Obligation to Turnover …

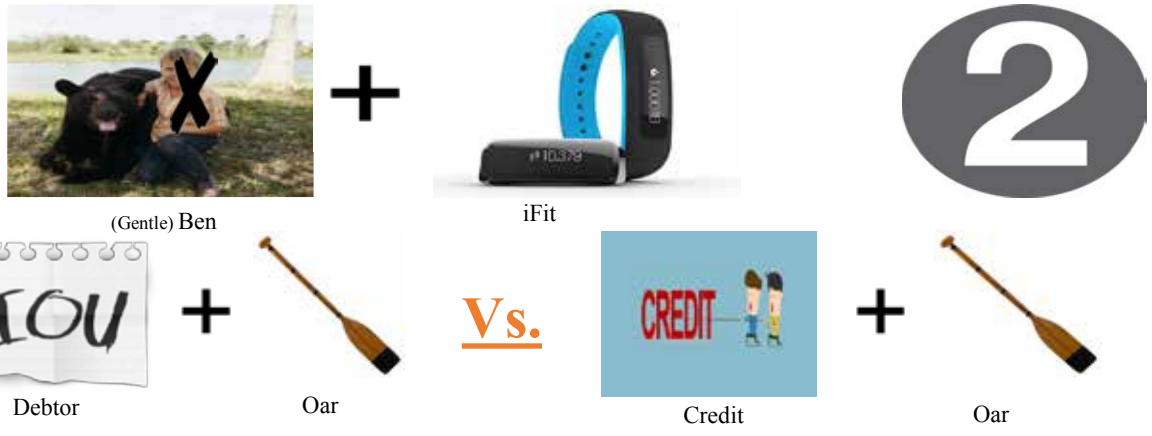
The Dispute: Is it **Self-Executing**?

"Level with me, Colonel. What kind of worst-case scenario are we talking about here?"

How to Get to the Minority Position

How to Get to the Minority Position

- Shift the Focus: **FROM BENEFIT TO DEBTOR TO CREDITOR**



(Gentle) Ben | iFit

Debtor | Oar | Credit | Oar

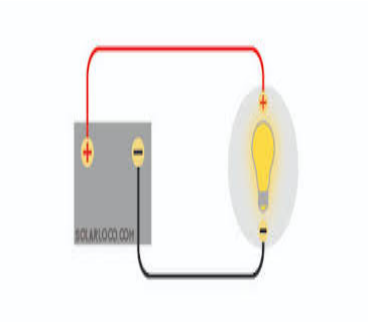
In re Shannon, 2019 WL 2521455 (7th Cir.)

- Argued May 14, Decided June 19, 2019 – "Quick for 7th Cir."*
- Upheld 7th Circuit Precedent
- § 362(3) – Attempt to Exercise Control
- § 363(e) – This Is the Post-petition Remedy Provision
- § 362(4) – Not Really a Police Power Issue
- § 362(6) – Looks Too Much Like Collecting $$

Source: 

What Do We Have?

Created a



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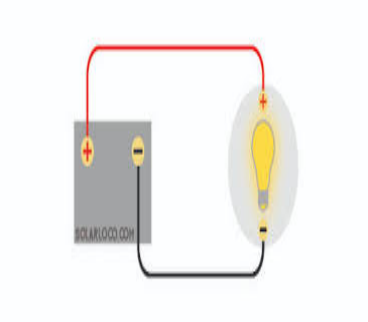
What Do We Have?

Created a **CIRCUIT SPLIT**



Circuit

+

Split

PARSING THE PARAGRAPH

THEODORE VON KELLER, ESQUIRE
CRAWFORD & VON KELLER, LLC

THE HANGING PARAGRAPH

- For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a **purchase money security interest** securing the debt that is the subject of the claim, the debt was incurred within the 910-day period preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) **acquired for the personal use of the debtor**, or if collateral for that debt consists of **any other thing of value**, if the debt was incurred during the 1-year period preceding that filing.

ISSUE ONE - PMSI

- Money paid by dealer to pay off trade-in (negative equity), GAP insurance/credit life insurance, extended warranties… are these secured by a PMSI?

NO (Minority view)

"The concept of 'purchase-money security interest' requires a close nexus between the acquisition of the collateral and the secured obligation."

"…multiple transactions are papered into one document."

"These provisions are evidence that neither GAP insurance nor credit disability insurance was even a consideration in the decision whether to loan money to these debtors to purchase cars."

"By its nature, negative equity is unsecured debt."

"The hanging sentence contemplates that different kinds of collateral even within a single debt transaction would be subject to different rules with respect to the application of §506 and treatment in a Chapter 13 Plan."

"GMAC and CitiFinancial hold reduced purchase money secured claims for purposes of the hanging sentence."

In re Hayes, Middle District of Tennessee, 376 B.R. 655*, 2007 Bankr. LEXIS 3867**, 58 Collier Bankr. Cas. 2nd (MB) 1554

ISSUE ONE - PMSI

- Money paid by dealer to pay off trade-in (negative equity), GAP insurance/credit life insurance, extended warranties… are these secured by a PMSI?

NO (Minority view)

See also: - *In re Smith*, C/A 06-20508, 2006 Bankr. LEXIS 2024 (Bankr. D. Kan. Nov 6, 2006)

- A Guide To Interpretation of the 2005 Bankruptcy Law- Jean Braucher; 16 Am. Bankr. Inst. L. Rev. 349 (Winter 2008)

ISSUE ONE - PMSI

- Money paid by dealer to pay off trade-in (negative equity), GAP insurance/credit life insurance, extended warranties… are these secured by a PMSI?

YES (Majority view)

"For the Debtor here to acquire ownership rights in the Vehicle, she needed financing and *under this transaction*, she could not get financing without including her trade in of the 2006 Jeep Wrangler. For her to include the trade in, she had to pay off the debt owed on it, and for her to pay the debt owed on it, and for her to pay the debt owed on the Jeep Wrangler, she had to borrow enough funds to cover the trade in debt as well as the price of the Vehicle."

"Thus, the Court concludes that the financing of the negative equity was an expense that was both part of the 'price of the collateral' and the 'value given' that enabled the Debtor to acquire rights in the Vehicle."

In re Myers, 393 B.R. 616*, 2008 Bankr. LEXIS 2172**, 66 U.C.C. Rep. Serv. 2d (Callaghan) 72

See also - *In re Townsend*, 387 B.R. 817 (Bankr. D. Kan 2008); cases cited in *In re Porch*, 2009 Bankr. LEXIS 3579
- Does Negative Equity Negate the Hanging Paragraph- David Gray Carlson, 20 Am. Bankr. Inst. L. Rev. 535

ISSUE TWO – PERSONAL USE

- How does the Court determine if a vehicle was "acquired for the personal use of the Debtor"?

PERSONAL USE v. BUSINESS USE

"Whether a vehicle is acquired for 'personal use' for purposes of §1325(a)(*) is determined at the time the vehicle is purchased in light of the **totality of the circumstances**."- *In re Matthews*, D.S.C. C/A 07-01846-JW (August 28, 2007) (emphasis added)

"The stipulated evidence shows that Debtor did not acquire the vehicle for business purposes. Merely acquiring a vehicle for her own use, with one of the uses contemplated being to drive to and from work, is not for "business" purposes; it is for personal use." *In re Lowder,* 2006, Bankr. LEXIS 1191

"Debtors intended that a **significant and material portion** of their use of both the Dodge pickup and the Ford Expedition would be for the personal use and benefit of both Debtors. Based on these findings, the Court finds the hanging paragraph in §1325(a) applies.."- *In re Wilson,* D.K.S. C/A 06-40637 (December 5, 2006) (emphasis added)

Statement in retail sales agreement that vehicle was purchased for "personal, family or household use" was not dispositive for creditor.- *In re Jackson*, 338 B. R. 923 (Bankr. M.D. Ga. 2006)

See also *In re Adams,* 2007 Bankr. LEXIS 616 (Bankr. M.D. Ga. Mar. 1, 2007)

ISSUE TWO – PERSONAL USE

- How does the Court determine if a vehicle was "acquired for the personal use of the Debtor"?

PERSONAL USE OF THE DEBTOR OR SOMEONE ELSE?

"Based on the above analysis, by giving meaning to all of the words within the hanging paragraph (personal use *of the debtor*), but being careful not to add words that are not there (personal, *family or household* use), this Court holds that the Debtor's Maxima does not qualify for the 910-day treatment because the Debtor acquired it for the personal use of this fiancée." *In re Ford*, E.D.WI C/A 07-28188-svk (April 29, 2008)

"This Court is nonetheless satisfied that where the car is acquired for the primary use of a nondebtor to the secured creditor, the car is not "acquired for the personal use of the debtor" within the meaning of the hanging paragraph in *§ 1325(a)*." *In re Press*, 2006 Bankr. LEXIS 2296

ISSUE THREE – ANY OTHER THING OF VALUE

- Does a business-use vehicle purchased within one year of filing qualify as "any other thing of value"?

YES (Minority)

"Only if the specific is assumed to be 'motor vehicle', rather than "motor vehicle… acquired for the personal use of the debtor,' the conclusion (a non-personal use motor vehicle cannot be an 'other thing') is, as Balsinde said, 'impossible."

"How, if at all, does the meaning of 'any other thing of value" differ from "anything else of value" on a straightforward reading?"

"I conclude that claims of creditors holding purchase money liens on motor vehicles acquired for nonpersonal use of the debtor cannot be modified if the debtor incurred the debt within a year of the bankruptcy filing."

In re Littlefield, 388 B.R. 1, *5, 2008 Bankr. LEXIS 1551**, 59 Collier Bankr. Cas. 2d (MB) 1375

ISSUE THREE – ANY OTHER THING OF VALUE

- Does a business-use vehicle purchased within one year of filing qualify as "any other thing of value"?

NO (Majority)

"In sum, a motor vehicle acquired within one year of the Bankruptcy filing is not an 'other thing of value' as that term is used in the last clause of the hanging paragraph." *In re Horton,* 389 B.R. 73*; Bankr. LEXIS 3326**, 21 Fla. L. Weekly Fed. B 533

"Since Nissan has a purchase money security interest in a *vehicle* and not 'any other thing of value', the second portion of the hanging paragraph does not apply …" *In re Ford,* E.D.WI C/A 07-28188-svk (April 29, 2008)

All Things Motor Vehicle in Bankruptcy

Substitutions of Collateral

Substitutions of Collateral

"Total Loss" Vehicle and the Chapter 13 Debtor

Substitutions of Collateral

Priority inchoate lien on insurance proceeds

See, e.g., Moore v. Ormond Wholesale Co., Inc. v. Moore (In re Moore), 54 B.R. 781 (Bankr. E.D.N.C. 1985); *Wilson v. Kleinfeld, Trustee (In re Garrett Marine, Inc.)*, 92 B.R. 519 (Bankr. M.D.Fl. 1988).

Substitutions of Collateral

Vehicles Sold Post-Petition

Repossessed vehicle sold after petition filed in violation of automatic stay

Questions?

American Bankruptcy Institute 2019 Southeast Bankruptcy Workshop

All Things Motor Vehicle in Bankruptcy (Co-Debtor Stay)

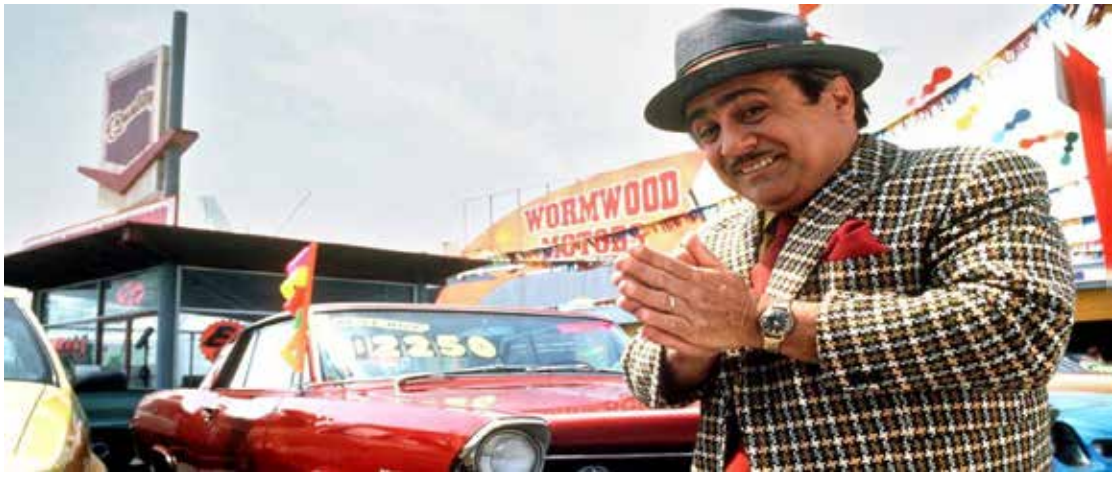
Pamela P. Keenan (Moderator), Kirschbaum, *et. al*, Raleigh, N.C.
Hon. Gregory R. Schaaf, USBC EDKy
Theodore von Keller, Crawford & von Keller, LLC, Columbia, S.C.

July 19, 2019

(Almost) Everyone Needs a Car

- Geography
- Mass Transit Limitations
- Age/health
- Children's Activities

(Almost) Everyone Needs a Loan



But, Can Everyone Get a Loan?

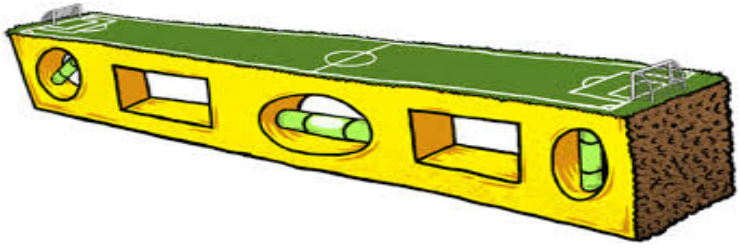
- Solution: Co-Signor
  - No Credit History (*E.g.,* child fresh out of school)
  - Low Credit Score (We are dealing w/ debtors)

Not Everyone Pays The Loan When Due

- Creditor Action: Repossession
- Debtor Response: Chapter 13 & Return of Vehicle
- But What If There Is a Non-debtor Co-Signor?

= **LEVERAGE** for Creditor

Level the Playing Field: Co-Debtor Stay



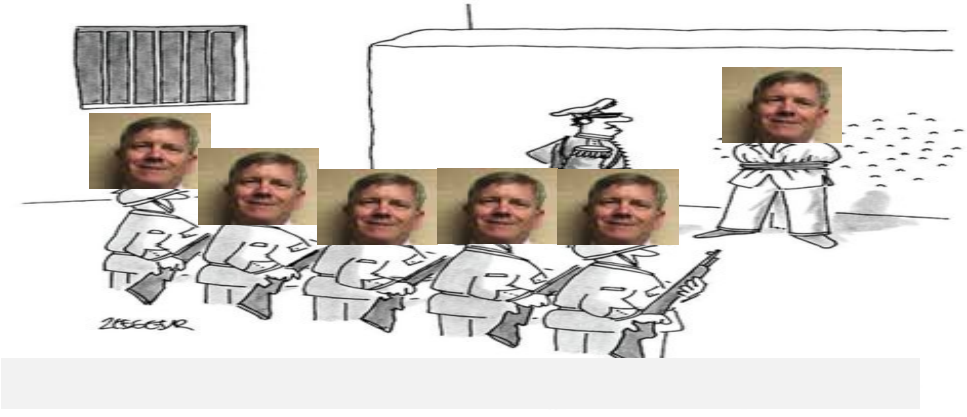
- § 1301(a): Stay of Civil Acts to Collect Pre-petition Consumer Debt
  - On Which an Individual
  - Is a Co-signor

Not a Complete Bar to Action

- Stay Does Not Apply to:
  - Business Debts
  - The Case is Closed, Dismissed, Converted
  - Debtor Is the Co-Signor for a Beneficiary
  - Plan Does Not Provide for Payment
  - Irreparable Harm to Creditor.

Co-Debtor Stay Relief

Remember This? – If No Objection w/in 20 Days, Relief Granted



The Problem: Not a Permanent Fix

The Co-Debtor Stay Only Delays the Inevitable

The Creditor Eventually Gets Paid (so it hopes).

Will the Creditor Forget?

- Maybe: 5 Year's Later – Is It Worth It?
  - Five More Years Wear and Tear
  - Probably Low Maintenance
- Maybe Not: Repossession
  - The Debtor Has Paid Something for Five Years
  - § 1301(a)(2): Stay Ends on Closing, Dismissal, or Conversion

Debtor:"*Give it back*"

C'or: "No way!"

How To Avoid (Maybe) Repossession

- § 1322(a)(3), § 1322(b)(1): Classification of Claims
- Follow § 1122 – Substantially Similar Claims
- May Not "Discriminate Unfairly"
- **The Big But in § 1322(b)(1)**: Can You?

"…however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;"

Separate Classification

1322 (b) Subject to subsections (a) and (c) of this section, the plan may—

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not **discriminate unfairly** against any class so designated; **however,** such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor **differently** than other unsecured claims;

VEHICLE VALUATIONS

THEODORE VON KELLER, ESQUIRE
CRAWFORD & VON KELLER, LLC

11 USC §506(a)(2)

If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.

DETERMINING THE VALUE

- Pre-Reform Act: "'replacement value'" is "the price a willing buyer in the debtor's….situation would pay to obtain like property from a willing seller." *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997)
- Post-Reform Act: The Code sets "replacement value of such property as of the date of the filing of the petition" as the standard in §506(a)(2) with the added guidance of "the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined."
- "Burden-Shifting":
  - The initial burden should be on the party challenging a secured claim's value, because "11 U.S.C. § 502(a) and Bankruptcy Rule 3001(f) grant prima facie effect to the validity and amount of a properly filed claim." In re Williams, 381 B.R. 742, 744 (Bankr.W.D.Ark.2008) as cited in *In re Heritage Highgate*, 2012 WL 1664174 *6
  - If the movant establishes with sufficient evidence that the proof of claim overvalues a creditor's secured claim because the collateral is of insufficient value, the burden shifts. The creditor thereafter bears "the ultimate burden of persuasion to demonstrate by a preponderance of the evidence both the extent of its lien and the value of the collateral securing its claim."[4] In re Robertson, 135 B.R. at 352 (Bankr.E.D.Ark.1992) as cited in *In re Heritage Highgate*, 2012 WL 1664174 *6

DETERMINING THE VALUE

- For vehicle valuations, many Courts utilize published guides such as NADA and Kelley Blue Book (KBB). However, some courts have criticized the NADA process as being too automated, thus lacking flexibility to consider property-specific issues. See *In re Arendarczyk, 2014 WL 6629770, at *5 (Bankr. S.D. Ga Nov. 21, 2014)*
- Some creditors also utilize professional appraisers to inspect the collateral and testify to its value.
- Determinations of value from prior cases are not binding in current case. *Estate Const. Co. v. Miller & Smith Holding Co., Inc., 14 F.3d 213, 219 (4th Cir. 1994)*

STARTING FROM NADA (OR KBB)

Among the Courts that utilize NADA or KBB, there are several approaches taken to derive a specific value for the vehicle in question:

1. A certain percentage is deducted from the NADA Clean Retail value.
   - A 10% deduction: *In re Mayland*, Bankr. L. Rep. 80, 679, 2006 WL 1476927, at *1 (Bankr. M.D.N.C. 2006);
   - A 5% deduction: *In re Cheatham*, 2007 WL 2428046, at *3 (Bankr. W.D. Mo. 2007)

2. The Court uses the NADA Clean Retail value as the presumptive value.
   In re Eddins, 355 B.R. 849, 852 (Bankr. W.D. Okla. 2006); *In re Morales*, 387 B.R. 36, 37 (Bankr. C.D. Cal. 2008); *In re Scott*, 437 B.R. 168, 170, 174 (Bankr. D.N.J. 2010)

3. The Court uses NADA or KBB as a starting point but applies the specific facts of the case in determining which value should be used (Clean Retail, Private Party, etc).
   In re Berry, 2008 WL 2064777, at *4 (Bankr. D.Vt. 2008); *In re Gonch*, 435 B.R. 857, 865 (Bankr. N.D.N.Y. 2010)

4. The Court uses the average of NADA Clean Retail and Clean Trade-In values.
   In re Nice, 355 B.R. 554, 557 (Bankr. N.D.W.Va. 2006); Bankr. D.Vt. R. 3012-1(b), *available at* http://www.vtb.uscourts.gov/Local_Rules_Supplement.php.

TESTIMONY AND EVIDENCE

- "When faced with competing evidence as to the value of property, an assessment as to the retail value of a vehicle under § 506(a)(2) ultimately depends on the facts presented in each case." *In re Morales*, 387 B.R. 36, 45 (Bankr. C.D.Cal. 2008)

- "[in regard to parties submitting internet sales reports] By contrast, blue book guidelines provide a neutral and independent source of a vehicle's value."
  "However, blue book guidelines are unable to account for the myriad of facts that may be peculiar to a debtor's particular vehicle. As such, blue book guidelines, while constituting strong probative evidence of value, are not necessarily conclusive."
  "Instead, when such evidence is available, as it is here, blue book guidelines should be used in conjunction with expert testimony"
  In re Wcislak, 446 B.R. 827 (2011) citing In *re Roberts*, 210 B.R. 325 (Bankr. N.D. Iowa 1997)

- "…in assessing a vehicle's value for purposes of § 506(a)(2), costs of necessary repairs are to be deducted. *In re Hauser*, 405 B.R. 684, 685 (Bankr. S.D.Fla. 2009)

- GETTING NADA OR KBB REPORT ADMITTED INTO EVIDENCE: *In re McElroy*, 339 B.R. 185, 188 (Bankr. C.D. Ill. 2006) (stating that NADA report is admissible under Federal Rule of Evidence's Rule 803(17) hearsay exception as "the authoritative source that is most relevant and applicable to the valuation" of vehicles in Chapter 13 cases)

WILD CARDS

- "Courts are free to form their own opinions based on the information provided to them that does not conform precisely to the conclusion presented." *In re Fortenberry*, Case No. 14-50768, 2014 WL 7407515, at *3 (Bankr. S.D. Miss. Dec. 30, 2014)
- The Court doesn't always have to determine a value: "Because Hendley bears the burden of proof for confirmation and failed to demonstrate that her proposed valuation…. complies with §1325 and applicable authorities, confirmation of the plan….is denied." *In re Hendley,* D.S.C C/A 17-03343-HB (October 6, 2017)
- Valuation issues and arguments can also arise from the Debtor's Objection to Allowance of Proof of Claim: *In re Nance,* 477 B.R. 638 (2012)

VALUATIONS WITH A NON-FILING CO-DEBTOR

Why do Debtors' attorneys continue to value liens on vehicles when there is a co-signed debts?

SURE, IT LOOKS GREAT ON PAPER:

- Paying the value instead of the balance means a lower monthly plan payment.

.

BUT THERE'S NO REAL BENEFIT FOR THE DEBTOR WHEN THERE'S A NON-FILING CO-DEBTOR:

- Debtor gets a discharge of the debt but this has no effect on the non-filing Co-Debtor's liability under the contract. 11 U.S.C. §524(e)
- Creditor's lien remains after discharge on the non-filing Co-Debtor's interest in the vehicle. *Brooks v. Gen. Motors Acceptance Corp. (In re Brooks),* 340 B.R. 648 (Bankr. D. Me. 2006)
- While the Creditor cannot collect or attempt to collect money from the discharged Debtor, it is under no obligation to release its lien on the title, said lien still being secured by the non-filing Co-Debtor's obligation on the non-filing Co-Debtor's interest in the vehicle. Creditor can still pursue collection efforts against the co-debtor for the remainder of their obligation and/or can repossess the vehicle. See Faulkner v. CEFCU (In re Faulkner), 2013 WL 2154790 (Bankr. C.D. Ill. May 17, 2013); In re Jackson, 2012 WL 6623497 (Bankr. M.D. Ga. Dec. 18, 2012); Brooks v. Gen. Motors Acceptance Corp. (In re Brooks), 340 B.R. 648 (Bankr. D. Me. 2006); In re Leonard, 307 B.R. 611 (Bankr. E.D. Tenn. 2004); Southeastern Bank v. Brown, 266 B.R. 900 (S.D. Ga. 2001)

All Things Motor Vehicle in Bankruptcy

Substitutions of Collateral and Dealing With Contracts For Aftermarket Products Financed Under a Retail Installment Sale Contract

Substitutions of Collateral

"Total Loss" Vehicle and Chapter 13 Debtor

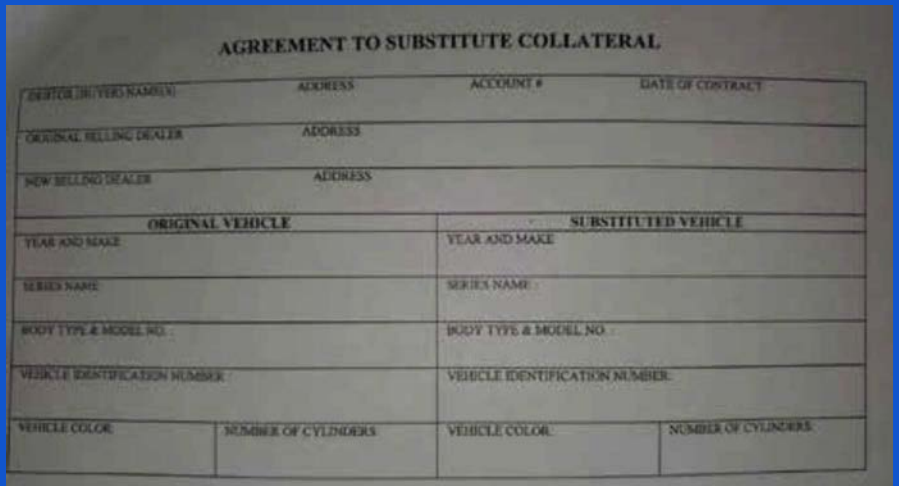
Substitutions of Collateral

Priority inchoate lien on insurance proceeds

See, e.g., Moore v. Ormond Wholesale Co., Inc. v. Moore (In re Moore), 54 B.R. 781 (Bankr. E.D.N.C. 1985); *Wilson v. Kleinfeld, Trustee (In re Garrett Marine, Inc.)*, 92 B.R. 519 (Bankr. M.D.Fl. 1988).

Substitutions of Collateral

Substitution of Collateral Order



AGREEMENT TO SUBSTITUTE COLLATERAL

DEBTOR (BUYER) NAME(S)	ADDRESS	ACCOUNT #	DATE OF CONTRACT
ORIGINAL SELLING DEALER	ADDRESS		
NEW SELLING DEALER	ADDRESS		

ORIGINAL VEHICLE		SUBSTITUTED VEHICLE	
YEAR AND MAKE		YEAR AND MAKE	
SERIES NAME		SERIES NAME	
BODY TYPE & MODEL NO.		BODY TYPE & MODEL NO.	
VEHICLE IDENTIFICATION NUMBER		VEHICLE IDENTIFICATION NUMBER	
VEHICLE COLOR	NUMBER OF CYLINDERS	VEHICLE COLOR	NUMBER OF CYLINDERS

Substitutions of Collateral

Vehicles Sold Post-Petition

Repossessed vehicle sold after petition filed in violation of automatic stay

GAP Insurance Policies, Extended Warranty Contracts, and Other Aftermarket Products

Additional collateral?

Executory contracts?

Questions?

American Bankruptcy Institute
2019 Southeast Bankruptcy Workshop

July 18-21, 2019
The Ritz-Carlton
Amelia Island, Florida

All Things Motor Vehicle in Bankruptcy

Hon. Gregory R. Schaaf
U.S. Bankruptcy Court, ED Kentucky
Lexington, Kentucky

Pamela P. Keenan (Moderator)
Kirschbaum, Nanney, Keenan & Griffin, P.A.
Raleigh, North Carolina

Theodore von Keller
Crawford & von Keller, LLC
Columbia, South Carolina

All Things Motor Vehicle In Bankruptcy:

Substitutions of Collateral and Dealing With Contracts For Aftermarket Products Financed Under a Retail Installment Sale Contract

By: Pamela P. Keenan
Kirschbaum, Nanney, Keenan & Griffin, P.A.

I. Introduction

These materials first cover substitutions of collateral in both the situation where a vehicle owned by a debtor in an on-going Chapter 12 or Chapter 13 case is involved in an accident and deemed a "total loss" by the insurance carrier, and the situation where a creditor which repossessed its motor vehicle collateral pre-petition sells that collateral post-petition but prior to having notice of the debtor's bankruptcy filing. Second, these materials address how to classify and appropriately provide for aftermarket products such as GAP insurance coverage and extended warranty contracts financed as part of a retail installment sale contract for a motor vehicle.

II. Substitutions of Collateral

A. Vehicles "Totaled" In An Accident.

For many Chapter 13 debtors, their vehicle is the key to the success of their Chapter 13 Plan. Without dependable transportation, maintaining steady employment becomes extremely difficult with a corresponding negative impact on the debtor's ability to maintain steady Plan payments. When a Chapter 13 debtor's vehicle is involved in an accident and declared a "total loss," she/he typically doesn't have any funds saved up to make a down payment on a replacement vehicle and the interest rates charged on vehicle loans to debtors in an active bankruptcy case are inevitably many percentage points higher than the interest rates those same debtors were able to negotiate for their pre-petition vehicle financing needs. As such, using the insurance proceeds paid out for the wrecked vehicle to purchase a similar replacement vehicle for cash, transferring the lender's lien from the wrecked vehicle to a replacement vehicle in the process, is often the only feasible option to keep the debtor on the road to and from work each day.

In effecting such a substitution of collateral, the needs of the Chapter 13 debtor have to be balanced with the rights of the effected lienholder. Apart from certain special provisions, the Bankruptcy Code generally leaves the determination of property rights in the assets of a bankrupt debtor's estate to applicable state law. *See Butner v. U.S.*, 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979). Applicable non-bankruptcy law in many states imposes a priority inchoate lien in favor of the lienholder on the insurance proceeds paid for its destroyed collateral, if insuring the collateral for the lienholder's benefit was a part of the parties' contractual agreement. *See e.g.*,

Moore v. Ormond Wholesale Co., Inc. v. Moore (In re Moore), 54 B.R. 781 (Bankr. E.D.N.C) 1985; *Wilson v. Kleinfeld, Trustee (In re Garrett Marine, Inc.),* 92 B.R. 519 (Bankr. M.D. Fl.) 1988. What form of adequate protection is reasonable and/or necessary to protect such inchoate lien rights therefore becomes the heart of the matter to both sides when working through a substitution of collateral scenario.

Of primary importance to the debtor who is proposing a substitution of collateral is moving the process along quickly since once a proposed replacement vehicle has been selected, most dealerships will not hold the selected vehicle for more than a day or two. Of primary importance to the lienholder is a right of approval for any proposed replacement vehicle, and no disbursement of the insurance proceeds to the seller of an approved replacement vehicle until the debtor has signed an appropriate security agreement giving the lienholder a purchase money security interest in the replacement vehicle and a title application showing the lienholder as having the first lien on the same. Given the bureaucratic structure and nature of many vehicle finance companies, meeting both of these objectives at the same time can often prove challenging.

To attempt to ameliorate this inherent tension, the Bankruptcy Courts in North Carolina have developed a fairly standard Substitution of Collateral Order that provides for the debtor's attorney to be the single party who controls the process. To that end, the insurance company in question is directed to deliver all available insurance proceeds to the debtor's attorney, who is directed to advise the lienholder of the delivery of such insurance funds and then hold such insurance proceeds in trust until such time as (i) the lienholder approves a particular replacement vehicle and (ii) the debtor has signed an appropriate security agreement/title application for same.

Such standard orders also include other pertinent provisions, such as the documents needed by the lienholder in order to assess whether a particular proposed replacement vehicle is or isn't a reasonable substitute for the wrecked vehicle. These are typically a bookout sheet showing the particulars of the vehicle, a bill of sale showing the breakdown of the proposed price for same, and a sworn odometer statement. Importantly, they also designate the specific time frame in which the lienholder must give the debtor its approval (or disapproval) of a particular proposed replacement vehicle, which is typically only 24-48 hours after the appropriate documents are submitted to the lienholder. These standard orders may also designate other documents the debtor needs to provide in connection with the transaction such as proof of insurance coverage on the replacement vehicle. Of course, any insurance proceeds not used for the replacement vehicle must go to pay down the debt secured by the wrecked vehicle, and any shortfall in the purchase price of the replacement vehicle has to be tendered by the debtor so that there are no other liens on the replacement vehicle.

A sample of such a standard Substitution of Collateral Order used by the Eastern District of North Carolina is attached as Exhibit 1.

As a practical matter, the key to a successful substitution of collateral is for the debtor's attorney to establish an effective line of communication with the lienholder as soon as he or she is advised

by the debtor of the loss of the wrecked vehicle and the need to do a substitution of collateral to obtain a replacement vehicle. This can often be best accomplished by the debtor's attorney reaching out to the attorney in his/her district who regularly represents the lienholder in question. If the debtor's attorney doesn't know who that attorney is, a quick way to find out is often to post the question on any bankruptcy group listserve to which the debtor's attorney has access. If no regularly appearing attorney is in play, the listserve participants may alternatively be able to provide the debtor's attorney with the name or contact number for the affected lienholder's office that handles its bankruptcy files.

Once contact has been successfully made with either the lienholder's regular bankruptcy attorney or an appropriate representative at the lienholder's offices, the next crucial step is for the debtor's attorney to get the name and direct phone/fax number and/or email address for the individual who will make the decision for the lienholder on approving or disapproving a replacement vehicle. With the relatively short turnaround times in substitution of collateral orders, getting the required information directly into the hands of the actual decision maker obviously serves the best interests of both the debtor and the lienholder.

Once a particular replacement vehicle has been approved, getting the appropriate address for the lienholder to be used on the title application is also imperative. Some states actually still issue paper titles for vehicles and mail them for safekeeping to the listed lienholder at its listed address. Also, the address listed for the lienholder on the title application is the only address the issuing DMV will put in its database for the lienholder *vis-à-vis* the replacement vehicle, meaning that is the only address to which any pertinent notices will be sent the lienholder by the issuing DMV should the replacement vehicle subsequently get impounded, left unclaimed at a mechanic's shop/storage facility, etc.

Finally, since these standard orders make the debtor's attorney the disbursing agent for the transaction, and therefore responsible for safeguarding the insurance proceeds until all the prerequisites for disbursement have been met, the debtor's attorney needs to take his/her responsibilities in this process seriously. In that regard, a debtor's attorney who hands over the insurance funds to the debtor in order for him or her to go to the dealership alone and close the deal acts at his or her own peril. If things don't go as planned, the debtor's attorney may well be staring down a contempt motion by the lienholder. Alternatively, if the debtor turns out to be less than honest and takes advantage of the situation to obtain a clean title to the replacement vehicle which is then "flipped" to a BFP, the lienholder may well file a negligence action against the debtor's attorney seeking recovery from him or her of the entire amount of the insurance proceeds that were not appropriately safeguarded for the lienholder's benefit.

The typical situation though is that many debtors in this situation simply won't grasp all the nuances of the transaction. When these debtors get to the dealership, the only thing the dealership is really worried about is closing the sale so it can get paid. At the same time, since it's a cash sale, the dealership may or may not be aware of the fact that there is indeed a lien in play that needs to be preserved via the listing of the lienholder on the title application for the replacement vehicle. Therefore, best practices would dictate that the debtor's attorney take the insurance proceeds and accompany the debtor to the dealership to insure that the new security

agreement and an appropriate title application are in fact signed by the debtor contemporaneously with the insurance funds being tendered to the dealership for the replacement vehicle. Alternatively, if the debtor's attorney is not willing to commit the time necessary to close the deal in person, he or she should at the least make sure the original security agreement signed by the debtor is in-hand for mailing to the lienholder and the debtor has a fully completed title application in his or her possession for signature and notarization at the dealership if the insurance funds are going to be given to the debtor to tender to the dealership.

B. *Vehicles Sold Post-Petition.*

Although it doesn't happen often, a lienholder will occasionally find itself in the position of having to substitute its own collateral due to an unauthorized post-petition sale of the debtor's vehicle that it can't unwind. This usually comes up right at the commencement of a bankruptcy case where the lienholder has repossessed the vehicle more than 10 days prior to the filing date and scheduled it for sale, and then conducts that sale after the bankruptcy case is commenced but prior to the lienholder having any knowledge of same. Such a sale clearly violates the automatic stay, inasmuch as the creditor disposed of an asset of the debtor's bankruptcy estate without permission of the Bankruptcy Court to do so.

In these circumstances, the debtor is again left without transportation that is likely essential to him/her holding down a job and therefore funding his/her Chapter 13 Plan. It is therefore necessary that the lienholder move with all due speed in remedying the situation as quickly as possible, to minimize any damages the debtor might look to recover from the lienholder in the form of lost wages, interim transportation costs, etc.

Typically, if the lienholder is one of the large national finance companies, it is able to quickly locate a proposed replacement vehicle somewhere in the U.S. that is very similar to the sold vehicle in terms of year, make, model, mileage, equipment, etc. If the lienholder is a small local car dealer, finding an appropriate replacement vehicle can be more challenging, although even these dealerships now have access to a much larger geographic marketplace for used vehicles in light of the internet.

Once a similar vehicle is located, the debtor is now the one who has the ability to approve or reasonably disapprove such vehicle. If approved, the same type of paperwork then comes into play, *i.e.*, a new security agreement for the replacement vehicle, a title application with the lienholder listed on the same, and proof of insurance coverage by the debtor for the replacement vehicle. Obviously though, there are no concerns presented by this scenario regarding the safeguarding of funds or the appropriate/inappropriate disbursement thereof since the lienholder will tender the sales proceeds (and any additional monies necessary) to purchase the replacement vehicle approved by the debtor.

Practically speaking, the challenge for the attorney representing the lienholder in these situations is to make sure that it doesn't include any costs it incurred in the unauthorized post-petition sale of the repossessed vehicle, and/or any additional monies it had to expend to obtain an appropriate replacement vehicle, in its proof of claim filed in the debtor's bankruptcy case. Since the replacement vehicle is being substituted for the original vehicle, the lienholder's proof of claim

should only appropriately reflect the balance due the lienholder for the original vehicle as of the petition date, unless the parties have agreed to increase the balance due under the debtor's contract in order for the debtor to get a better replacement vehicle than the original vehicle.

III. GAP Insurance Policies, Extended Warranty Contracts and Other Aftermarket Products

A. Overview.

When purchasing and financing a motor vehicle, debtors often "bundle" and finance other products at the same time as part of their retail installment sale contract (the "RISC"). The most common of these include an extended warranty for future repairs the vehicle may need, GAP insurance coverage if the vehicle is wrecked and the debtor's comprehensive and collision insurance coverage doesn't pay the entire balance still owed by the debtor for the vehicle, and credit life/disability insurance coverage should the debtor's ability to make the payments due for the vehicle be interrupted or impaired. While the "hanging paragraph" to Section 1325(a) eliminates the need in many instances for a creditor who finances these products along with the vehicle to worry about all the various things that got financed under the RISC when the debtor files for bankruptcy, the undersecured creditor who doesn't have a "910" claim must still take one or more extra steps if it wants to try and capture any additional monies that may be properly owed to it by the Debtor in addition to just the "replacement value" of the subject vehicle.

B. Are These Products Additional Collateral And If So, What Is Their "Value" as of the Petition Date ?

Many finance contracts for vehicles specifically provide that the debtor grants the finance company a security interest not only in the vehicle, but also in any insurance policies covering the vehicle, warranty policies, and the proceeds from same. In those cases, the enumerated aftermarket products purchased and financed along with the vehicle appear to be additional collateral for the finance company securing the total amount financed by the debtor for the vehicle and the aftermarket products combined. But while all of the Bankruptcy Courts have enumerated some type of standard for determining the "replacement value" of a motor vehicle for purposes of determining the finance company's secured claim for a motor vehicle, no such widely-accepted valuation standard exists with respect to valuing aftermarket products ancillary to a motor vehicle finance contract.

A good place to start though is to ask the question, "are there any unearned premiums for any of these aftermarket products that could be rebated and applied to the balance due if the aftermarket product was cancelled as of the petition date?" If the answer is no, then the aftermarket product has essentially been fully depreciated/depleted and has no remaining value. However, if the answer is "yes," the creditor has an argument that the amount of such unearned premium rebate is the current fair market value of the aftermarket product in question, and the debtor should be required to increase the secured portion of the finance company's claim for the vehicle/aftermarket product by such amount if the debtor wants to keep such aftermarket product post-petition. Otherwise, the debtor should be required to "surrender" his or her interest in the aftermarket product so that the finance company can cancel it and apply the unearned premium

rebate to the amount due under the finance contract. This would unquestionably be the case if it were the vehicle that was in question. If the debtor doesn't wish to pay the finance company the current fair market value of the vehicle, he or she clearly has no right to retain its possession and corresponding benefit. The outcome presumably shouldn't be any different with any other type of collateral in which the debtor gave the finance company a security interest, including these aftermarket products.

C. *Alternatively, Are These Aftermarket Products Executory Contracts The Debtor Must Assume Or Reject ?*

If the debtor's finance contract doesn't expressly grant the finance company a security interest in these aftermarket products, the finance company may alternatively be able to argue that they are executory contracts the debtor must assume or reject in order to keep them. Of course, if the debtor assumes them, he or she must pay the amounts remaining due under them, just like any other executory contract.

The Bankruptcy Code does not expressly define "executory contract." However, most courts have defined an executory contract as "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." *See, e.g., In re Murexco Petroleum, Inc.*, 15 F.3d 60 (5th Cir. 1994); *Gloria Mfg. Corp. v. Internat'l Ladies Garment Workers' Union*, 734 F.2d 1020, 1021 (4th Cir. 1984). Various courts have expressly held that insurance policies in particular are in fact executory contracts that the debtor can assume or reject.

If an aftermarket product qualifies as an executory contract in the debtor's particular case, the amount "remaining due" under same again appears to be the amount of any unearned premium rebate that would be issued if the aftermarket product was rejected and therefore cancelled. Accordingly, the finance company should request the Bankruptcy Court specifically require the debtor assume or reject the aftermarket product contract and, if assumed, increase the amount being paid to the finance company with respect to the RISC by the amount of the unearned premium rebate in question.

EXHIBIT 1

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NORTH CAROLINA
WILMINGTON DIVISION

IN RE:	)	
	)	
XXX,	)	**CASE NO. _____**
	)	**CHAPTER 13**
DEBTOR.	)	

CONSENT ORDER ALLOWING SUBSTITUTION OF COLLATERAL

THIS CAUSE comes on before the Court upon the joint request of the Debtor and YYY ("Lienholder"), by and through their respective counsel, and without objection by the Trustee, for entry of this Consent Order allowing for a substitution of collateral as described below. After having considered the record in this case, and with the consent of the parties subscribed hereto, the Court makes the following:

FINDINGS OF FACT

1. The Debtor commenced this case by a Chapter 13 petition filed _____.

2. As of the petition date, the Debtor was the owner of a _____, VIN #_____ (the "Wrecked Vehicle") on which Lienholder holds a duly perfected first lien.

3. The Debtor's confirmed Chapter 13 Plan provides Lienholder with a secured claim for the Wrecked Vehicle in the amount of $_____ with interest thereon at the rate of ___% *per annum*.

4. The Wrecked Vehicle was recently involved in an accident and deemed a total loss, and there is $_____ in insurance proceeds available with respect to same which the Debtor wishes to use to purchase a replacement vehicle.

BASED UPON THE FOREGOING FINDINGS OF FACT, THE COURT CONCLUDES AS A MATTER OF LAW THAT:

1. This Court has jurisdiction over the parties and subject matter of this action.

2. The loss of the Wrecked Vehicle leaves the Debtor without reliable transportation necessary for a successful reorganization.

3. The Debtor's request for a substitution of collateral would not cause undue hardship to Lienholder and replacement of the Wrecked Vehicle with an appropriate replacement vehicle would not adversely affect Lienholder's secured clam for the Vehicle in this case.

ACCORDINGLY, IT IS HEREBY ORDERED AS FOLLOWS:

1. The Debtor is hereby authorized to use the insurance proceeds available for the Wrecked Vehicle for the purposes of obtaining a replacement vehicle to be substituted for the Wrecked Vehicle under the Debtor's existing vehicle loan with Lienholder, on the terms set forth below.

2. The replacement vehicle chosen by the Debtor must be mutually acceptable to the Debtor and Lienholder, and must be comparable in value to the Wrecked Vehicle. In order to obtain Lienholder's consent to a replacement vehicle, the Debtor must provide Lienholder with (i) a copy of a bookout sheet listing all options on the proposed replacement vehicle, (ii) an Odometer Statement for same signed by the selling dealership and the Debtor, and (iii) a Buyer's Order signed by the selling dealership and the Debtor. Prompt consent (within three (3) business days after receiving this required information) shall not be unreasonably withheld or delayed by Lienholder.

3. The Debtor's insurance company is hereby authorized to pay all proceeds available for the Wrecked Vehicle directly to the Debtor's attorney, to be held by the Debtor's attorney in his trust account and released to the selling dealership only at such time as the Debtor's attorney has confirmed that:

(i) the attached Security Agreement for the replacement vehicle has been completed and signed/notarized as indicated;
(ii) the attached Application For Title and Lien Recording has been completed and signed/notarized as indicated.

4. The Debtor's attorney shall provide Lienholder's undersigned counsel with the original completed Security Agreement, and a copy of the completed Application For Title and Lien Recording being submitted by the selling dealership to the DMV, within five (5) business days of his release of the insurance proceeds.

5. Any insurance proceeds not used for the purchase of the replacement vehicle shall be delivered by the Debtor's attorney to the Trustee for disbursement on Lienholder's secured claim for the Vehicle.

6. Upon notification from the Debtor's attorney that he is in receipt of the insurance proceeds for the Wrecked Vehicle, Lienholder is required to release its lien on the Wrecked Vehicle and surrender its certificate of title to the insurance company paying the claim for the Wrecked Vehicle.

CONSENTED TO:

AGREEMENT TO SUBSTITUTE COLLATERAL

DEBTOR (BUYER) NAME(S)	ADDRESS	ACCOUNT #	DATE OF CONTRACT
ORIGINAL SELLING DEALER	ADDRESS		
NEW SELLING DEALER	ADDRESS		

ORIGINAL VEHICLE		SUBSTITUTED VEHICLE	
YEAR AND MAKE		YEAR AND MAKE	
SERIES NAME:		SERIES NAME :	
BODY TYPE & MODEL NO. :		BODY TYPE & MODEL NO. :	
VEHICLE IDENTIFICATION NUMBER :		VEHICLE IDENTIFICATION NUMBER:	
VEHICLE COLOR:	NUMBER OF CYLINDERS:	VEHICLE COLOR:	NUMBER OF CYLINDERS:

Whereas, Original Selling Dealer and Buyer(s) entered into a Retail Installment Contract identified by the above account number (the "Contract") for the purchase of the Original Vehicle; and

Whereas, the Contract was assigned by Selling Dealer to _____ ("Assignee"); and

Whereas, the Original Vehicle has been determined to be a total loss as a result of theft or damage; and

Whereas, Buyer(s) and Assignee wish to use the insurance proceeds to acquire the Substituted Vehicle from the New Selling Dealer and substitute the Substituted Vehicle for the Original Vehicle under the Contract;

Now, therefore, in consideration of the undertakings herein, the receipt and sufficiency of which is hereby acknowledged, the parties hereby agree as follows:

1. **Release of Original Vehicle.** Buyer(s) relinquish to New Selling Dealer all of their title and interest in the insurance proceeds from the Original Vehicle.

2. **Delivery of Substituted Vehicle/Grant of Security Interest by Buyer(s).** Buyer(s) accepts delivery of the Substituted Vehicle and agrees that the terms and conditions of the Contract shall apply to the Substituted Vehicle, and Assignee shall have a security interest in the Substituted Vehicle as provided in the Contract.

3. **Consent to Security Interest/ Release of Security Interest in Original Vehicle.** Assignee accepts a security interest in the Substituted Vehicle and releases its security interest in the insurance proceeds from the Original Vehicle.

4. **Effect on Other Agreements.** Except as stated above and except for a premium adjustment for physical damage insurance (if any), the terms and conditions of the Contract shall continue in full force and effect. The terms and conditions of the agreement between Selling Dealer and Assignee shall apply to the Substituted Vehicle and shall otherwise remain in full force and effect.

By signing below, we acknowledge our agreement to the above Agreement to Substitute Collateral, effective as of _____, 20____.

Buyer: _____

Co-Buyer: _____

_____(Assignee)

By: _____

Title: _____

PARSING THE PARAGRAPH

THEODORE VON KELLER, ESQUIRE
CRAWFORD & VON KELLER, LLC

THE HANGING PARAGRAPH

- For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a **purchase money security interest** securing the debt that is the subject of the claim, the debt was incurred within the 910-day period preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) **acquired for the personal use of the debtor**, or if collateral for that debt consists of **any other thing of value**, if the debt was incurred during the 1-year period preceding that filing.

ISSUE ONE - PMSI

- Money paid by dealer to pay off trade-in (negative equity), GAP insurance/credit life insurance, extended warranties… are these secured by a PMSI?

NO (Minority view)

"The concept of 'purchase-money security interest' requires a close nexus between the acquisition of the collateral and the secured obligation."

"…multiple transactions are papered into one document."

"These provisions are evidence that neither GAP insurance nor credit disability insurance was even a consideration in the decision whether to loan money to these debtors to purchase cars."

"By its nature, negative equity is unsecured debt."

"The hanging sentence contemplates that different kinds of collateral even within a single debt transaction would be subject to different rules with respect to the application of §506 and treatment in a Chapter 13 Plan."

"GMAC and CitiFinancial hold reduced purchase money secured claims for purposes of the hanging sentence."

In re Hayes, Middle District of Tennessee, 376 B.R. 655*, 2007 Bankr. LEXIS 3867**, 58 Collier Bankr. Cas. 2nd (MB) 1554

ISSUE ONE - PMSI

- Money paid by dealer to pay off trade-in (negative equity), GAP insurance/credit life insurance, extended warranties… are these secured by a PMSI?

NO (Minority view)

See also *In re Smith*, C/A 06-20508, 2006 Bankr. LEXIS 2024 (Bankr. D. Kan. Nov 6, 2006)

ISSUE ONE - PMSI

- Money paid by dealer to pay off trade-in (negative equity), GAP insurance/credit life insurance, extended warranties… are these secured by a PMSI?

YES (Majority view)

"For the Debtor here to acquire ownership rights in the Vehicle, she needed financing and *under this transaction*, she could not get financing without including her trade in of the 2006 Jeep Wrangler. For her to include the trade in, she had to pay off the debt owed on it, and for her to pay the debt owed on it, and for her to pay the debt owed on the Jeep Wrangler, she had to borrow enough funds to cover the trade in debt as well as the price of the Vehicle."

"Thus, the Court concludes that the financing of the negative equity was an expense that was both part of the 'price of the collateral' and the 'value given' that enabled the Debtor to acquire rights in the Vehicle."

In re Myers, 393 B.R. 616*, 2008 Bankr. LEXIS 2172**, 66 U.C.C. Rep. Serv. 2d (Callaghan) 72

See also *In re Townsend*, 387 B.R. 817 (Bankr. D. Kan 2008); cases cited in *In re Porch*, 2009 Bankr. LEXIS 3579

ISSUE TWO – PERSONAL USE

- How does the Court determine if a vehicle was "acquired for the personal use of the Debtor"?

PERSONAL USE v. BUSINESS USE

"Whether a vehicle is acquired for 'personal use' for purposes of §1325(a)(*) is determined at the time the vehicle is purchased in light of the **totality of the circumstances**."- *In re Matthews*, D.S.C. C/A 07-01846-JW (August 28, 2007) (emphasis added)

"The stipulated evidence shows that Debtor did not acquire the vehicle for business purposes. Merely acquiring a vehicle for her own use, with one of the uses contemplated being to drive to and from work, is not for "business" purposes; it is for personal use." *In re Lowder*, 2006, Bankr. LEXIS 1191

"Debtors intended that a **significant and material portion** of their use of both the Dodge pickup and the Ford Expedition would be for the personal use and benefit of both Debtors. Based on these findings, the Court finds the hanging paragraph in §1325(a) applies."- *In re Wilson*, D.K.S. C/A 06-40637 (December 5, 2006) (emphasis added)

Statement in retail sales agreement that vehicle was purchased for "personal, family or household use" was not dispositive for creditor.- *In re Jackson*, 338 B. R. 923 (Bankr. M.D. Ga. 2006)

See also *In re Adams*, 2007 Bankr. LEXIS 616 (Bankr. M.D. Ga. Mar. 1, 2007)

ISSUE TWO – PERSONAL USE

- How does the Court determine if a vehicle was "acquired for the personal use of the Debtor"?

PERSONAL USE OF THE DEBTOR OR SOMEONE ELSE?

"Based on the above analysis, by giving meaning to all of the words within the hanging paragraph (personal use *of the debtor*), but being careful not to add words that are not there (personal, *family or household* use), this Court holds that the Debtor's Maxima does not qualify for the 910-day treatment because the Debtor acquired it for the personal use of this fiancée." *In re Ford*, E.D.WI C/A 07-28188-svk (April 29, 2008)

"This Court is nonetheless satisfied that where the car is acquired for the primary use of a nondebtor to the secured creditor, the car is not "acquired for the personal use of the debtor" within the meaning of the hanging paragraph in *§ 1325(a)*." *In re Press*, 2006 Bankr. LEXIS 2296

ISSUE THREE – ANY OTHER THING OF VALUE

- Does a business-use vehicle purchased within one year of filing qualify as "any other thing of value"?

YES (Minority)

"Only if the specific is assumed to be 'motor vehicle', rather than "motor vehicle... acquired for the personal use of the debtor,' the conclusion (a non-personal use motor vehicle cannot be an 'other thing') is, as Balsinde said, 'impossible."

"How, if at all, does the meaning of 'any other thing of value" differ from "anything else of value" on a straightforward reading?"

"I conclude that claims of creditors holding purchase money liens on motor vehicles acquired for nonpersonal use of the debtor cannot be modified if the debtor incurred the debt within a year of the bankruptcy filing."

In re Littlefield, 388 B.R. 1, *5, 2008 Bankr. LEXIS 1551**, 59 Collier Bankr. Cas. 2d (MB) 1375

ISSUE THREE – ANY OTHER THING OF VALUE

- Does a business-use vehicle purchased within one year of filing qualify as "any other thing of value"?

NO (Majority)

"In sum, a motor vehicle acquired within one year of the Bankruptcy filing is not an 'other thing of value' as that term is used in the last clause of the hanging paragraph." *In re Horton*, 389 B.R. 73*; Bankr. LEXIS 3326**, 21 Fla. L. Weekly Fed. B 533

"Since Nissan has a purchase money security interest in a *vehicle* and not 'any other thing of value', the second portion of the hanging paragraph does not apply …" *In re Ford*, E.D.WI C/A 07-28188-svk (April 29, 2008)

VEHICLE VALUATIONS

11 USC §506(a)(2)

- If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.

STARTING FROM NADA (OR KBB)

Among the Courts that utilize NADA or KBB, there are several approaches taken to derive a specific value for the vehicle in question:

- A certain percentage is deducted from the NADA Clean Retail value.

In re Mayland, Bankr. L. Rep. 80, 679, 2006 WL 1476927, at *1 (Bankr. M.D.N.C. 2006); *In re Cheatham*, 2007 WL 2428046, at *3 (Bankr. W.D. Mo. 2007)

- The Court uses the NADA Clean Retail value as the presumptive value.

In re Eddins, 355 B.R. 849, 852 (Bankr. W.D. Okla. 2006); *In re Morales*, 387 B.R. 36, 37 (Bankr. C.D. Cal. 2008); *In re Scott*, 437 B.R. 168, 170, 174 (Bankr. D.N.J. 2010)

- The Court uses NADA or KBB as a starting point but apply the specific facts of the case in determining which value should be used (Clean Retail, Private Party, etc).

In re Berry, 2008 WL 2064777, at *4 (Bankr. D.Vt. 2008); *In re Gonch*, 435 B.R. 857, 865 (Bankr. N.D.N.Y. 2010)

- The Court uses the average of NADA Clean Retail and Clean Trade-In values.

In re Nice, 355 B.R. 554, 557 (Bankr. N.D.W.Va. 2006); Bankr. D.Vt. R. 3012-1(b), *available at* http://www.vtb.uscourts.gov/Local_Rules_Supplement.php.

TESTIMONY AND EVIDENCE

- "When faced with competing evidence as to the value of property, an assessment as to the retail value of a vehicle under § 506(a)(2) ultimately depends on the facts presented in each case." *In re Morales*, 387 B.R. 36, 45 (Bankr. C.D.Cal. 2008)

- "By contrast, blue book guidelines provide a neutral and independent source of a vehicle's value."
"However, blue book guidelines are unable to account for the myriad of facts that may be peculiar to a debtor's particular vehicle. As such, blue book guidelines, while constituting strong probative evidence of value, are not necessarily conclusive."
"Instead, when such evidence is available, as it is here, blue book guidelines should be used in conjunction with expert testimony" *In re Roberts*, 210 B.R. 325 (Bankr. N.D. Iowa 1997)

- "...in assessing a vehicle's value for purposes of § 506(a)(2), costs of necessary repairs are to be deducted. *In re Hauser*, 405 B.R. 684, 685 (Bankr. S.D.Fla. 2009)

PostPetition Turnover of Repossessed Vehicles

by: Holly N. Lankster, Esq.[1]

Individuals need automobiles for transportation to work, medical appointments, and other family obligations. Therefore, repossession of a vehicle is often the catalyst for filing a chapter 13 bankruptcy petition. The debtor will quickly seek turnover of the vehicle under 11 U.S.C. § 542(a) because his chance of reorganization is unlikely without it.

The secured creditor does not want to turn over the vehicle and lose its primary leverage. The majority of courts hold that § 541, § 542, and § 362 require a creditor to immediately turnover the vehicle upon the bankruptcy filing. Any delay results in sanctions for violation of the automatic stay. A few courts have allowed passive retention of the repossessed vehicle until the debtor's turnover action is decided.

The majority position is presently under scrutiny in an appeal to the Seventh Circuit. The Seventh Circuit follows the majority of cases for consensual liens and will soon decide whether to extend the majority position to creditors with an involuntary possessory lien on a debtor's vehicle.

I. The Majority Position.

A creditor in the First, Second, Sixth, Seventh, Eighth, Ninth, and Eleventh Circuits must voluntarily and unconditionally turnover a vehicle repossessed prepetition pursuant to § 542(a). Continued retention of the debtor's property is a violation of the automatic stay under § 362(a).

A. The Basis for the Majority Position.

The basis for the majority's position is the interaction of § 541, § 542, and § 362 and the United States Supreme Court decision in *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 103 S. Ct. 2309, 76 L.Ed.2d 515 (1983).

1. The Interaction Between § 541, § 542, and § 362.

Section 541 creates a bankruptcy estate that includes "all legal or equitable interests of the debtor." 11 U.S.C. § 541(a)(1). This section brings into the estate all interests in property "wherever located and by whomever held." 11 U.S.C. § 541(a).

Section 542 helps assemble the bankruptcy estate. It requires that an entity "in possession, custody, or control" of property of the estate "shall deliver" such property to the trustee "unless such property is of inconsequential value or benefit to the estate." 11 U.S.C. § 542(a). The property at issue is property the trustee "may use, sell or lease under section 363 of this title" or that the debtor may exempt. *Id.* In a chapter 13 case, the debtor possesses all

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property in the estate and acts as a trustee under § 542(a) unless the chapter 13 plan provides otherwise. 11 U.S.C. § 1306(b).

Section 362(a) stays action affecting estate property once the petition is filed. It prevents, among other things, "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). It also prevents "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case…" 11 U.S.C. § 362(a)(6).

The majority interprets § 541, § 542, and § 362 as working in tandem to "shelter the debtor's estate from action by creditors, enabling the debtor to get the relief and fresh start that are among the goals of the bankruptcy regime." *In re Weber*, 719 F.3d 72, 76 (2d Cir. 2013). Under the majority view, a creditor must immediately turnover collateral repossessed prepetition or risk sanctions for violating the automatic stay. *Id.* at 81; *Thompson v. Gen. Motors Acceptance Corp., LLC*, 566 F.3d 699, 703 (7th Cir. 2009); *Motors Acceptance Corp. v. Rozier (In re Rozier)*, 376 F.3d 1323, 1324 (11th Cir. 2003); *State of Cal. Employ. Dev. Dept. v. Taxel (In re Del Mission Ltd.)*, 98 F.3d 1147, 1152 (9th Cir. 1996); *Knaus v. Concordia Lumber Co., Inc. (In re Knaus)*, 889 F.2d 773, 775 (8th Cir. 1989); *TranSouth Fin. Corp. v. Sharon (In re Sharon)*, 234 B.R. 676, 686 (B.A.P. 6th Cir. 1999); *STMIMA Corp. v. Carrigg (In re Carrigg)*, 216 B.R. 303, 305 (B.A.P. 1st Cir. 1998); *Abrams v. Southwest Leasing and Rental Inc. (In re Abrams)*, 127 B.R. 239, 242 (B.A.P. 9th Cir. 1991).

2. The Impact of *United States v. Whiting Pools, Inc.*

The majority also relies on the Supreme Court's decision in *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983). According to the Second Circuit, "*Whiting Pools* teaches that, upon [the debtor's] filing of the bankruptcy petition, [the debtor's] equitable interest under state law gave the bankruptcy estate a possessory right in the secured property…that took precedence over the state law possessory right of [the creditor]." *In re Weber*, 719 F.3d at 78.

The issue in *Whiting Pools* was whether the Internal Revenue Service ("IRS") was required to turnover personal property seized prepetition. After the bankruptcy filing, the IRS filed a motion for relief from stay to seek permission to sell the property. The debtor counterclaimed and successfully sought an order from the bankruptcy court that required the IRS to return the property to the estate under § 542. *Whiting Pools*, at 199, 201.

The Supreme Court affirmed the bankruptcy court's turnover order. It explained that § 542(a) grants the estate a possessory interest in property not in the debtor's possession at the time the petition is filed, *id.* at 207, and "requires an entity … holding any property of the debtor that the trustee can use under § 363 to turn that property over to the trustee." *Id.* at 205-06.[2]

[2] *Whiting Pools* involved a chapter 11 reorganization. The Supreme Court expressly reserved judgment on whether its decision applies to a chapter 13 reorganization. *Whiting Pools*, 462 U.S. at 208 n. 17. The courts that have addressed this distinction do not believe it is relevant because § 541, § 542, and § 362 apply to the "estate" and not just the "reorganization estate." *In re Weber*, 719 F.3d at 78; *Thompson*, 566 F.3d at 705-06.

B. The Obligation to Turnover is Not Conditional.

The majority also holds that § 542 is self-executing and unconditional. *In re Weber*, 719 F.3d at 79; *In re Thompson*, 566 F.3d at 700; *In re Rozier*, 376 F.3d at 1324. Thus, the creditor must surrender the property before it can seek adequate protection. 11 U.S.C. § 362(d), § 363(e); *see also In re Sharon*, 234 B.R. at 683-684. A creditor can seek expedited relief under § 362(f) if the creditor is concerned that adequate protection is immediately at risk. 11 U.S.C. § 362(f); *In re Sharon*, 234 B.R. at 685.

This position is bolstered by the Supreme Court's comments in *Whiting Pools* that the Code requires a creditor holding estate property to turn that property over to the trustee. *Whiting Pools*, 462 U.S. at 205. The Supreme Court discussed three exceptions to § 542, and none of the exceptions recognized lack of adequate protection. *Id.* at 206 n.12. In addition, the Supreme Court noted that the burden is on the creditor, not the debtor, to seek relief. *Id.* at 204; *see also In re Thompson*, 566 F.3d at 706.

Policy considerations further support this conclusion. The purpose of reorganization is to allow the debtor to "regain his financial foothold and repay his creditors." *In re Thompson*, 566 F.3d at 706. A debtor cannot effectively do so if the creditor retains his property. Allowing the creditor to retain possession "unfairly tips the bargaining power in favor of the creditor." *Id.* at 707. In addition, requiring the debtor to bear the costs of seeking relief decreases the value of the bankruptcy estate. *Id.*

C. Failure to Immediately Turnover Repossessed Property Violates the Automatic Stay.

The failure to immediately turnover the vehicle to the debtor is a violation of the automatic stay under § 362(a)(3). Section 362(a)(3) prevents an entity from exercising "control" over property of the estate. 11 U.S.C. § 362(a)(3). Under the majority position, control includes affirmative acts and passive conduct. *In re Weber*, 719 F.3d at 79; *In re Thompson*, 566 F.3d at 703; *In re Sharon*, 234 B.R. at 682; *In re Knaus*, 889 F.2d at 241-243; *In re Carrigg*, 216 B.R. at 304-305; *In re Del Mission Ltd.*, 98 F.3d at 1152; *In re Abrams*, 127 B.R. at 242.

The majority holds that any conclusion otherwise would unfairly place the burden on the debtor or trustee to undertake a series of adversary proceedings to gather the bankruptcy estate. This increases the costs of administrating the estate while decreasing assets available for reorganization. *In re Weber*, 719 F3d. at 780. Further, if a creditor is allowed to retain possession, then its burden to request adequate protection under § 363(e) is meaningless because the creditor has no incentive to seek protection of an asset in its possession. *In re Thompson*, 566 F.3d at 704.

II. The Minority Position.

A few courts have rejected the majority's position. *See In re Cowen*, 849 F.3d 943, 949-950 (10th Cir. 2017); *In re Hall*, 502 B.R. 650, 653 (Bankr. D.C. 2014). These courts conclude that § 542 is conditional and not self-executing, so passive retention of property is not a violation of § 362(a).

A. Section 542(a) Is Conditional and Not Self-Executing.

The most in-depth discussion of the minority position is in the case of *In re Hall*, 502 B.R. 650 (Bankr. D.D.C. 2014). *Hall* rejects the majority view primarily because it rests on an erroneous conclusion that § 542(a) is self-executing and unconditional.

According to *Hall*, § 542(a) permits an entity in possession of property of the estate to voluntarily turn over that property to the trustee rather than the debtor. 502 B.R. at 655-656. But a creditor is not required to turnover its collateral until the debtor provides adequate protection. *Id.* at 656.

Hall rejects the idea that § 542(a) is unconditional. It recognizes that § 542(a) includes certain conditions to turnover, such as when property is "of inconsequential value or benefit to the estate," or "property that the trustee may use, sell, or lease under section 363 of this title," or property that the debtor may exempt. Turnover is also an equitable claim that is subject to defenses. *Id.* at 662-663.

Contrary to the majority, *Hall* focuses on prejudice to the creditor. One concern is that the creditor will lose the value of its lien if required to turnover an uninsured vehicle to the debtor and the vehicle is subsequently destroyed. Another concern raised by *Hall* relates to a possessory, rather than consensual, lien. A lien perfected by possession is lost when possession is relinquished. *Id.* at 660-661. This is the problem at issue in an appeal before the Seventh Circuit, which tests the majority position and is discussed further below.

B. Passive Retention of Repossessed Property Does Not Violate the Stay.

Hall looks at the plain language of § 362(a)(3) to conclude that the word "act" in the phrase "any act to obtain possession of property" requires affirmative action. *Hall*, 502 B.R. at 664-65. *Hall* criticizes the majority for ignoring basic principles of statutory interpretation and argues the majority's conclusion leads to an absurd result because a creditor with a valid defense to turnover may violate the automatic stay. *Id.* at 666. The Tenth Circuit in *Cowen* reached the same conclusion on similar grounds. 849 F.3d at 949.

Hall also rejects a view that the repossessed property is property of the estate at the outset of the filing. The court focuses on language in § 541(a)(1) pertaining to "all legal or equitable interests of the debtor in property *as of the commencement of the case*." 11 U.S.C. § 541(a) (emphasis added). It notes that § 541(a)(3) and § 541(a)(7) are the provisions that include a possessory interest in property recovered pursuant to § 542, § 543, § 547, and § 548, and "they do not purport to make possession of the recovered property an interest of the estate in property until there is an actual recovery." *Id.* at 668. *Hall* thus concludes that even if a passive act is an "act to obtain possession of property," then "it is not an exercise of control over a present possessory interest that is property of the estate, and thus does not violate the automatic stay." *Hall*, 502 B.R. at 669.

III. The Majority Position Challenged: Is *Thompson* Correct and Does the Stay Apply to Possessory Liens?

The majority position is being tested in the Seventh Circuit, where *Thompson* is controlling. This challenge arises out of a recent line of cases issued by bankruptcy courts in Illinois. The city of Chicago enacted a local municipal ordinance that grants the city a possessory lien on vehicles impounded for parking-related debt. This practice forces many debtors to file for chapter 13 relief and seek return of their vehicles. The debtors argue that retention of their repossessed vehicles is a stay violation under *Thompson*. The city refuses to return the vehicles without adequate protection and argues *Thompson* is incorrectly decided. It believes the stay does not apply because possession of the vehicle is an act to maintain perfection of its lien under § 362(b)(3) or an action taken pursuant to its police power under § 362(b)(4). See EUGENE R. WEDOFF, *Return of Vehicles Seized Before a Chapter 13 Filing: Does the Debtor Have to File a Turnover Motion?*, AM. BANKR. INST. J., April 2019, at 14.

Five bankruptcy courts have addressed these issues. The first court to take up the issue recognized the validity of the city's possessory lien. *In re Avila*, 566 B.R. 558, 560-61 (Bankr. N.D. Ill. 2017). The *Avila* court distinguished *Thompson* on the grounds that it addressed consensual security interests and held that continued possession of the vehicle was not a stay violation because it was an act to maintain perfection of the city's possessory lien under § 362(b)(3). *Id.* at 561-62.

The next court rejected the city's contention that it had a possessory lien and determined that the city willfully violated the automatic stay. *In re Howard*, 584 B.R. 252, 258 (Bankr. N.D. Ill. 2018). The third court agreed with the decision in *Howard* and held there is no reason for the city to refuse turnover because the city could be granted a replacement lien that satisfies its right to payment. *In re Fulton*, Case No. 18-BK-02860, 2018 WL 2570109, at *6 (Bankr. N.D. Ill. May 31, 2018).

The fourth court held the city had a right under Illinois law to impound and possess the vehicle. *In re Peake*, 588 B.R. 811, 823 (Bankr. N.D. Ill. 2018). Even so, the bankruptcy court held that passively retaining the vehicle did not qualify for protection from the stay under § 362(b)(3). *Id.* at 830-32. The *Peake* court further concluded that the city's retention was an attempt to enforce a monetary judgment and did not qualify for the police power exception under § 362(b)(4). *Id.* at 832-33.

Finally, *In re Shannon* recognized the city's possessory lien but held its conditional retention of the vehicle was a violation of the automatic stay. 590 B.R. 467 (Bankr. N.D. Ill. 2018). It determined the city did not qualify for either exception under § 362(b)(3) or (b)(4). *Id.* at 480-90. It also concluded that the city did not have to possess the vehicle to maintain its possessory lien under state law. *Id.*

The city appealed the four decisions finding a violation of the stay and the Seventh Circuit consolidated the cases for a direct appeal on October 10, 2018, under the case of *City of Chicago v. Shannon*, Case No. 18-3023. WEDOFF, at 14.

The city makes three main arguments that the stay does not apply. WEDOFF, at 94. The city first relies on the minority decisions that hold § 542 requires debtors to obtain a court order before creditors must turnover seized property. *Id.* The contrary argument is that this interpretation is inconsistent with the text of § 542. *Id.*

The city argues in favor of the minority's conclusion that § 362(a)(3) requires an affirmative act to violate the stay. *Id.* at 95. The challenge to this argument is that a refusal to return estate property is the equivalent of a creditor actively preventing a debtor from gaining possession. *Id.*

The city also focuses on the extraordinary burden on the creditor if required to return its collateral without adequate protection. *Id.* The contrary argument is that this is no different than the situation faced by any creditor whose collateral is not adequately protected when the bankruptcy is filed. *Id.* Further, the remedy is to seek a court order for stay relief on an expedited basis. *Id.*

Oral arguments were scheduled for May 14, 2019. The Seventh Circuit must decide whether to deviate from the majority position in *Thompson*. If the Seventh Circuit follows its prior precedent, it then must address whether the majority position is limited to consensual liens or if it extends to possessory liens. If the majority position extends to possessory liens, the question then is whether the exception under § 362(a)(3) applies. Regardless of what the Seventh Circuit decides, its decision is certain to have an effect on chapter 13 practice.

June 21, 2019

Seventh Circuit Solidifies a Circuit Split on the Automatic Stay

Disagreeing with the Tenth and D.C. Circuits and siding with four other circuits, the Seventh Circuit rules that passively holding estate property violates the automatic stay.

Solidifying a split of circuits, 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 decision lays the foundation for the Supreme Court to grant *certiorari* and decide whether violation of the automatic stay requires an affirmative action or whether inaction amounts to control over estate property and thus violates the stay.

The Second, Seventh, Eighth, Ninth and Eleventh Circuits hold that a secured creditor or owner must turn over repossessed property immediately or face a contempt citation. The Tenth and the District of Columbia Circuits have ruled that passively holding an asset of the estate in the face of a demand for turnover does not violate the automatic stay in Section 362(a)(3), which prohibits "any act . . . to exercise control over property of the estate."

The same issue was argued on May 23 in the Third Circuit, where the lower courts were siding with the minority. *See Denby-Peterson v. NU2U Auto World*, 18-3562 (3d Cir.). For ABI's report on *Denby*, click here.

The Impounded Cars in Chicago

Four cases went to the circuit together. The facts were functionally identical.

The chapter 13 debtors owed between $4,000 and $20,000 on unpaid parking fines. Before bankruptcy, the city had impounded their cars. Absent bankruptcy, the city will not release impounded cars unless the fines are paid. If the cars are not redeemed by their owners, most of them are scrapped.

In 2016, Chicago passed an ordinance giving the city a possessory lien on impounded cars.

After filing their chapter 13 petitions, the debtors demanded the return of their autos. The city refused to release the cars unless the fines and other charges were paid in full.

The debtors mounted contempt proceedings in which four different bankruptcy judges held that the city was violating the automatic stay by refusing to return the autos. After being held in contempt, the city returned the cars but appealed.

In all four cases, the owners confirmed chapter 13 plans treating the city as holding unsecured claims. The city did not object to confirmation or appeal.

In the four cases, the city never sought adequate protection for its alleged security interests under Section 363(e).

Thompson Controls

Circuit Judge Joel M. Flaum was not writing on a clean slate in his June 19 opinion, given the circuit's controlling precedent in *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009). *Thompson*, he said, presented "a very similar factual situation."

Although *Thompson* came down only 10 years ago, Judge Flaum nonetheless wrote a comprehensive, 27-page opinion, perhaps sensing that the case will go to the Supreme Court on *certiorari*.

In *Thompson*, Judge Flaum said, "we held that a creditor must comply with the automatic stay and return a debtor's vehicle upon her filing of a bankruptcy petition. We decline the City's request to overrule *Thompson*." He also agreed with the bankruptcy courts "that none of the exceptions to the stay apply."

Quoting extensively from *Thompson*, Judge Flaum said that the Seventh Circuit had already "rejected" the city's contention that "passively holding the asset did not satisfy the Code's definition of exercising control." He noted that Congress amended Section 362 in 1984 by adding subsection (a)(3) and making the automatic stay "more inclusive by including conduct of 'creditors who seized an asset pre-petition,'" citing *U.S. v. Whiting Pools Inc.*, 264 U.S. 198, 203-204) (1983).

Again citing *Whiting Pools*, Judge Flaum said that Section 362(a)(3) "becomes effective immediately upon the filing of the petition and is not dependent on the debtor first bringing a turnover action." He added, the "creditor . . . has the burden of requesting protection of its interest in the asset under Section 363(e)."

Judge Flaum found support for his conclusion in Section 542(a). Again quoting *Thompson*, he said the section "'indicates that turnover of a seized asset is compulsory.'" *Thompson*, *supra*, at 704.

"Applying *Thompson*," Judge Flaum held "that the City violated the automatic stay . . . by retaining possession . . . after [the debtors] declared bankruptcy." The city, he said, "was not passively abiding by the bankruptcy rules but actively resisting Section 542(a) to exercise control over the debtors' vehicles."

Telling Chicago how to proceed in the future, Judge Flaum said the city must turn over the car and may seek adequate protection on an expedited basis. The burden of seeking adequate protection, he said, "is not a reason to permit the City to ignore the automatic stay and hold captive property of the estate, in contravention of the Bankruptcy Code."

In sum, Judge Flaum declined the city's invitation to overrule *Thompson*. He said, "Our reasoning in *Thompson* continues to reflect the majority position and we believe it is the appropriate reading of the bankruptcy statutes."

Exceptions to the Automatic Stay

Judge Flaum devoted the last third of his opinion to explaining why Chicago was not eligible for any of the exceptions to the automatic stay.

Section 362(b)(3), allowing acts to perfect or continue perfection of liens, does "not permit creditors to retain possession of debtors' property," Judge Flaum said. Rather, it allows creditors to file notices to continue or perfect a lien when bankruptcy has intervened. The city, he said, could perfect its possessory lien by a filing with the Secretary of State.

Judge Flaum cited Illinois decisions holding that giving up possession involuntarily does not destroy a possessory lien. The notion that turning over cars would abrogate the possessory lien was one of Chicago's primary arguments on appeal.

Judge Flaum held that Section 362(b)(4), excepting police or regulatory powers from the automatic stay, did not apply. On balance, he said, the municipal machinery to impound cars "is an exercise of revenue collection more so than police power."

Is *Certiorari* Next?

In the term that ends this month, the Supreme Court denied a petition for *certiorari* raising the same question. *See Davis v. Tyson Prepared Foods Inc.*, 18-941 (Sup. Ct.) (cert. denied May 20, 2019).

Davis, from the Tenth Circuit, was a challenge to the Tenth Circuit's holding in *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017). In *Cowen*, the Tenth Circuit ruled that passively holding an asset of the estate in the face of a demand for turnover does not violate the automatic stay in Section 362(a)(3) as an act to "exercise control over property of the estate." To read ABI's discussion of the denial of *certiorari*, click here.

In this writer's opinion, the Chicago parking ticket cases are a better vehicle for *certiorari* because they raise the issue more cleanly. *Davis* was a step or two removed from the question of whether overt action is required to violate the automatic stay.

Given the recent change in administration in Chicago, it is not certain that the city will pursue *certiorari*.

Eric Brunstad told ABI, "The issue is certainly not going away. I predict that eventually the Supreme Court will grant *certiorari* in a case involving the issue and resolve the conflict among the courts of appeals." Brunstad represented the debtor who unsuccessfully sought Supreme Court review in *Davis*

In the

United States Court of Appeals

For the Seventh Circuit

No. 18-2527

IN RE: ROBBIN L. FULTON,

Debtor-Appellee.

APPEAL OF: CITY OF CHICAGO

Appeal from the United States Bankruptcy Court
for the Northern District of Illinois, Eastern Division-BK.
No. 18-02860 — **Jack B. Schmetterer**, *Bankruptcy Judge.*

No. 18-2793

IN RE: JASON S. HOWARD,

Debtor-Appellee.

APPEAL OF: CITY OF CHICAGO

Appeal from the United States Bankruptcy Court
for the Northern District of Illinois, Eastern Division-BK.
No. 17-25141 — **Jacqueline P. Cox**, *Bankruptcy Judge.*

No. 18-2835

IN RE: GEORGE PEAKE,

Debtor-Appellee.

APPEAL OF: CITY OF CHICAGO

Appeal from the United States Bankruptcy Court
for the Northern District of Illinois, Eastern Division-BK.
No. 18-16544 — **Deborah Lee Thorne**, *Bankruptcy Judge.*

No. 18-3023

IN RE: TIMOTHY SHANNON,

Debtor-Appellee.

APPEAL OF: CITY OF CHICAGO

Appeal from the United States Bankruptcy Court
for the Northern District of Illinois, Eastern Division-BK.
No. 18-04116 — **Carol A. Doyle**, *Chief Bankruptcy Judge.*

ARGUED MAY 14, 2019 — DECIDED JUNE 19, 2019

Before FLAUM, KANNE, and SCUDDER, *Circuit Judges.*

FLAUM, *Circuit Judge.* In this consolidated appeal of four Chapter 13 bankruptcies, we consider whether the City of Chicago may ignore the Bankruptcy Code's automatic stay and continue to hold a debtor's vehicle until the debtor pays her outstanding parking tickets. Prior to the debtors' filing for bankruptcy, the City impounded each of their vehicles for

failure to pay multiple traffic fines. After the debtors filed their Chapter 13 petitions, the City refused to return their vehicles, claiming it needed to maintain possession to continue perfection of its possessory liens on the vehicles and that it would only return the vehicles when the debtors paid in full their outstanding fines. The bankruptcy courts each held that the City violated the automatic stay by "exercising control" over property of the bankruptcy estate and that none of the exceptions to the stay applied. The courts ordered the City to return debtors' vehicles and imposed sanctions on the City for violating the stay.

This is not our first time addressing this issue: in *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009), we held that a creditor must comply with the automatic stay and return a debtor's vehicle upon her filing of a bankruptcy petition. We decline the City's request to overrule *Thompson*. We therefore affirm the bankruptcy courts' judgments relying on *Thompson*, and we also agree with the bankruptcy courts that none of the exceptions to the stay apply.

I. Background

The Chicago Municipal Code permits creditor-appellant the City of Chicago to immobilize and then impound a vehicle if its owner has three or more "final determinations of liability," or two final determinations that are over a year old, "for parking, standing, compliance, automated traffic law enforcement system, or automated speed enforcement system violation[s]." Municipal Code of Chicago ("M.C.C.") § 9-100-120(b); *see also id.* § 9-80-240(a) (providing for impoundment of vehicles "operated by a person with a suspended or revoked driver's license"). The fines for violations of the City's Traffic Code range from $25 (*e.g.*, parallel parking violation)

to $500 (*e.g.*, parking on a public street without displaying a wheel tax license emblem). *Id.* § 9-100-020(b)–(c). Failure to pay the fine within twenty-five days automatically doubles the penalty. *Id.* § 9-100-050(e). After a vehicle is impounded, the owner is further subjected to towing and storage fees, *see id.* § 9-64-250(c), and to the City's costs and attorney's fees for collection activity. *Id.* §§ 1-19-020, 2-14-132(c)(1)(A). To retrieve her vehicle, an owner may either pay the fines, towing and storage fees, and collection costs and fees in full, *id.* § 2-14-132(c)(1)(A), or pay the full amount via an installment plan over a period of up to thirty-six months, provided she makes an initial payment of half the fines and penalties plus all of the impoundment, towing, and storage charges. *Id.* § 9-100-101(a)(2)–(3).

In 2016, the City amended the Code to include: "Any vehicle impounded by the City or its designee shall be subject to a possessory lien in favor of the City in the amount required to obtain release of the vehicle." *Id.* § 9-92-080(f). Based on this provision, the City began refusing to release impounded vehicles to debtors who had filed Chapter 13 petitions. That is just what occurred in these four cases.

A. *In re Fulton*

Debtor-appellee Robbin Fulton uses a vehicle to commute to work, transport her young daughter to day care, and care for her elderly parents on weekends. On December 24, 2017, three weeks after she purchased a 2015 Kia Soul, the City towed and impounded the vehicle for a prior citation of driving on a suspended license. Fulton filed a Chapter 13 bankruptcy petition on January 31, 2018 and filed a plan on February 5, treating the City as a general unsecured creditor. The City filed a general unsecured proof of claim on February 23

for $9,391.20. After the court confirmed Fulton's plan on March 21, she requested the City turn over her vehicle. The City then amended its proof of claim to add impound fees, for a total of $11,831.20, and to assert its status as a secured creditor; it did not return Fulton's vehicle.

On May 2, Fulton filed a motion for sanctions arguing the City was required to turn over her vehicle pursuant to *Thompson* and that its failure to do so was sanctionable conduct. The City countered that Fulton must seek turnover through an adversary proceeding. It asserted it was retaining possession to perfect its possessory lien and was thus excepted from the automatic stay pursuant to 11 U.S.C. § 362(b)(3).

On May 25, the bankruptcy court held that the City was required to return Fulton's vehicle under *Thompson* and that the City was not excepted from the stay under § 362(b)(3). The court ordered the City to turn over Fulton's vehicle no later than May 29, imposed a sanction of $100 for every day the City failed to comply, and sustained Fulton's objection to the City's claim as a secured creditor. The City moved to stay the order in the district court pending appeal; the district court denied the stay request on September 10. Eventually, the City returned Fulton's vehicle. At no point did the City initiate proceedings to protect its rights under § 363(e).

B. *In re Shannon*

The City impounded debtor-appellee Timothy Shannon's 1997 Buick Park Avenue on January 8, 2018 for unpaid parking tickets. Shannon filed a Chapter 13 petition on February 15. On February 27, the City filed an unsecured proof of claim for $3,160 in fines dating back to 1999. Shannon, in turn, filed a proposed plan that did not include the City as a secured

creditor, to which the City did not object, and the court confirmed the plan on May 1. When Shannon sought the return of his vehicle, the City amended its proof of claim, adding fines, storage, and towing fees for a total of $5,600, and stated the claim was secured by its possession of Shannon's vehicle.

Shannon filed a motion for sanctions on June 12, asserting the stay required the City to turn over his vehicle. The court granted his motion on September 7; it held the City's claim was unsecured because it did not object to the plan that characterized the debt as such. It also determined the City violated the stay by failing to return Shannon's vehicle, that the §§ 362(b)(3) and (b)(4) exceptions to the stay did not apply, and that the City further violated § 362(a)(4) and (a)(6) by retaining the vehicle. The court noted the City was free to file a motion seeking adequate protection of its lien. The City returned Shannon's car and did not file any such motion.

C. *In re Peake*

Debtor-appellee George Peake relies on his car to travel approximately forty-five miles from his home to work. The City impounded his 2007 Lincoln MKZ for unpaid fines on June 1, 2018. Peake filed a Chapter 13 petition on June 9. In response, the City filed a secured proof of claim for $5,393.27 and asserted a possessory lien on his vehicle. After the City refused Peake's request to return his vehicle, he filed a motion for sanctions and for turnover. On August 15, the bankruptcy court granted the motion; it held that neither § 362(b)(3) nor (b)(4) applied, so the City's retention of Peake's vehicle violated the stay, and it ordered the City to release his vehicle immediately. The City filed a motion to stay the order pending appeal, which the court denied on August 22. The same day, Peake filed a motion for civil contempt based on the

City's refusal to release his vehicle. The court granted the motion and entered an order requiring the City to pay monetary sanctions—$100 per day from August 17 through August 22 and $500 per day thereafter until the City returned his vehicle. The City filed an emergency motion for a stay pending appeal in our Court, which we denied. Finally, the City released Peake's vehicle. At no point did the City file a motion to protect its interest in the vehicle.

D. *In re Howard*

The City immobilized debtor-appellee Jason Howard's vehicle on August 9, 2017 and impounded it soon after. Howard filed a Chapter 13 petition on August 22. The City filed a secured proof of claim on August 23 for $17,110.80. The court confirmed Howard's plan on October 16, which included a nonpriority unsecured debt of $13,000 owed to the City for parking tickets. Though the Code did not impose an automatic stay when Howard filed his petition due to his prior dismissed bankruptcy petitions, *see* 11 U.S.C. § 362(c)(4)(A), the court granted Howard's motion to impose a stay when it confirmed his plan on October 16. The City did not object to its treatment as unsecured under the plan and did not appeal the confirmation order; rather, it simply refused to release Howard's vehicle unless he paid 100% of its claim.

On January 22, 2018, the court issued a rule to show cause to the City why it should not be sanctioned for refusing to release Howard's vehicle in accordance with *Thompson*. The court rejected the City's argument that it was excepted from the stay under § 362(b)(3) and, on April 16, 2018, ordered sanctions of $50 per day beginning August 22, 2017 for the City's violation of the stay.

After the City filed its opening appellate brief, Howard filed notice of his intention not to participate in the appeal. His counsel explained Howard's bankruptcy case had been dismissed and the City disposed of his vehicle. He has since filed a new bankruptcy case to address his parking tickets but has abandoned interest in the vehicle that was the subject of the relevant Chapter 13 petition in the bankruptcy court below. However, "issues related to an alleged violation of the automatic stay" are not mooted by dismissal of a bankruptcy petition, *Denby-Peterson v. Nu2u Auto World*, 595 B.R. 184, 188 (D.N.J. 2018); a court "must have the power to compensate victims of violations of the automatic stay and punish the violators, even after the conclusion of the underlying bankruptcy case." *In re Johnson*, 575 F.3d 1079, 1083 (10th Cir. 2009) (citing *In re Davis*, 177 B.R. 907, 911–12 (B.A.P. 9th Cir. 1995)).

* * *

In each of these four cases, the City appealed the bankruptcy courts' orders finding the City violated the stay. These cases have been consolidated for appeal.

II. Discussion

The main question before us is 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. We review a bankruptcy court's factual findings for clear error and conclusions of law de novo. *In re Jepson*, 816 F.3d 942, 945 (7th Cir. 2016).

A. The Automatic Stay

Section 362(a)(3) of the Bankruptcy Code provides that a Chapter 13 bankruptcy 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) (emphasis added). We applied this provision to a very similar factual situation in *Thompson v. General Motors Acceptance Corp.* There, a creditor seized a debtor's car after he defaulted on payments. 566 F.3d at 700. The debtor filed a Chapter 13 petition and attempted to retrieve his car, but the creditor refused. *Id.* We considered two issues relating to § 362(a)(3): whether the creditor "exercised control" of property of the bankruptcy estate by failing to return the vehicle after the debtor filed for bankruptcy, and whether the creditor was required to return the vehicle prior to a court determination establishing the debtor could provide adequate protection for the creditor's interest in the vehicle. *Id.* at 701.

1. "Exercise Control"

First, we observed in *Thompson* there was no debate the debtor has an equitable interest in his vehicle, and "as such, it is property of his bankruptcy estate." 566 F.3d at 701 (citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983)); *see* 5 Collier on Bankruptcy ¶ 541.01 (16th ed. 2019) ("Congress's intent to define property of the estate in the broadest possible sense is evident from the language of the statute which, in section 541(a)(1), initially defines the scope of estate property to be all legal or equitable interests of the debtor in property as of the commencement of the case, wherever located and by whomever held."). We then rejected the creditor's argument

that passively holding the asset did not satisfy the Code's definition of exercising control: "Holding onto an asset, refusing to return it, and otherwise prohibiting a debtor's beneficial use of an asset all fit within th[e] definition, as well as within the commonsense meaning of the word." *Thompson*, 566 F.3d at 702. As we explained, limiting the reach of "exercising control" to "selling or otherwise destroying the asset," as the creditor proposed, did not fit with bankruptcy's purpose: "The primary goal of reorganization bankruptcy is to group *all* of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts; this necessarily extends to all property, even property lawfully seized pre-petition." *Id.* (citing *Whiting Pools*, 462 U.S. at 203–04).

Additionally, Congress amended § 362(a)(3) in 1984 to prohibit conduct that "exercise[d] control" over estate assets. We determined this addition suggested congressional intent to make the stay more inclusive by including conduct of "creditors who seized an asset pre-petition." *Id.*; *see In re Javens*, 107 F.3d 359, 368 (6th Cir. 1997) ("The fact that 'to obtain possession' was amended to 'to obtain possession ... or to exercise control' hints [] that this kind of 'control' might be a broadening of the concept of possession ... It could also have been intended to make clear that [§ 362](a)(3) applied to property of the estate that was not in the possession of the debtor." (first alteration in original)); *In re Del Mission Ltd.*, 98 F.3d 1147, 1151 (9th Cir. 1996) (The 1984 amendment "broaden[ed] the scope of § 362(a)(3) to proscribe the mere knowing retention of estate property."). We therefore held that in retaining possession of the car, the creditor violated the automatic stay in § 362(a)(3). *Thompson*, 566 F.3d at 703.

2. *Compulsory Turnover*

Next, we concluded § 362(a)(3) becomes effective immediately upon filing the petition and is not dependent on the debtor first bringing a turnover action. *Id.* at 707–08. In so concluding, we relied on a plain reading of §§ 363(e) and 542(a) and the Supreme Court's decision in *Whiting Pools*.

Section 363(e) provides:

> [O]n 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.

11 U.S.C. § 363(e). The creditor acknowledged, and we agreed, that it has the burden of requesting protection of its interest in the asset under § 363(e). "However, if a creditor is allowed to retain possession, then this burden is rendered meaningless—a creditor has no incentive to seek protection of an asset of which it already has possession." *Thompson*, 566 F.3d at 704. For § 363(e) to have meaning then, the asset must be returned to the estate prior to the creditor seeking protection of its interest. *Id.*; *cf. In re Sharon*, 234 B.R. 676, 684 (B.A.P. 6th Cir. 1999) ("[T]he Bankruptcy Code does not elevate [the creditor's] adequate protection right above the Chapter 13 debtor's right to possession and use of a car.").

Moreover, § 542(a) "indicates that turnover of a seized asset is compulsory." *Thompson*, 566 F.3d at 704. Section 542(a) requires that a creditor in possession of property of the estate "*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." 11 U.S.C. § 542(a) (emphasis added). We observed that a majority of courts had found § 542(a) worked in conjunction with § 362(a) "to draw back into the estate a right of possession that is claimed by a lien creditor pursuant to a pre-petition seizure; the Code then substitutes 'adequate protection' for possession as one of the lien creditor's rights in the bankruptcy case." *Thompson*, 566 F.3d at 704 (quoting *Sharon*, 234 B.R. at 683). Because "[t]he right of possession is incident to the automatic stay," *id.*, the creditor must first return the asset to the bankruptcy estate. Only then is "the bankruptcy court [] empowered to condition the right of the estate to keep possession of the asset on the provision of certain specified adequate protections to the creditor." *Id.*; *see also* 11 U.S.C. § 362(d)(1) ("On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under [§ 362](a) ... for cause, including the lack of adequate protection of an interest in property ...."). The Supreme Court indicated as much in *Whiting Pools* when it explained that a "creditor with a secured interest in property included in the estate must look to [§ 363(e)] for protection, *rather than to the nonbankruptcy remedy of possession*." 462 U.S. at 204 (emphasis added).

3. Thompson *Controls*

Applying *Thompson* to the facts before us, we conclude, as each bankruptcy court did, that the City violated the automatic stay pursuant to § 362(a)(3) by retaining possession of the debtors' vehicles after they declared bankruptcy. *See In re Shannon*, 18-bk-04116, Mem. Op. at 11 (Bankr. N.D. Ill. Sept. 7, 2018), ECF No. 64 ("*Thompson* [] requires any secured creditor in possession of a debtor's vehicle to return it immediately

and seek adequate protection ...."); *In re Peake*, 18-bk-16544, Mem. Op. at 3 (Bankr. N.D. Ill. Aug. 15, 2018), ECF No. 40 ("[T]he City's conduct in retaining possession of the vehicle violates [§] 362(a)(3) as that section has been interpreted ... in *Thompson* ...."); *In re Fulton*, 18-bk-02860, Mem. Op. at 2 (Bankr. N.D. Ill. May 25, 2018), ECF No. 39 ("[T]he City is circumventing entirely the procedural burden imposed on it by *Thompson* and the protections provided to debtors by the automatic stay."); *In re Howard*, 17-bk-25141, Mem. Op. at 10 (Bankr. N.D. Ill. Apr. 16, 2018), ECF. No. 63 ("[Section 362(a)] does not authorize continued possession of impounded vehicles in contravention of the *Thompson* ruling."). The City was required to return debtors' vehicles and seek protection within the framework of the Bankruptcy Code rather than through "the nonbankruptcy remedy of possession." *Whiting Pools*, 462 U.S. at 204.

The City acknowledges *Thompson* controls but asks us to overrule *Thompson* for three reasons: (1) property impounded prior to bankruptcy is not property of the bankruptcy estate because the debtors did not have a possessory interest in their vehicles at the time of filing; (2) the stay requires creditors to maintain the status quo and not take any action, such as returning property to the debtor, so the onus is on the debtor to move for a turnover action to retrieve her vehicle; and (3) the plain language of § 362(a)(3) requires an "act" to exercise control, and passive retention of the vehicle is not an "act."

We decline the City's request; *Thompson* considered and rejected these arguments. More fundamentally, the City's arguments ignore the purpose of bankruptcy—"to allow the debtor to regain his financial foothold and repay his credi-

tors." *Thompson*, 566 F.3d at 706; *see also* 5 Collier on Bankruptcy ¶ 541.01 ("[The] central aggregation and protection of property [] promote[s] the fundamental purposes of the Bankruptcy Code: the breathing room given to a debtor that attempts to make a fresh start, and the equality of distribution of assets among similarly situated creditors according to the priorities set forth within the Code."). To effectively do so, a debtor must be able to use his assets "while the court works with both debtor and creditors to establish a rehabilitation and repayment plan." *Thompson*, 566 F.3d at 707; *see also Whiting Pools*, 462 U.S. at 203 ("[T]o facilitate the rehabilitation of the debtor's business, all the debtor's property must be included in the reorganization estate."). This is why § 542 compels the return of property to the estate, including "property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced." *Whiting Pools*, 462 U.S. at 205; *see In re Weber*, 719 F.3d 72, 79 (2d Cir. 2013) ("*Whiting Pools* teaches that the filing of a petition will generally transform a debtor's equitable interest into a bankruptcy estate's possessory right in the vehicle."). Thus, 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 § 542(a) to exercise control over debtors' vehicles.

What's more, the position we took in *Thompson* brought our Circuit in line with the majority rule, held by the Second, Eighth, and Ninth Circuits. *See Weber*, 719 F.3d 72; *Del Mission* 98 F.3d 1147; *In re Knaus*, 889 F.2d 773 (8th Cir. 1989). Although the Tenth Circuit recently adopted the City's view, *see In re Cowen*, 849 F.3d 943 (10th Cir. 2017), that position is still

the minority rule. Our reasoning in *Thompson* continues to reflect the majority position and we believe it is the appropriate reading of the bankruptcy statutes. At bottom, the City wants to maintain possession of the vehicles not because it wants the vehicles but to put pressure on the debtors to pay their tickets. That is precisely what the stay is intended to prevent.[1]

The City, though, pleads necessity; it claims that, without retaining possession, it is helpless to prevent the loss or destruction of the vehicles. It did not attempt in any of these cases, however, to seek adequate protection of its interests through the methods available under the Bankruptcy Code, and at oral argument, the City asserted it did not have "the opportunity" to request such protection before the bankruptcy courts ordered it to return the vehicles. The record belies this statement. In each case, the parties engaged in motion practice, often over the course of months, before the courts held the City to be in violation of the stay. At any point the City could have sought adequate protection of its interests, but it chose not to avail itself of the Code's available procedures. *See, e.g.*, 11 U.S.C. § 362(d)(1) (court may relieve creditor from the stay if debtor cannot adequately protect creditor's interest in the property); *id.* § 362(f) (court may relieve creditor from stay "as is necessary to prevent irreparable damage to the interest of an entity in property"); *id.* § 363(e) (creditor may request court to place limits or conditions on

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[1] The *In re Shannon* court further found that § 362(a)(4) and (a)(6) also prohibit the City's continued retention of debtors' vehicles. Because the City is bound by the stay under § 362(a)(3), we do not reach the applicability of the additional stay provisions.

trustee's power to use, sell, or lease property to protect creditor's interest).

We recognize that once the City complies with the automatic stay and immediately turns over vehicles, it will need to seek protection on an expedited basis. Though we leave it to the City and the bankruptcy courts to fashion the precise procedure for doing so, we note the following: The City will have notice of the bankruptcy petition when the debtor requests her vehicle, if not sooner. At that time, the City may immediately file an emergency motion for adequate protection of its interest in a debtor's vehicle, which may be heard within a day or so, and the City can even file such motions ex parte if necessary. *See id.* § 363(e); Fed. R. Bankr. P. 4001(a)(2); *see also* 11 U.S.C. § 362(d)(1), (f); Bankr. N.D. Ill. R. 9013-9(B)(9)(d) (motion for relief from stay under § 362 where movant alleges security interest in vehicle "ordinarily [] granted without hearing"). It will be the rare occasion where a single day's delay will have lost the City the value of its security. Regardless, the Code is clear that it is the creditor's obligation to come to court and ask for protection, not, as the City advocates, the debtor's obligation to file an adversary proceeding against every creditor holding her property at the time she files for bankruptcy. *Cf. In re Lisse*, 921 F.3d 629, 639 (7th Cir. 2019) ("The basic premise [of Chapter 13] is to facilitate the debtor's ability to pay his creditors ....").

The City's argument that it will be overburdened with responding to Chapter 13 petitions is ultimately unavailing; any burden is a consequence of the Bankruptcy Code's focus on protecting debtors and on preserving property of the estate for the benefit of *all* creditors. It perhaps also reflects the importance of vehicles to residents' everyday lives, particularly

where residents need their vehicles to commute to work and earn an income in order to eventually pay off their fines and other debts.[2] It is not a reason to permit the City to ignore the automatic stay and hold captive property of the estate, in contravention of the Bankruptcy Code.

Furthermore, if a debtor files a bankruptcy petition in bad faith and immediately dismisses her case, as the City claims many debtors do solely to retrieve their impounded vehicles, the City has recourse: it may file a bad faith motion against the debtor. If the court finds bad faith, it may immediately

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[2] We additionally note that the "flood" of Chapter 13 filings is evidence of the disproportionate effect of the City's traffic fines and fees on its low-income residents, an issue that is not unique to Chicago. *See, e.g.*, Maura Ewing, *Should States Charge Low-Income Residents Less for Traffic Tickets?*, The Atlantic (May 13, 2017), https://www.theatlantic.com/politics/archive/2017/05/traffic-debt-california-brown/526491/ (California); Sam Sanders, *Study Finds The Poor Subject To Unfair Fines, Driver's License Suspensions*, NPR: The Two-Way (Apr. 9, 2015), https://www.npr.org/sections/thetwo-way/2015/04/09/398576196/study-find-the-poor-subject-to-unfair-fines-drivers-license-suspensions (Missouri and California); Melissa Sanchez & Sandhya Kambhampati, *How Chicago Ticket Debt Sends Black Motorists Into Bankruptcy*, ProPublica Illinois (Feb. 27, 2018), https://features.propublica.org/driven-into-debt/chicago-ticket-debt-bankruptcy/ ("[African-American] neighborhoods account for 40 percent of all debt, though they account for only 22 percent of all the tickets issued in the city over the past decade—suggesting how the debt burdens the poor."); *see also* Torie Atkinson, Note, *A Fine Scheme: How Municipal Fines Become Crushing Debt in the Shadow of the New Debtors' Prisons*, 51 Harv. C.R.-C.L. L. Rev. 189, 217–22 (2016) ("The consequences of fines and fees can be dramatic and unforgiving: unemployment, loss of transportation, homelessness, loss of government or community services, and poor credit. And without the ability to accumulate wealth or capture even the smallest windfall for themselves, the poor become poorer, unable to climb out of an economic chasm.").

dismiss the case and may even sanction the debtor. 11 U.S.C. § 1307(c); *see, e.g., Lisse*, 921 F.3d at 639–41 (affirming sanctions and dismissal of Chapter 13 petition filed in bad faith to collaterally attack state court judgment); *In re Bell*, 125 F. App'x 54, 57 (7th Cir. 2005) (affirming dismissal of Chapter 13 petition with prejudice where debtors filed multiple petitions "solely to impede the foreclosure sale" of their home).

B. Exceptions to the Stay

The City next argues that even if the stay applies, it is excepted under § 362(b)(3) and (b)(4). "We construe the Bankruptcy Code 'liberally in favor of the debtor and strictly against the creditor.'" *Village of San Jose v. McWilliams*, 284 F.3d 785, 790 (7th Cir. 2002) (quoting *In re Brown*, 108 F.3d 1290, 1292 (10th Cir. 1997)). The automatic stay is "one of the fundamental debtor protections provided by the bankruptcy laws." *Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 503 (1986) (quoting S. Rep. No. 95–989, at 54 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5840). We therefore narrowly construe exceptions "to give the automatic stay its intended broad application." *In re Grede Foundries, Inc.*, 651 F.3d 786, 790 (7th Cir. 2011); *see In re Stringer*, 847 F.2d 549, 552 (9th Cir. 1988) ("Congress clearly intended the automatic stay to be quite broad. Exemptions to the stay, on the other hand, should be read narrowly to secure the broad grant of relief to the debtor." (footnotes omitted)).

1. Section 362(b)(3)

Section 362(b)(3) provides that a Chapter 13 bankruptcy petition does not operate as a § 362(a) automatic stay:

> of any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of [the Bankruptcy Code] or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of [the Bankruptcy Code].

11 U.S.C. § 362(b)(3). Section 546(b) limits a trustee's power to avoid a nonperfected lien by making that power subject to any nonbankruptcy law that "permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection," or "provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation." 11 U.S.C. § 546(b)(1). The classic example of this exception is for a creditor who has a grace period for perfecting its interest, such as under the Uniform Commercial Code. *See* 3 Collier on Bankruptcy ¶ 362.05 (explaining § 362(b)(3) permits a purchase-money secured creditor to retroactively perfect under the twenty-day grace period provided in Article 9 of the U.C.C. and permits the filing of continuations of financing statements under U.C.C. § 9-515).

As the *In re Shannon* court explained, through §§ 362(b)(3) and 546(b), "Congress sought only to prevent a trustee from

avoiding the lien of a creditor when only the intervening bankruptcy stopped the creditor from perfecting or continuing perfection of its lien." Thus, the purpose of these sections is to prevent creditors from losing their lien rights because of the bankruptcy; they do not permit creditors to retain possession of debtors' property. Indeed, if the nonbankruptcy law requires a creditor to seize property after the filing of a bankruptcy petition to perfect or maintain the perfection of a lien, § 546(b)(2) replaces the seizure requirement with the giving of notice. *See* 3 Collier on Bankruptcy ¶ 362.05. "This assures that the trustee's right to maintain possession of the property will be unaffected by the creditor's right to perfect its interest." *Id.* And the (b)(3) exception permits a creditor to give notice under § 546(b)(2) without violating the automatic stay.

Here, the City argues the Chicago Municipal Code (a nonbankruptcy law) gives it the right to retain possession of a debtor's vehicle until the debt is paid, thereby creating a possessory lien on the vehicle. *See, e.g.*, M.C.C. §§ 9-92-080(f), 9-100-120(b)–(c). It further asserts it must retain the vehicle to maintain perfection of its lien.

First, as to perfection, it is commonly understood that an interest in property is perfected when it is valid against other creditors who have an interest in the same property. *See Perfection*, Black's Law Dictionary (11th ed. 2019). The City's continued possession of a debtor's vehicle is one way to perfect its lien because it can demand the amount owed to it from any holder of an interest in the vehicle before it gives up possession, be that the debtor or another lienholder asserting its right to possession of the vehicle. *See* M.C.C. § 9-92-080(a), (c). However, possession is not the only way to perfect; the City can also perfect its lien by filing notice of its interest in the

vehicle, such as with the Secretary of State or the Recorder of Deeds. And the Chapter 13 plan, itself, provides a public record of secured liens. *See* 11 U.S.C. § 1325(a)(5) (regarding the rights of secured creditors related to confirmation of the plan). Thus, the City does not need to retain possession of the vehicle to maintain perfection of its lien.

Second, despite its arguments to the contrary, the City's possessory lien is not destroyed by its involuntary loss of possession due to forced compliance with the Bankruptcy Code's automatic stay. The City did not indicate any intent to abandon or release its lien, so its possessory lien survives its loss of possession to the bankruptcy estate. *See In re Estate of Miller*, 556 N.E.2d 568, 572 (Ill. App. Ct. 1990) ("The law respecting common law retaining liens is that the involuntary relinquishment of retained property pursuant to a court order does not result in the loss of the lien."); *see also In re Borden*, 361 B.R. 489, 495 (B.A.P. 8th Cir. 2007) ("[I]nvoluntary loss of possession does not defeat the [] lien."); Restatement (First) of Security § 80 cmt. c (1941) ("The lien is a legal interest dependent upon possession. Where the lienor voluntarily gives up the possession, his lien, at least so far as it is a legal interest, is gone. The lienor … does not lose his legal interest if he is deprived without his consent of his possession.").[3]

[3] The City's attempt to distinguish between loss of possession due to compliance with a court order versus compliance with the automatic stay is in vain. Section 362 provides for the imposition of punitive damages for willful violations of the automatic stay. *See* 11 U.S.C. § 362(k)(1). This demonstrates that failure to comply with the stay may be punished even more severely than failure to comply with a court order and, correspondingly, there is no question the stay *compels* the City to return the vehicles.

Because the City does not lose its perfected lien via the involuntary loss of possession of the debtors' vehicles to the bankruptcy estates, § 362(b)(3) does not apply to except it from the stay. To the extent the City has any doubt about the continuation of its lien, when it requests relief from the automatic stay and adequate protection, it could also ask the bankruptcy court to include in its order a notation of the City's continuing lien on the property.

2. *Section 362(b)(4)*

Alternatively, the City looks to § 362(b)(4) to except it from the stay. That section provides that a Chapter 13 bankruptcy petition does not operate as a § 362(a) automatic stay:

> of the commencement or continuation of an action or proceeding by a governmental unit ... to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's ... police or regulatory power.

11 U.S.C. § 362(b)(4). "This exception has been narrowly construed to apply to the enforcement of state laws affecting health, welfare, morals and safety, but not to 'regulatory laws that directly conflict with the control of the res or property by the bankruptcy court.'" *In re Cash Currency Exch., Inc.*, 762 F.2d 542, 555 (7th Cir. 1985) (quoting *In re Missouri*, 647 F.2d 768, 776 (8th Cir. 1981)). The City asserts its impoundment of vehicles is an exercise of its police power to enforce traffic regulations as a matter of public safety. The debtors respond that

the impoundment of vehicles enhances the City's revenue collection rather than protects public safety, and it is therefore an enforcement of a money judgment which § 362(b)(4) does not permit.

Courts apply two tests to determine whether a state's actions fall within the scope of § 362(b)(4)—the pecuniary purpose test and the public policy test. *Chao v. Hosp. Staffing Servs., Inc.*, 270 F.3d 374, 385–86 (6th Cir. 2001); *In re First All. Mortg. Co.*, 263 B.R. 99, 107–08 (B.A.P. 9th Cir. 2001). Satisfying either test is sufficient for the exception to apply. *See First All. Mortg.*, 263 B.R. at 108; *see also* 3 Collier on Bankruptcy ¶ 362.05.

The pecuniary purpose test requires the court to "look to what specific acts the government wishes to carry out and determine if such execution would result in an economic advantage over third parties in relation to the debtor's estate." *Solis v. Caro*, No. 11-cv-6884, 2012 WL 1230824, at *5 (N.D. Ill. Apr. 12, 2012) (quoting *In re Emerald Casino, Inc.*, No. 03-cv-05457, 2003 WL 23147946, at *8 (N.D. Ill. Dec. 24, 2003)). "[I]f the focus of the police power is directed at the debtor's financial obligations rather than the [government's] health and safety concerns, the automatic stay is applicable." *In re Ellis*, 66 B.R. 821, 825 (N.D. Ill. 1986) (quoting *In re Sampson*, 17 B.R. 528, 530 (Bankr. D. Conn. 1982)). Though the City says its impoundment laws are "designed to further the safety and welfare of Chicago residents" with just an "ancillary pecuniary benefit," we disagree. In retaining possession of the vehicles until it is paid in full, the City is "attempting to satisfy a debt outside the bankruptcy process," which would give it an advantage over other parties interested in the debtors' estates.

Emerald Casino, 2003 WL 23147946, at *9. The City's act is focused on the debtor's financial obligation, not its safety concerns, and thus fails the pecuniary purpose test.

Alternatively, the public policy test considers whether the state action is principally to effectuate public policy or to adjudicate private rights. *Hosp. Staffing Servs.*, 270 F.3d at 385–86; *Caro*, 2012 WL 1230824, at *4. The public policy the City highlights is enforcing its traffic ordinances against repeat offenders "for the safety and convenience of the public." It explains the traffic ordinance system gradually escalates, beginning with the issuance of fines then intensifying to immobilization and impoundment only after an individual ignores repeat citations. Without impoundment as a general deterrence, the City argues, it cannot enforce its traffic regulations. *See Emerald Casino*, 2003 WL 23147946, at *6.

The debtors argue the balance between revenue collection and public safety weighs heavily toward the former. Additionally, prior to the 2016 Municipal Code amendment imposing a possessory lien on impounded vehicles, the City released impounded vehicles to Chapter 13 debtors. When the City recently amended the Code, it did not mention public safety concerns but rather stated the amendment was "in response to a growing practice of individuals attempting to escape financial liability for their immobilized or impounded vehicles." Chi., Ill., Ordinance, Amendment of M.C.C. § 9-100-120 (July 6, 2017).

We are persuaded that, on balance, this is an exercise of revenue collection more so than police power. As debtors observe, a not insignificant portion of the City's annual operating fund comes from its collection of parking and traffic tickets. *See* City of Chicago, 2019 Budget Overview 29, 192 (2018),

https://chicago.legistar.com/View.ashx?M=F&ID=6683992&GUID=CAEFBC7F-7C1A-4B2E-9F8B-0CB931B3EE88 (fines, forfeitures, and penalties—primarily from parking tickets—constitute approximately nine percent of the 2019 fund). Moreover, the kind of violations the City enforces are not traditional police power regulations; these fines are for parking tickets, failure to display a City tax sticker, and minor moving violations. Even tickets for a suspended license, a seemingly more serious offense, are often the result of unpaid parking tickets and are thus not related to public safety. And the City impounds vehicles regardless of what violations the owner has accrued, without distinguishing between more serious violations that could affect public safety versus the mere failure to pay for parking. Most notably, the City imposes the monetary penalty on the owner of the vehicle, not the driver, which signals a seeming disconnect if the City actually has safety concerns about the offending driver. As the ordinance amending M.C.C. § 9-100-120 demonstrates, the City's focus is on the financial liability of vehicle owners, not on public safety.

But even if we assume that the adjudication of these violations is the result of the City's exercise of police and regulatory power, the City cannot enforce these final determinations of liability if they are "money judgment[s]" as the term is used in § 362(b)(4). *See* S. Rep. No. 95-989, at 52 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5838 ("Since the assets of the debtor are in the possession and control of the bankruptcy court, and ... constitute a fund out of which all creditors are entitled to share, enforcement by a governmental unit of a money judgment would give it preferential treatment to the detriment of all other creditors."). A judgment is a "money judgment" that cannot be enforced without violating the automatic stay if it

requires payment. 3 Collier on Bankruptcy ¶ 362.05 ("[T]he governmental unit still may commence or continue any police or regulatory action, including one seeking a money judgment, but *it may enforce only those judgments and orders that do not require payment*." (emphasis added)); *First All. Mortg.*, 263 B.R. at 107 (same); *see also* 3 Collier on Bankruptcy ¶ 362.05 ("Although a governmental unit may obtain a liability determination, *it may not collect* on any monetary judgment received." (emphasis added)); *SEC v. Brennan*, 230 F.3d 65, 71 (2d. Cir. 2000) ("[Section] 362(b)(4) permits the *entry* of a money judgment against a debtor ... [but] *anything beyond the mere entry of a money judgment* against a debtor is prohibited by the automatic stay.").

The City claims it did not have money judgments "because it did not pursue the additional steps required to turn the citations into money judgments in the circuit court." We disagree. A "money judgment" is simply an order that identifies "the parties for and against whom judgment is being entered" and "a *definite* and *certain* designation of the amount ... owed." *Penn Terra Ltd. v. Dep't of Envtl. Res.*, 733 F.2d 267, 275 (3d Cir. 1984). Prior to impounding a vehicle, the City must administratively adjudicate the debtor's violations, *see* M.C.C. § 9-100-010, and those adjudications result in a determination of final liability—*i.e.*, a judgment. Only after a debtor has two or three judgments against it does the Municipal Code authorize the City to impound the vehicle until the debtor pays the judgments and related costs and fees. *See id.* §§ 2-14-132(c)(1)(A), 9-92-080, 9-100-120(b). So, without any additional steps, the City had final determinations of liability requiring these particular debtors to pay it specific sums.

The City does not contest that it conditioned the release of the debtors' vehicles on payment of the amount specified in the final determinations of liability. *Cf. id.* § 9-100-100(b) ("Any fine and penalty ... remaining unpaid after the notice of final determination of liability is sent shall constitute a debt due and owing the city ...."). The continued possession of the vehicles is the City's attempt to short-circuit the state court collection process and to enforce final judgments requiring monetary payment from the debtors. As such, the City is not excepted from the stay under § 362(b)(4). That the City is not excepted under § 362(b)(4) does not "permit[] debtors to park for free wherever they like, or to drive without a risk of fines for moving violations ...." *In re Steenes*, 918 F.3d 554, 558 (7th Cir. 2019). This just means the City needs to satisfy the debts owed to it through the bankruptcy process, as do all other creditors.

III. Conclusion

For the foregoing reasons, we AFFIRM the judgments of the bankruptcy courts.