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The Honorable James F. Queenan, Jr. Seaside Chat

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HON. JAMES F. QUEENAN – SEASIDE CHAT

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ARE PREFERENCE AND FRAUDULENT CONVEYANCE ACTIONS CORE PROCEEDINGS?

I. Background - The Act.

Under the Bankruptcy Act, which governed bankruptcy proceedings until it was repealed in 1979, the issue of whether preferences and fraudulent conveyances could be tried in bankruptcy courts was of paramount importance. The outside scope of bankruptcy court jurisdiction was determined by an analysis of whether a particular activity fell within summary or plenary jurisdiction. If the jurisdiction was summary, the action was cognizable in the bankruptcy court. If it was plenary, the action had to be determined by the district court, absent consent to the bankruptcy judge hearing the matter.[1] The distinguishing characteristic was whether what was at issue was part of the bankruptcy administration or whether the dispute related to an asset that was within the actual or constructive possession of the bankruptcy court. An issue of determining rights in property held by the trustee was a summary proceeding. An action by the trustee to recover property held by a third party was a plenary matter, as long as the defendant had a colorable right to the asset. The recovery of a preference or a fraudulent conveyance was therefore a plenary matter. This often created an administrative burden to trustees trying to administer estates. A trial in the bankruptcy court was swift and took place before a bankruptcy judge who had the obligation to oversee the administration of the estate. Needless to say, if such preference or fraudulent conveyance litigation were triable in the bankruptcy court, the trustee had strong leverage. If the matter was triable in the district court, the delay to trial and the more complex procedures along the way caused pressure for the trustee to settle. How long would the trustee be willing to keep an estate open to allow for litigation to be finally resolved in the district court? This was part of the impetuous to "fix" the summary and

[1] *Exec. Bens. Ins. Agency v. Arkinson*, 573 U.S. 25, 31 (2014).

plenary problems by the passage of the Bankruptcy Code.[2] From the effective date of the Code until the decision bankruptcy in *Marathon*,[3] practitioners thought the problem had been fixed because the distinction between summary and plenary was no longer to exist under the Bankruptcy Code. Many bankruptcy practitioners and judges today are surprised and disappointed by the concept that preferences and fraudulent conveyances may not be "core", but that was the clear rule before 1979. There is a strong impetuous for those of us in the field to want to expand bankruptcy court jurisdiction to preferences and fraudulent conveyances in order to protect the efficient administration of estates and to create the leverage in the hands of trustees or debtors in possession necessary to accomplish that goal. However, while that is the strong consensus among bankruptcy professionals, it is not necessarily the correct answer under Article III of the Constitution. That determination is far more complicated.

II. Background - The Code.

Today, the limits of Bankruptcy Court Jurisdiction over adversary proceedings is determined with reference to whether an action is " arising in" (not based on any right created by the Bankruptcy Code, but having no existence outside of bankruptcy); "arising under" ((proceedings which involve a cause of action created by or determined by a statutory provision of the Bankruptcy Code") or "related to" (proceedings independent from the bankruptcy case but related to the outcome of the bankruptcy case). This was restated by Congress, in response to the *Marathon* decision which determined that the broad grant by congress of jurisdiction to the bankruptcy courts violated Article III of the Constitution. The issue in the *Marathon* case was

[2] In *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989) the Supreme Court held that the fact that a procedure established by Congress "would impede swift resolution of bankruptcy proceedings and increase the expense of Chapter 11 reorganizations.." does not justify providing that defendants no longer have the constitutional rights to jury trial in matters where such rights have traditionally existed.

[3] *Northern Pipeline Constr., Co. v. Marathon Pipeline Co.,* 458 U.S. 50 (1982).

whether an action against a non-governmental agency, arising under state law, but which, if successful would increase the assets of the bankruptcy estate, had to be finally decided by a court created under Article III of the U.S. Constitution. As we all know the answer was yes. Congress responded to the Supreme Court's *Marathon* decision by passage of the Bankruptcy Amendments and Federal Judgeship Act of 1984 (the "1984 Amendments"). After the 1984 Amendments which included the passage of 28 U.S.C. § 157, the extent of bankruptcy court jurisdiction over litigation is determined by the concepts of "arising in", "arising under" or "related to" or the similar determination of whether an action is "core" or "non-core." These determinations are very similar to the pre-Code determination of "summary" or "plenary" under the Act.[4] Under that Section 157, federal district courts were provided with jurisdiction over all civil actions, whether "arising in", "arising under" or "related to"[5]. Bankruptcy courts were given authority to hear and finally determine all "core proceedings" (presumably the proceedings which were "arising in" or "arising under."[6] However, non-core (presumably proceedings which are "related to") had to be finally decided by an Article III court.[7] The bankruptcy court can hear non-core matters and make recommended findings and conclusions to the district court which then issues a final order.[8] The district court is required to consider the report of the bankruptcy judge and to make a de novo review of the proposed findings and conclusions to which a party

[4] "The 1984 Act largely restored the bifurcated jurisdictional scheme that existed prior to the 1978 Act." *Executive Benefits* at 33.

[5] 28 U.S.C. § 157(a).

[6] 28 U.S.C. § 157(b)(1)

[7] 28 U.S.C. § 157(c)(1)

[8] 28 U.S.C. § 157(c)(1).

objected.[9] Further, even if a matter is non-core, the parties may consent to the jurisdiction of the bankruptcy court to enter final orders in such matters.[10]

The concepts of "core" and "non-core" seem to mirror the concepts of "arising in", "arising under" and "related to" which are used in 11 U.S.C. § 1334. In fact the latter set of terms are explicitly utilized in 28 U.S.C. § 157(a) to describe the universe of matters that are to be referred from the district courts to the bankruptcy courts[11], and in 28 U.S.C. § 157(b)(1) to describe the limits of the jurisdiction of the bankruptcy courts[12]. Section 157(b)(2) then goes on to list, in a non-exhaustive manner, the type of issues that may be finally determined by the bankruptcy courts (those that are deemed "core")[13]. With respect to non-core matters, the bankruptcy courts may not enter final orders without the parties consent. Therefore there seems no difference between matters which are "core" and matters which are "arising in" or "arising under." Likewise non-core matters seem to be the same thing as "related to" matters. Instead of stating it that way, Section 157 attempts to list matters which are core. Given the context of the times and the separation of powers issues that led to the *Marathon* decision it seems likely that the drafters of Section 157, which was promulgated in response to *Marathon*, wanted to be sure that the bankruptcy court would have jurisdiction to enter final orders determining certain key issues. These issues were therefore listed specifically as part of core jurisdiction. Among the matters listed as core, most are not controversial. However some of the list includeds matters which might be "related to." For example, Section 157 (b)(B)(2)(C) lists counterclaims by the

[9] 28 U.S.C. § 157(c)(1).

[10] 28 U.S.C. § 157(c)(2)

[11] "Each district court may provide that…any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." 28 U.S.C. § 157(a).

[12] "Bankruptcy Judges may hear and determine… all core proceedings arising under title 11, or arising in a case under title 11…" 28 U.S.C. § 157(b)(1).

[13] *Stern v. Marshall*, 564 U.S. 462, 471-472 (2011).

estate against persons filing claims against the estate. This was the subject of the decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011). In that case, the Supreme Court decided that the filing of a claim did not give the bankruptcy court the right to enter final orders on counterclaims that would not be decided as part of the determination of the claim. Therefore matters deemed "core" by Section 157(B)(2)(C) might not really be "core" in the sense that the bankruptcy court does not have the power to issue final findings and conclusions, absent consent of the parties. In *Stern*, the filing of a proof of claim did not constitute consent to the final adjudication by the bankruptcy courts of state law based counterclaims. Unless such counterclaims would be decided as part of the process of determining a claims objection, the determination of the counterclaim was not core. Any attempt by Congress to authorize non-Article III courts to determine such issues violates the separation of powers required by the Constitution.[14]-[15]

Another section of Section 157 which purports to list core proceedings but may include non-core proceedings is the catch all section, Section 157(b)(B)(2)(O). That section includes as "core": "other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury or wrongful death claims." Since any proceeding, including any "related to" proceeding, could arguably fall into this broad category, there will be proceedings that might technically fall within this category that will not be "core" and as to which the bankruptcy court cannot issue final conclusions of law and findings of fact, absent consent of the parties.

For purposes of this paper, the key sections are sections 157(b)(2)(F) and (H) which designate as core, proceedings "to determine, avoid, or recover preferences" and proceedings "to

[14] *Stern* at 484.

[15] Claims that are designated as core, but which, under *Stern*, constitute an unconstitutional grant of jurisdiction by Congress are often termed Stern Claims. In *Executive Benefits* the Supreme Court decided that such claims would be determined in the same manner as if they were non-core claims. *Executive Benefits* at 35.

determine, avoid, or recover fraudulent conveyances." The question is whether Congress listing such actions as core makes them core even if such a result does not comport with the Constitution. In other words, can a bankruptcy court issue final conclusions of law and findings of fact in preference and fraudulent conveyance cases, absent consent of the parties?

III. The Supreme Court Cases

Since *Marathon* the Supreme Court has decided at least five matters[16] which explain the jurisdictional scheme in bankruptcy and determine the constitutionality of the components of the jurisdiction granted by Congress. In *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989) the Supreme Court decided that unless a proof of claim had been filed in a bankruptcy proceeding,[17] that a defendant could not be deprived by Congress of its right to jury trial in a fraudulent conveyance action. The Court based its view on a number of considerations:

1. Unless Congress has permissibly assigned resolution of a claim to a non-Article III adjudicative body that does not use a jury as a factfinder, the Seventh Amendment entitles a person who has not filed a claim against a bankruptcy estate to a jury trial when sued by a trustee to recover an allegedly fraudulent monetary transfer.[18]

2. Since, in 18th century England actions to recover fraudulent conveyances were actions at common law rather than in equity (at least as to a recovery of money), a

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[16] *Granfinanciera v. Nordberg*, 492 U.S. 33 (1989); *Langenkamp v. Culp*, 498 U.S. 42 (1990); *Stern v. Marshall*, 564 U.S. 462 (2011); *Executive Benefits Insurance Agency, Inc. v. Atkinson*, 573 U.S. 25 (2014); *Wellness Int'l Network, Ltd. v. Shariff*, 135 S. Ct. 1932.

[17] The reason that the filing of a proof of claim by a preference or fraudulent conveyance defendant make the preference or fraudulent conveyance susceptible to final determination in the bankruptcy court is that section 502(d) of the Bankruptcy Code requires the repayment of the preference or fraudulent conveyance before a dividend may be paid on the claim. Therefore the determination of the claim involves the determination of the preference or fraudulent conveyance. This has long been the law. *See Katchen v. Landy*, 382 U.S. 323 (1965) which relied upon section 502(d)'s predecessor under the Bankruptcy Act, Section 57(g).

[18] 492 U.S. at 57.

defendant today in an action to recover a monetary fraudulent conveyance would have the right to a jury trial under the Seventh Amendment.[19]

3. The nature of relief is the recovery of money which demonstrates that the cause of action is legal as opposed to equitable and therefore the defendants are entitled to a jury trial.[20]

4. Congress can deprive parties of their Seventh Amendment rights by assigning matters of a "legal" nature to a non-Article III tribunal that does not use a jury as a fact finder but only when dealing with "public" as opposed to private "rights." Public rights are those where the government is a party or where what looks like a private right is intertwined with a federal regulatory program that Congress has the power to enact.[21]

5. In *Northern Pipeline Construction Co.*, 458 U.S. 50 (1982), the Supreme Court decided that a state created cause of action was a private action even though the restructuring of interests between a debtor and its creditors "might" be a public action. The Court in *Granfinanciera* determined that the right to collect fraudulent conveyances is more accurately characterized as a private right rather than a public right.[22] Congress did not create a new cause of action for fraudulent conveyance which was not known at common law because existing rights and remedies were insufficient. It simply reclassified a pre-existing common law cause of action. Under those circumstances, Congress cannot strip a defendant of its Constitutional rights to a jury trial.[23]

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[19] *Id* at 41-42.

[20] *Id* at 47.

[21] *Id* at 49.

[22] *Id* at 55.

[23] *Id* at 61.

While the *Granfinanciera* case dealt with a fraudulent conveyance action, the words of the Court would indicate that the majority thought that the result would be the same with respect to preferences.[24]-[25]-[26]-[27] While this may technically be dicta, since this case did not deal with preferences, it is worth noting that preference and fraudulent conveyances were treated interchangeably for purposes of rights to jury trial. The issue of jury trial rights was again considered by the Supreme Court in *Langenkamp v. Culp*, 498 U.S. 42 (1990), only one year after *Granfinanciera*. In *Langenkamp* the Supreme Court followed *Granfinanciera* finding that the filing of a proof of claim subjected a defendant in a preference action to the claims allowance process because a dividend on the claim cannot be paid until any preference or fraudulent conveyance has been repaid *Langenkamp* at 44-45. Therefore a preference defendant who files a proof of claim subjects themselves to the bankruptcy courts equitable power to determine the allowance and disallowance of claims and there is no right to jury trial. However, "If a party

[24] There is no dispute that actions to recover preferential or fraudulent transfers were often brought in late 18-century England. As we noted in *Schoenthal v. Irving Trust Co.,* 287 U. S. 92 (1932) (footnote omitted): "In England, long prior to the enactment of our first Judiciary Act, common law actions of trover and money had and received were resorted to for the recovery of preferential payments by bankrupts." *Granfinanciera* at 43.

[25] In *Schoenthal*, the trustee sued in equity to recover alleged preferential payments, claiming that it had had no adequate remedy at law. As in this case, the recipients of the payments apparently did not file claims against the bankruptcy estate. The Court held that the suit had to proceed at law instead, because "the long–settled rule that suits in equity will not be sustained where a complete remedy exists at law." *Id* at 48. In *Schoenthal*, the trustee sued in equity to recover alleged preferential payments, claiming that it had had no adequate remedy at law. As in this case, the recipients of the payments apparently did not file claims against the bankruptcy estate. The Court held that the suit had to proceed at law instead, because the long–settled rule that the suits in equity will not be sustained where a complete remedy exists at law. *Id* at 48.

[26] Although related to bankruptcy proceedings, fraudulent conveyance and preference actions brought by a trustee in bankruptcy were deemed separate, plenary suits to which the Seventh Amendment applied. *Id* at 50 (citing *Schoenthal v. Irving Trust Co.*, 287 U.S. 92, 94-95 (1932) which discussed of summary and plenary jurisdiction and determined that preferences and fraudulent conveyances were both the subject of plenary proceedings). *Id* at 50.

[27] "We expressly stated that, if petitioner had not submitted a claim to the bankruptcy court, the trustee could have recovered the preference only by a plenary action…" *Id* at 57 (discussion of *Katchen v. Landy*, 38 U.S. 323 (1966). "We read *Schoenthal* and *Katchen* as holding that, under the Seventh Amendment, a creditor's right to a jury trial on a bankruptcy trustee's preference claim depends upon whether the creditor has submitted a claim against the estate, not upon Congress' precise definition of the "bankruptcy estate" or upon whether Congress chanced to deny jury trials to creditors who have not filed claims and who are sued by a trustee to recover an alleged preference." *Id* at 58.

does not submit a claim against the bankruptcy estate… the trustee can recover allegedly preferential transfers only by filing what amounts to a legal action to recover a monetary transfer. In those circumstances, the preference defendant is entitled to a jury trial." *Langenkamp* at 45. Therefore the rule seems the same for preference defendants and fraudulent conveyance defendants.

The jury trial cases are critical in determining the scope of bankruptcy jurisdiction and whether a non-public legal action may be assigned to a non-Article III court. The Supreme Court in *Granfinanciera* determined that "if a statutory cause of action, such as respondent's right to recover a fraudulent conveyance under 11 U.S.C. § 548(a)(2), is not a "public right" for Article III purposes, then Congress may not assign its adjudication to a specialized non-Article III court lacking "the essential attributes of the judicial power… [a]nd if the action must be tried under the auspices of an Article III court, then the Seventh Amendment affords the parties a right to a jury trial whenever the cause of action is legal in nature. Conversely, if Congress may assign the adjudication of a statutory cause of action to a non-Article III tribunal, then the Seventh Amendment poses no independent bar to the adjudication of that action by a nonjury factfinder." *Granfinanciera* at 53-54. The Supreme Court, in deciding whether a defendant would have jury trial right's did not just look at the jury trial cases but also determined that it was necessary to look to precedent "exploring the restrictions Article III places on Congress' choice of adjudicative bodies to resolve disputes over statutory rights." *Granfinanciera* at 54.

Therefore the Court explicitly determined in *Granfinanciera* that if there was a right to have a case tied before an Article III Court there was a right to jury trial and vice versa.[28] In so doing, the Supreme Court has seemingly decided that fraudulent conveyance actions for money

[28] *Id* at 54-55.

recovery and preference actions must be finally decided by an Article III tribunal (absent consent to bankruptcy court jurisdiction).[29] However, not all lower courts agree that the Supreme Court so held. In particular two bankruptcy courts have very recently decided otherwise.

IV. The Recent Bankruptcy Cases

The first such case is *Paragon Litigation Trust V. Noble Corp*., in which an order was entered on March 11, 2019. This matter was decided by Bankruptcy Judge Sontchi of the District of Delaware. The case dealt with fraudulent conveyance claims which had been brought by a liquidation trust against defendants that had not filed claims in the bankruptcy proceeding. 11 U.S.C. 157(b)(2)(H) lists fraudulent conveyances actions as "core" proceeding. This means that the bankruptcy court may issue final orders on the merits rather than issuing proposed findings and conclusions to the district court. However, it was determined in *Stern* that some matters that are designated as "core" by Congress are not "core" in spite of such designation. *Stern* dealt with state law counter-claims and determined that Congress exceeded its power in granting such jurisdiction to a non-Article III Court. The issue in *Paragon* was whether fraudulent conveyance actions fall within the same *Stern* prohibition-Did Congress have the power to list such actions as "core?" The designation as "core" would allow bankruptcy courts to make final determinations on such matters rather than preparing recommendations to the district court. Judge Sontchi upheld the designation as "core" for the following reasons:

1. The judge pointed out that he was being asked to determine that part of Section 157 is unconstitutional[30] in accordance with *Granfinanciera* and *Stern*. The judge noted

[29] The *Executive Benefits* case from 2014 also dealt with a fraudulent conveyance. In that matter, the Third Circuit decided that a fraudulent conveyance action was not a core proceeding and had to be determined by a final order of an Article III Court. That issue was not raised on appeal and was assumed, but not decided, by the Supreme Court. *Executive Benefits* at 35.

[30] *Paragon Litigation Trust v. Nobile Corporation PLC et al*., Adv. Proc. No: 17-51882 (CSS) at 16.

that federal legislation is presumed to be constitutional.[31] However, if the Supreme Court has already ruled on the constitutionality issue the lower courts would be bound.[32]

2. The judge discussed that *Granfinanciera* was not an Article III case but rather was a jury trial case. While the court acknowledged that the Supreme Court seems to say that the Seventh Amendment issue and the Article III issue are both determined in the same manner and with the same result,[33] the court felt that *Granfinanciera* did not require that Section 157(b) be declared unconstitutional.[34]

3. The court relied on the statement by the Supreme Court in Granfinanciera which purports to limit its sole issue to whether the Seventh Amendment confers on the defendants a right to jury trial.[35]

4. Further, Judge Sontchi justified his decision on the statement by the Supreme Court in *Granfinanciera* that the Supreme Court "did not express any view as to whether… Article III allows jury trials in [fraudulent conveyance] actions to be held before non-Article III bankruptcy judges subject to the oversight provided by the district courts pursuant to the 1984 Amendments…" Judge Sontchi seems to say that because 1) the quoted phrase specifically mentions Article III[36] and 2) the Supreme Court was deciding a Seventh Amendment issue (and referred to that as the "sole issue" it was deciding), and did not determine the

[31] Paragon at 16.
[32] Paragon at 16.
[33] *Paragon* at 19.
[34] *Paragon* at 19.
[35] *Paragon* at 20.
[36] Albeit in the context of the Supreme Court specifically not deciding whether the current statutory provisions for jury trial as well as Article III and the Seventh Amendment would allow such jury trial to take place in the bankruptcy courts with the oversight of the district courts pursuant to the 1984 Amendments. It could be argued that a refusal to decide whether a case which gives rise to a jury trial right could lead to a jury trial in the bankruptcy court under the supervision of the district court, is different from not deciding whether an Article III judge must adjudicate a particular matter.

constitutionality of Section 158(b)(2)(H) which purports to make fraudulent conveyance actions core proceedings. However, that was precisely the issue in the *Paragon* case and therefore Judge Sontchi did not feel he was bound by *Granfinanciera* in deciding an issue that was not decided by the Supreme Court.[37]-[38]

5. *Judge Sontchi pointed out that Stern* does not extend *Granfinanciera* by deciding that fraudulent conveyance actions must be decided by Article III courts. Further, Judge Sontchi noted that Stern also did not conclude that the statutory authority for a fraudulent conveyance action to be decided as a "core proceeding" is unconstitutional. Judge Sontchi relied on the fact that the only another type of proceeding listed as core in Sec. 157(b)(2), but which was really non-core were state law counterclaims. Therefore the *Stern* case did not deal with fraudulent conveyances. Judge Sontchi also referred to the Supreme Court emphasizing that the Stern decision should be read narrowly and talking about Section 157 being unconstitutional "in one isolated respect." The issue in *Stern* was the constitutionality of Section 157 as it related to state law counterclaims to claims, not fraudulent conveyances.[39]

6. Judge Sontchi did note that The Ninth Circuit found that fraudulent conveyance claims are Stern Claims in the Executive Benefits case. However, on appeal of that

[37] *Paragon* at 19-21.

[38] While it is true that Granfinanciera was a Seventh Amendment case and not an Article III case, the Supreme Court's references to whether an Article III Judge was required to decide a particular matter was not just an extraneous thought unrelated to the outcome. The Supreme Court thought that to decide the Seventh Amendment issue a court would have to review Article III precedent as well as Seventh Amendment precedent in order to determine the correct result. On the same facts, the result of the two inquiries would always be the same and therefore precedent for each needs to be consulted. If this is a correct reading of the references to Article III cases, then such references go to the heart of how a court must make a right to jury trial determination. Viewed in this way, the Article III analysis is central to the Court's determination.

[39] *Paragon* at 21-22.

decision, the Supreme Court in *Executive Benefits*, only assumed that fraudulent conveyance actions are Stern Claims, since this proposition was not contested by any party.[40]

7. Judge Sontchi didn't think that *Granfinanciera* or *Stern* were controlling and he declined to extend such rulings in a manner that would declare another part of Section 157 to be unconstitutional.[41]

The second recent bankruptcy court decision is *In re Swift Air LLC* where an order was entered on March 15, 2019 in Adversary No. 2:14-ap-00534-DPC (*Morris Anderson & Associates LTD v. Redeye II, LLC*, et al.). This case was heard by Bankruptcy Judge Daniel P. Collins of the District of Arizona. A liquidating trustee brought actions against multiple defendants claiming breach of fiduciary duty, preferences and fraudulent conveyances. The issue was with respect to each type of action did the court have the power to enter final orders or was the court required to submit proposed findings and conclusions to the district court. The court had little trouble finding that state law fiduciary duty claims are non-core claims. No party disagreed with his conclusion, and in light of the *Marathon* and *Stern* decisions dealing with state law claims and counterclaims there was little room for disagreement.[42]

The preferences were held to be "core" whether a claim had been filed or not. The Court thought that *Stern* required reference to two criteria: First, does the action stem from the bankruptcy itself? And second, would the claim necessarily be resolved in the claims allowance process?[43] On the first point the court felt that "preference claims only exist as a matter of

[40] *Id* at 22-23

[41] *Id* at 23.

[42] *Morris Anderson* at 5-6. Judge Sontchi made a similar determination as to a state law based unjust enrichment claim in Paragon.

[43] *Paragon* at 7.

bankruptcy law."[44] As to the second question, if a claim is filed then will the preference be determined as part of the claims resolution process.[45] Section 11 U.S.C. 502(d) requires that the recipient of a preference or fraudulent conveyance cannot hold an allowed claim until the preference or fraudulent conveyance has been repaid. Therefore the determination of the claim necessarily requires the determination of the preference…[46] Also the court joins Judge Sontchi in highlighting that Sterns own words suggest that it is to be construed narrowly. Further, Judge Collins discusses the fact that other courts have relied on a narrow reading of *Stern*.[47] Since *Stern* is to be read narrowly and the concept of preferences emanates from the bankruptcy code itself the court found that preferences were core proceedings whether or not a proof of claim had been filed by the defendant.[48]

Judge Collins decided that the fraudulent conveyance claims were to be treated differently. He ultimately decided that if the defendant filed a claim, that the preference action was a core proceeding. However if no claim was filed by the defendant, the determination of the fraudulent conveyance was not core. In *Executive Benefits* the Third Circuit had decided that

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[44] *Id* at 7.

[45] *Id* at 7.

[46] *See* earlier discussion of *Katchen v. Landy* in footnote 17.

[47] *See In re Paragon Offshore PLC*, No. 17-51882 (Bankr. D. Del. Mar. 11, 2019) where the court held that defendants who did not file claims against the debtor and were later sued on fraudulent transfer grounds arising from a "spinoff" transaction, were the subject of non-*Stern*, core proceedings. The court held that neither *Granfinanceria* nor *Stern* required disposition of these fraudulent transfer claims by an Article III court, therefore, the bankruptcy court may finally adjudicate these fraudulent transfer claims. *See also In re DBSI, Inc.*, 467 B.R. 767, 772 (Bankr. D. Del. 2012) (applying a narrow holding of *Stern* to conclude that the bankruptcy court had the authority to enter a final judgment on preference, post-petition transfer, fraudulent transfer and unjust enrichment claims); *In re Apex Long Term Acute Care – Kate, L.P.*, 465 B.R. 452, 458 (Bankr. S.D. Tex. 2011) (determining that after *Stern* most fundamental bankruptcy matters, including preference claims, are within the bankruptcy courts' authority to enter final orders); *In re USDigital Inc.*, 461 B.R. 276, 285 (Bankr. D. Del. 2011) (applying a narrow holding of *Stern* to determine that the bankruptcy court had authority to enter a final order on an equitable subordination claim because, like a preference claim, it is "a unique creature of bankruptcy law."). Morris Anderson at 8.

[48] *Morris Anderson* at 8-9.

Stern and *Granfinanciera*, taken together, had determined that bankruptcy courts lack the authority to issue final judgements on fraudulent conveyances where the defendant has not file a claim.[49] Judge Collins felt that this determination by the Ninth Circuit was dicta, and therefore not binding, since the case was decided on issues of consent. However the court found the Ninth Circuit decision was compelling even if only dicta.[50] Therefore the fraudulent conveyance actions were found to be core proceedings if the defendant had filed a claim or had consented to the jurisdiction of the bankruptcy court. In the absence of a claim being filed or consent, the bankruptcy would issue proposed findings and conclusions to the district court for final disposition.

V. Conclusion

It is hard not to read the Supreme Court cases to have looked at preference and fraudulent conveyances in the same way, and looked at the jury trial issue and the Article III issues as requiring the same results on the same facts. Then again, while it appears that the Supreme Court in *Granfinanciera* and *Stern* already decided that fraudulent conveyance actions were not core, they were not willing to so state in Executive Benefits. With the makeup of the Supreme Court changing at the rate of a speedy glacier, there is no way to predict how this will all come out. As with many issues, time and politics can lead to surprising future results. The jurisdictional issues with respect to preferences and fraudulent conveyances might have been conclusively decided by *Stern*, *Granfinanciera* and *Langenkamp*. However it is apparent that wiggle room has been found. In fact the Supreme Court itself in *Executive Benefits* assumed that fraudulent conveyances were Stern Claims, rather than explicitly deciding the very issue it might

[49] *Id* at 9.

[50] *Id* at 10.

have already decided in the earlier cases. While a lot of progress has been made in sorting out bankruptcy court jurisdiction since *Marathon*, it would be nice to "nail down" the issues that remain.

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Paragon Litigation Trust, Plaintiff,
v.
Noble Corporation PLC, Noble Corporation Holdings Ltd, Noble Holding International (Luxembourg) S.A.R.I., Noble FDR Holdings Limited, Ashley Almanza, Julie H. Edwards, Gordon T. Hall, Jon A. Marshall, James A. MacLennan, Mary P. Ricciardello, Julie J. Robertson, and David Williams, Defendants.

Case No.: 16-10386 (CSS)
|
Adv. Proc. No.: 17-51882(CSS)
|
Signed March 11, 2019

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OPINION[1]

1 This Opinion constitutes the Court's findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

Sontchi, CJ.

INTRODUCTION

***1** The Bankruptcy Code has its origins in the Constitution itself. Article I authorizes Congress to pass "uniform laws on the subject of bankruptcies."[2] As Madison observed, "[t]he power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce...that the expediency of it seems not likely to be drawn into question."[3] The uniform laws of bankruptcy remain, though, subordinate to the Constitution, and in enacting such laws, Congress must abide by another of the Constitution's clear directives:

> The judicial power of the United States shall be vested in one supreme court and in such inferior courts as the Congress may from time to time ordain and establish. The judges shall hold their offices during good behavior....
>
> [...]
> The judicial power shall extend to all cases, in law and equity, arising under...the laws of the United States....[4]

2 U.S. Const., Art. I, § 8, cl. 4.

3 The Federalist No. 42, p. 285 (N.Y. Heritage Press 1945).

4 U.S. Const., Article III, §§ 1-2.

Bankruptcy judges only hold office for fourteen years, no matter how good their behavior may be. And because bankruptcy judges do not have life tenure, they may not wield the judicial power of the United States.[5] These facts necessarily limit the ability of Congress to entrust adjudicative authority to bankruptcy courts. As a result, certain claims—commonly referred to as *Stern* claims—"may not be adjudicated to final judgment by [a] bankruptcy court" even though the Bankruptcy Code directs otherwise.[6] Instead, the Supreme Court instructs a bankruptcy court that is faced with a *Stern* claim to "hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review and entry of judgment."[7]

5 28 U.S.C. § 152(a)(1).

6 *Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25, 35, 134 S.Ct. 2165, 189 L.Ed.2d 83 (2014) (citing 11 U.S.C. § 157(c)).

7 *Executive Benefits*, 573 U.S. at 36, 134 S.Ct. 2165.

Determining which claims may not be finally adjudicated by this Court without running afoul of Article III is no simple task. The constitutional limits that Article III places on Congress' ability to grant authority to bankruptcy judges have been described—if not completely demarcated—in a handful of important opinions. In *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,[8] a plurality of that Court deemed the Bankruptcy Act of 1978 to have impermissibly vested "most, if not all, of the 'essential attributes of the judicial power' " in the bankruptcy courts.[9] The general principle to emerge from that plurality was that "Art. III bars Congress from establishing legislative courts to exercise jurisdiction over all matters related to those arising under the bankruptcy laws."[10]

8 *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed. 2d 598 (1982)(plurality opinion).

9 *Id.* at 87, 102 S.Ct. 2858.

10 *Id.* at 76, 102 S.Ct. 2858.

In response to *Northern Pipeline*, Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 (commonly referred to as "the **1984 Amendments**").[11] That act created the familiar statutory distinction between "core" and "non-core" matters, allowing bankruptcy courts to continue to enter final orders in "core" matters and to submit findings of fact and conclusions of law in "non-core" matters. (Bankruptcy practitioners are, undoubtedly, already aware that the 1984 Amendments were codified in part at 28 U.S.C. §§ 157 and 158.)

11 *In re United Missouri Bank of Kansas City, N.A.*, 901 F.2d 1449, 1453 (8th Cir. 1990).

***2** The Supreme Court would go on to address the Article III issues raised by the 1984 Amendments in two important opinions, issued twenty-two years apart. In 1989, with *Granfinanciera, S.A. v. Nordberg*,[12] the Supreme Court—although ruling on a 7th Amendment issue—addressed the judicial power question at some length, setting the stage for *Stern v. Marshall*.[13] That 2011 opinion discussed *Granfinanciera* at length (and gave us "*Stern* claims.") After considering what Justice Scalia called a "sheer surfeit of factors,"[14] Chief Justice Roberts ultimately concluded that by the 1984 Amendments Congress had exceeded its authority in "one isolated respect."[15] For, while those Amendments permit the Bankruptcy Court to "enter a final judgment on [ ] state law counterclaim[s] that [are] not resolved in the process of ruling on a creditor's proof of claim," Article III of the Constitution does not.[16]

12 *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989).

13 *Stern v. Marshall*, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011).

14 *Id.* at 504, 131 S.Ct. 2594 (Scalia, J., concurring in part and concurring in judgment).

15 *Stern v. Marshall*, 564 U.S. at 503, 131 S.Ct. 2594.

16 *Id.*

* * *

Granfinanciera and *Stern* are, of course, binding on this Court, but determining the exact scope and proper *application* of those opinions is not easy work. In his *Northern Pipeline* concurrence, then-Justice Rehnquist observed that "[t]he cases dealing with the authority of Congress to create courts other than by use of its power under Art. III do not admit of easy synthesis."[17] That observation rings true today. As aptly summarized by Hart & Weschler's, "[f]ew observers would view the Supreme Court's shifting decisions in this area as having provided a coherent approach to the general question of the

constitutionality of non-Article III adjudication."[18] Nevertheless, this Court must approach this issue, while taking into account both the dictates of Congress and the guidance provided by the Supreme Court: Are bankruptcy courts in violation of Article III of the United States Constitution when they enter final judgment on core fraudulent transfer claims brought against non-claimant defendants? The best answer that this Court can provide to that question is "no." Bankruptcy courts, having been granted the authority to do so by Congress, may enter final judgments in *all* core fraudulent transfer claims.

17 *Northern Pipeline*, 458 U.S. at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in part and concurring in judgment).

18 Hart and Wechsler's The Federal Courts and the Federal System 388-389 (7th Edition 2015) (hereinafter "Hart & Weschler's").

JURISDICTIONAL STATEMENT

This Court has jurisdiction to consider this motion under 28 U.S.C. §§ 157 and 1334. Venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.

PROCEDURAL HISTORY

A. The Original Bankruptcy

On February 14, 2016, Paragon Offshore plc and certain of its affiliates (hereinafter "**Debtors**" or "**Paragon**") filed voluntary petitions under chapter 11 of the Bankruptcy Code.[19] On April 19, 2016, Debtors filed their second plan (the "**Failed Plan**").[20] Debtors subsequently filed a number of modifications, amendments, and supplements to the Failed Plan. One such plan supplement, filed on May 20, 2016, included a settlement agreement between Noble Corporation plc ("**Noble**")—a defendant in this action—and Paragon Offshore plc (the "**Settlement Agreement**").[21]

19 [Docket No. 1].

20 "Second Amended Joint Chapter 11 Plan of Paragon Offshore PLC and its Affiliated Debtors" [Docket No. 318].

21 [Docket No. 399, Exhibit D at 6].

The Settlement Agreement provided for broad releases in favor of Noble and affiliated parties. Provided that certain conditions were met, Paragon agreed to provide "releases in favor of the Noble Releasees" which were defined as "Noble and each of its Affiliates" as well as their "respective current and former principals, officers, directors, managers, general partners, employees, agents, parent companies, subsidiaries, affiliates, attorneys, accountants, predecessors, successors, assigns, heirs, administrators, executors, supervisors, and representatives of any kind and nature." These releases were to effectuate the release of the "Noble Releasees" from a wide variety of potential claims, including claims that "Paragon or any of its Affiliates has or might claim...in any way arising out of, relating to, or in connection with any matter relating to the Spin-Off" including "any fraudulent transfer or similar claims arising under section 548 of the Bankruptcy Code or any similar state or foreign statute."[22] The Settlement Agreement included language that would prevent these releases from taking effect unless certain conditions were either met or waived.[23]

22 Settlement Agreement § 2.1(a) [Docket No. 399, Exhibit D at 8].

23 Settlement Agreement § 6.2(a) [Docket No. 399, Exhibit D at 16].

***3** Ultimately, on November 15, 2016, this Court denied confirmation of the Failed Plan, finding that it was not feasible.[24] On May 2, 2017, a fifth plan was filed by the Debtor, which did not incorporate the Settlement Agreement,[25] and after some modification, on June 7, 2017, that plan was confirmed ("**the Confirmed Plan**").[26] The Confirmed Plan created a successor to the Debtor, the Paragon Litigation Trust ("**Plaintiffs**," "the **Paragon Litigation Trust**," or "**Respondent**"), and distributed interests in that trust to creditors. Pursuant to the Confirmed Plan, the right to pursue certain claims, including fraudulent transfer claims, was transferred from the Debtors to the Paragon Litigation Trust. Noble provided input into the formation of that plan, but the record does not reflect that they objected at any point to that plan's inclusion of language granting this Court exclusive jurisdiction to "adjudicate" claims by the Trust

"to the fullest extent permitted by law."

24 "Findings of Fact and Conclusions of Law Denying Confirmation of The Amended Joint Chapter 11 Plan of Paragon Offshore Plc and Its Affiliated Debtors" [Docket No. 890].

25 [Docket No. 1459].

26 "Findings of Fact, Conclusions of Law And Order Confirming The Fifth Joint Chapter 11 Plan Of Paragon Offshore Plc And Its Affiliated Debtors" [Docket No. 1614, Exhibit A].

B. The Adversary Proceeding and the Motion to Determine

This adversary proceeding was initiated by the Paragon Litigation Trust, which filed a complaint in this Court on December 15, 2017 ("**the Complaint**"). The Complaint names a number of Defendants ("**Defendants**" or "**Movant**"), including Noble Corporation plc, the counterparty to the Settlement Agreement.

On September 20, 2018, the Defendants filed the instant motion and a related memorandum of law (collectively, the "**Motion to Determine**"), seeking an order determining that this court may only enter proposed findings of fact and conclusions of law with respect to Counts I through VIII of the complaint.[27] They argue that Counts VI-VIII are non-core matters, and that, therefore, 28 U.S.C. § 157 requires that this Court enter proposed findings of fact and conclusions of law with regards to those Counts. Counts I-V are characterized by both parties as fraudulent transfer claims and, therefore, as statutory core matters.[28] Counts VI and VII are indisputably non-core claims. The parties dispute whether Count VIII, a state law claim for unjust enrichment, is a core or non-core claim.

27 "Motion Pursuant to Bankruptcy Rule 7016(b) and 11 U.S.C. § 157(b)(3) [**sic**] for an Order Determining That This Court May Only Enter Proposed Findings of Fact and Conclusions of Law With Respect to Counts I Through VIII of the Complaint" (hereinafter "the Motion to Determine") [Adv. Docket No. 94]; "Memorandum of Law" [Adv. Docket No. 95].

28 [Adv. Docket No 95 at 6].

More importantly, the Defendants argue that Counts I-V are *Stern* claims. In other words, they argue that Counts I-V are statutorily core matters, but that this Court may not constitutionally enter final orders in those matters. In support of this assertion, they cite *Granfinanciera*[29] and, of course, *Stern v. Marshall*.[30] They argue that that these Supreme Court precedents demand the conclusion that this Court lacks power to issue final orders when a debtor (or a successor-in-interest to a debtor) files a fraudulent transfer claim against a party that has not filed a claim in the underlying bankruptcy case.

29 *Granfinanciera*, 492 U.S. at 33, 109 S.Ct. 2782.

30 *Stern v. Marshall*, 564 U.S. at 462, 131 S.Ct. 2594.

On October 26, 2018, Paragon Litigation Trust responded with an objection to the Motion to Determine ("the **Objection**").[31] The Objection addresses the *Stern* issue, asserting that Counts I-V are core and that this Court may enter final orders. In the alternative, the Objection contends that, even if Counts I-V are *Stern* claims, that the Movants have consented to this Court's entry of final orders. While the parties have not consented explicitly, the Objection argues that Movants have consented implicitly, focusing on two facts in particular: first, the Debtor's entry into the Settlement Agreement, which required this Court's approval of that Agreement as a condition precedent to certain obligations, and second, the Debtor's failure to object to this Court's entry of final orders during the confirmation process for the Failed Plan.

31 [Adv. Docket No. 103].

***4** On November 9, 2018, the Movants filed a reply in further support of the Motion to Determine.[32] On January 29, 2019, this Court heard oral argument from the parties and took the matter under advisement.

32 [Adv. Docket No. 114].

ANALYSIS

A. Unjust Enrichment Claim Is Non-Core

The Court first turns to question of whether Count VIII is core or non-core. It is a claim for unjust enrichment, based on the factual predicate laid out to support the fraudulent transfer claims made by Plaintiffs. In this circuit, *Halper v. Halper* provides the standard for determining whether a proceeding is "core":

> To determine whether a proceeding is a "core" proceeding, courts of this Circuit must consult two sources. First, a court must consult § 157(b). Although § 157(b) does not precisely define "core" proceedings, it nonetheless provides an illustrative list of proceedings that may be considered "core." *See id.* § 157(b)(2)(A)-(O). Second, the court must apply this court's test for a "core" proceeding. Under that test, "a proceeding is core [1] if it invokes a substantive right provided by title 11 or [2] if it is a proceeding, that by its nature, could arise only in the context of a bankruptcy case."[33]

33 *Halper v. Halper*, 164 F.3d 830, 836 (3d Cir. 1999), *see also In re LTC Holdings, Inc.*, 587 B.R. 25, 36 (Bankr. D. Del. 2018) ("As the Third Circuit delineated in *Halper*, core proceeding[s] are those matters listed under 28 U.S.C. § 157(b), as well as proceedings that either (1) invoke a substantive right under the Bankruptcy Code or (2) could only arise within a bankruptcy context.").

Unjust enrichment claims are not included in the "illustrative" list in § 157(b).[34] Nor does the unjust enrichment claim at issue here "invoke a substantive right under the Bankruptcy Code"; nor could it "only arise within a bankruptcy context."[35] Respondents point to the fact that the unjust enrichment claim "seeks recovery of the same transfers alleged to be fraudulent." That may be the case. However, while the Plaintiffs may, by their unjust enrichment claim, seek the remedy that would be provided by a successful fraudulent transfer claim, state law unjust enrichment actions are distinct from fraudulent transfer actions under the Bankruptcy Code. In Delaware, unjust enrichment claims can, and do, arise outside of a "bankruptcy context."[36] Given that, Count VIII of the complaint for unjust enrichment is non-core.

34 The Third Circuit noted in *In re Exide Technologies* that an unjust enrichment claim does not "fall neatly into the list of core proceedings" under 11 U.S.C. § 157 and that, "on its face" it does not invoke a substantive right under the Bankruptcy Code. *In re Exide Techs.*, 544 F.3d 196, 207 (3d Cir. 2008).

35 *In re LTC Holdings, Inc.*, 587 B.R. at 36.

36 See, e.g., *Schock v. Nash*, 732 A.2d 217, 232 (Del. 1999) (finding that an attorney-in-fact was unjustly enriched when she gratuitously transferred funds to family members and ordering restitution be paid to the successor-in-interest of the party who suffered a loss as a result of that unjust enrichment).

B. Defendants Have Not Consented to This Court's Final Adjudication of Any Aspect of the Complaint

The Court next turns to the issue of consent, because if both parties have, as Respondent asserts, consented to this Court's entry of final orders on all counts, this Court would not need to reach the Article III issue raised by Movants. Given that, the Court turns first to the issue of consent under *Wellness*[37] and *In re Tribune Media*,[38] finding that the standards set for implied consent by those precedents have not been met.

37 *Wellness Int'l Network, Ltd. v. Sharif*, —— U.S. ——, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015).

38 *In re Tribune Media Co.*, 902 F.3d 384 (3d Cir. 2018).

***5** Respondents argue that Movants have implicitly consented to this Court's entry of final orders. Parties may consent to the entry of final orders by a bankruptcy judge, even if they have the constitutional right to an Article III tribunal,[39] and their consent need not be express.[40] When determining whether parties have implicitly consented, the "key inquiry is whether 'the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case' before the" bankruptcy judge.[41] Allowing consent to be implied by the actions of the parties has the effect of "increasing judicial efficiency[,] and checking gamesmanship."[42]

39 *Wellness*, 135 S.Ct. at 1944–45 (2015).

40 *Id.* at 1947-48.

41 *Id.* at 1948 (quoting *Roell v. Withrow*, 538 U.S. 580, 588, 123 S.Ct. 1696, 155 L.Ed.2d 775 (2003)).

42 *In re Tribune Media*, 902 F.3d at 395 (quoting *Wellness*, 135 S.Ct. at 1948).

The parties, in their briefs and at oral argument, discussed a number of facts that might tend to lead to a finding of implied consent. The Court has considered all such facts presented by the parties, and finds that Noble's actions do not constitute implied consent to this Court's authority to enter final orders. In addition to that finding, the Court writes specifically to address two potential factual bases for implied consent: Noble's entry into the Settlement Agreement with Paragon; and Noble's failure to object to certain jurisdictional language in the Confirmed Plan.

The Settlement Agreement entered into by Noble and Paragon provided for a release of all of Noble's liability "in any way arising out of, relating to, or in connection with any matter relating to the Spin-Off," and explicitly included releases of "any fraudulent transfer or similar claims arising under section 548 of the Bankruptcy Code or any similar state or foreign statute."[43] The Settlement Agreement included conditions precedent to the effectiveness of the releases provided to the "Noble Releasees" pursuant to that agreement. Two of those conditions precedent turned on this Court's action: "[t]he Bankruptcy Court shall have entered an order approving this Agreement (including, without limitation, the Confirmation Order), which order shall not be subject to a stay of execution;"[44] and "[a]ll conditions precedent to the 'Effective Date' as defined in the Paragon Plan shall have been satisfied or waived in accordance with the terms of the Paragon Plan."[45]

43 Settlement Agreement § 2.1(a) [Docket No. 399, Exhibit D at 8].

44 Settlement Agreement § 6.2(a) [Docket No. 399, Exhibit D at 17].

45 *Id.*

Applying the *Wellness* standard to the instant facts, the Court finds that one of the Defendants' entry into the Settlement Agreement does not, in this circumstance, constitute implied consent under the standard set by *Wellness* and *In re Tribune Media*. It is true that one of the Defendants agreed to allow this Court to determine that the Settlement Agreement met the standards of § 1123(b)(3)(A) and Bankruptcy Rule 9019. However, that act does not necessarily constitute consent to this Court's later adjudication of certain issues that were included in, but not the sole subject of, the Agreement. While respondent cites three cases that seem to hold the opposite, those cases are easily distinguishable from the facts here.[46]

46 The first such case, *In re Bartock*, holds that entry into a settlement agreement and submission of a stipulated order pursuant to that agreement constitutes consent to a bankruptcy court's later interpretation of that settlement agreement. *In re Bartock*, 398 B.R. 135, 161 (Bankr. W.D. Pa. 2008). In the next cited by Respondents, *In re G.S.F. Corp.*, parties' mutual consent to a stipulated order was used as definitive evidence that those parties consented to the final entry of that same stipulated order. *In re G.S.F. Corp.*, 938 F.2d 1467, 1475 (1st Cir. 1991). The last case cited by Respondents, *Fed'n of Puerto Rican Organizations of Brownsville, Inc. v. Howe,*, 157 B.R. 206 (E.D.N.Y. 1993), found consent because the judicial power issue was not raised until one—previously consenting—party was held in contempt of a stipulated order. There is, then, no precedent to support the idea that entering into a Settlement Agreement in the context of a plan, before the commencement of any adversary proceeding, necessarily constitutes consent to the Court's final orders.

***6** In addition to the Settlement Agreement, another factual basis forwarded by Plaintiffs in support of a finding of implied consent is the failure of Noble to object to certain jurisdictional provisions in the Confirmed Plan, even though Noble could be said to have been an active participant in the formation and confirmation of the Confirmed Plan. The specific provision pointed to by the Plaintiffs in the Confirmed Plan states that this Court retains "exclusive jurisdiction" over the Noble Claims "to the fullest extent permitted by law."[47] The Court finds that the Movants' failure to object to the Confirmed Plan's jurisdictional provisions does not constitute consent to this Court's entry of final orders under the *Wellness* standard.

47 "Fifth Joint Chapter 11 Plan of Paragon Offshore PLC and its Affiliated Debtors" [Case No. 16-10386, Docket No. 1614, Exhibit A. at § 11.1(r)].

A failure to object to a plan provision providing for this Court's continued jurisdiction does not constitute waiver of a party's right to have claims heard by an Article III tribunal. As described by the Supreme Court in *Stern*, 28 U.S.C. §§ 157(b)(1) and (c)(1) "allocate[ ] the authority to enter final judgment between the bankruptcy court and the district court. That allocation does not implicate questions of subject matter jurisdiction."[48]

48 *Stern v. Marshall*, 564 U.S. at 462, 131 S.Ct. 2594 (citing 28 U.S.C. §§ 157(b)(1), (c)(1)).

C. Core Fraudulent Conveyance Claims Are Not *Stern* Claims

The Court now turns to the Article III issue raised by the Movants: whether this Court may enter final judgment on core fraudulent transfer claims when those claims are brought against non-claimant defendants by a successor-in-interest to the debtor. Before continuing to a detailed analysis of *Granfinanciera* and *Stern*, it is important to clarify what, exactly, the movants are requesting: a determination that a federal statute is, in part, unconstitutional. After all, this Court's authority to enter final orders in core bankruptcy matters stems directly from Congress' 1984 Amendments to the Bankruptcy Code. Enacted after *Marathon*, these amendments were codified, in part, in 28 U.S.C. §§ 157 and 158.[49] Read together, 28 U.S.C. §§ 157 and 158 direct bankruptcy courts to enter "final...orders" in "core proceedings," which final orders shall be subject to appellate review by either the appropriate District Court or by a duly appointed Bankruptcy Appellate Panel.[50] Core proceedings include "proceedings to determine, avoid, or recover fraudulent conveyances."[51]

49 Lawrence P. King, Jurisdiction and Procedure Under the Bankruptcy Amendments of 1984, 38 Vand. L. Rev. 675, 679; 709 (1985) (describing the history, context, and codification of the 1984 Amendments).

50 In 28 U.S.C. § 157, Congress directs that "Bankruptcy judges may hear and determine...all core proceedings arising under title 11, or arising in a case under title 11...and may enter appropriate orders and judgments, subject to review" provided for by 28 U.S.C. § 158. The review provided for by 28 U.S.C. § 158 is—unless a BAP is appointed—that "[t]he district courts of the United States shall have jurisdiction to hear appeals (1) from final judgments, orders, and decrees...of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title." 28 U.S.C. § 158 (a).

51 28 U.S.C. § 157 (b)(2)(H).

Asking this Court to find that bankruptcy judges may not enter final orders in a subset of fraudulent conveyance actions is, then, asking this Court to declare that a portion of 28 U.S.C. § 157 is unconstitutional as written. The general principle of judicial restraint weighs heavily against such a declaration: "[f]ederal statutes are presumed constitutional."[52] "Every legislative act is to be presumed to be a constitutional exercise of legislative power until the contrary is clearly established...."[53] However, if the Supreme Court has, as Movants argue, already ruled on the constitutionality of 28 U.S.C. § 157(b)(1) as it is applied to fraudulent transfer actions against parties who have not filed a claim against the estate, this Court would, of course, be bound by such a ruling.[54]

52 *Koslow v. Commonwealth of Pennsylvania*, 302 F.3d 161, 175 (3d Cir. 2002) (citing *Reno v. Condon*, 528 U.S. 141, 147, 120 S.Ct. 666, 145 L.Ed.2d 587 (2000); *Union Pac. R.R. Co. v. United States*, 99 U.S. 700, 718, 25 L.Ed. 496 (1878)).

53 *Close v. Glenwood Cemetery*, 107 U.S. 466, 2 S.Ct. 267, 27 L.Ed. 408 (1883).

54 "The Supreme Court itself has admonished lower courts to follow its directly applicable precedent..." *United States v. Singletary*, 268 F.3d 196, 205 (3d Cir. 2001); *see also Maldonado v. Houstoun*, 157 F. 3d 179, 190 (3d Cir. 1998) (holding that "[b]ecause [Supreme Court cases] *Shapiro* [*v. Thompson*, 394 U.S. 618, 89 S.Ct. 1322, 22 L.Ed.2d 600 (1969)] and [*Memorial Hospital v.*] *Maricopa County* [415 U.S. 250, 94 S.Ct. 1076, 39 L.Ed.2d 306 (1974)] have never been overruled by the Court... they dictate the result of this case..."); *United States v. Extreme Assocs., Inc.*, 431 F.3d 150, 156 (3d Cir. 2005) (holding that "even where a lower court's analytical position has merit, the obligation to follow applicable Supreme Court precedent is in no way abrogated...").

***7** With those principles in mind, the Court now turns to the pivotal question: what, exactly, is compelled by *Granfinanciera* and its close cousin, *Stern v. Marshall*, the two Supreme Court cases touching on this issue?[55]

55 The 3rd Circuit has not extended the holding of *Granfinanciera* from the jury trial right to the Article III issue at question here. Nor are any of their cases directly on point. There are two 3rd Circuit cases which address *Granfinanciera* in depth. In *Beard v. Braunstein*, the 3rd Circuit cites *Granfinanciera* for the premise that the right to a jury trial does not rely on the statutory distinction between core and non-core matters. *Beard v. Braunstein*, 914 F.2d 434, 437 (3d Cir. 1990). In *In re Pasquariello*, the 3rd Circuit denied a petition for mandamus based on the alleged violation of a non-creditor's right to a jury trial that occurred when a bankruptcy court heard a fraudulent transfer claim. *In re Pasquariello*, 16 F.3d 525, 530-31 (3d Cir. 1994) (citing *Granfinanciera* generally). The *Pasquariello* court held that mandamus, an extraordinary remedy, was not warranted because the issue in that case was a fraudulent transfer of real property, not of cash as in *Granfinanciera*. *In re Pasquariello*, 16 F.3d at 530-31.

i. Granfinanciera: *Closely Related, but Not Binding*

Movants argue that this Court, as a non-Article III tribunal, may not enter final orders regarding core fraudulent transfer claims that are brought against a party that has not filed a claim in the underlying bankruptcy case. In support of this argument, Movants rely heavily on the 1989 Supreme Court case *Granfinanciera*, which, they argue, was "affirmed" in 2011 by *Stern v. Marshall*.[56] The facts in *Granfinanciera* are closely analogous to the facts here. As in this case, a party with no claim against a bankruptcy estate was haled into bankruptcy court to defend against a fraudulent transfer claim.[57] Its ultimate holding was that "a person who has not submitted a claim against a bankruptcy estate has a right to a jury trial when sued by the trustee in bankruptcy to recover an allegedly fraudulent monetary transfer."[58]

56 Motion to Determine [Adv. Docket No. 94 at 6].

57 *Granfinanciera*, 492 U.S. at 36, 109 S.Ct. 2782.

58 *Id.*

Although the facts of *Granfinanciera* are closely analogous to the facts here, they are not identical. *Granfinanciera*—an opinion which the leading federal courts casebook calls "particularly confusing"—was not issued in an Article III case.[59] Instead, the issue squarely before the Supreme Court was the extent of the 7th Amendment right to a jury trial, and whether such a right could be limited by the so-called "public rights exception."[60] This exception, which has a long and complex history in the Supreme Court, had been shaped by that court in 7th Amendment cases.[61] However, the "public rights exception" had also surfaced from time to time in bankruptcy—most recently, the familiar Article III problem of Bankruptcy Courts' non-Article-III authority had been addressed by the Court in *Northern Pipeline v. Marathon*.[62]

59 Hart & Weschler's at 383 ("This 1989 decision was actually about whether there is a right to a jury trial...").

60 *Granfinanciera*, 492 U.S. at 51, 109 S.Ct. 2782.

61 *Id.* at 53-55, 109 S.Ct. 2782.

62 *Id.* at 54, 109 S.Ct. 2782. *See also Northern Pipeline*, 458 U.S. at 67–70, 102 S.Ct. 2858 (Brennan, J.) (plurality).

***8** The *Granfinanciera* Court addressed the extent of the "public rights exception" in the wake of Congress' post-*Marathon* amendments to the Bankruptcy Code.[63] Instead of addressing the Article III implications of those amendments' distinctions between core and non-core matters, the opinion answered another question: were non-claimant defendants entitled to a 7th Amendment "right of trial by jury" in core fraudulent transfer actions?[64] Or did those fraudulent transfer actions fall within the "public rights exception," allowing them to be tried without a jury?[65] To answer this question, the *Granfinanciera* Court considered both 7th Amendment and Article III precedents, stating that "we...rely on our decisions exploring the restrictions Article III places on Congress' choice of adjudicative bodies...to determine whether petitioners are entitled to a jury trial."[66] This is because "if a statutory cause of action is legal in nature, the [Seventh Amendment question] requires the same answer as the question whether Article III allows Congress to assign adjudication of that cause of action to a non-Article III tribunal."[67] The Court then went on to cite Article III case law on the "public rights exception" to bolster its ultimate conclusion about the scope of the exception in the 7th Amendment context.[68]

63 *Granfinanciera*, 492 U.S. at 50, 109 S.Ct. 2782.

64 *Id.*

65 *Id.* at 50-51, 109 S.Ct. 2782.

66 *Id.* at 53, 109 S.Ct. 2782.

67 *Id.*

68 *Id.* at 55-56, 109 S.Ct. 2782 ("Although the issue admits of some debate, a bankruptcy trustee's right to recover a fraudulent conveyance under 11 U.S.C. § 548(a)(2) seems to us more accurately characterized as a private rather than a public right as we have used those terms in our Article III decisions.").

If the "public rights exception" is, in fact, identical in both the 7th Amendment and Article III contexts, it seems only natural to read *Granfinanciera*'s conclusion as applying to *both* the 7th Amendment question *and* to the contemporary Article III question: whether "a person who has not submitted a claim against a bankruptcy estate has the right to" a final determination by an Article III tribunal "when sued by the trustee in bankruptcy to recover an allegedly fraudulent monetary transfer."[69] Movants argue that such a reading is not only plausible, but compelled by both *Granfinanciera* and the 2011 opinion in *Stern v. Marshall*, which references and describes *Granfinanciera* at length. Although this is, admittedly, a difficult question, the Court does not agree.

69 *Id.* at 36, 109 S.Ct. 2782.

Granfinanciera alone does not require this Court to find that 28 U.S.C. § 157(b)(2) is in violation of Article III of the Constitution. That opinion mentions the current statutory scheme—in which bankruptcy courts enter final opinions in some matters and proposed findings of fact and conclusions of law in others—and specifically *avoids* determining that this division of labor between bankruptcy courts and District Courts is unconstitutional. The meat of that Court's 7th Amendment analysis begins with a declaration that "[t]he sole issue before us is whether the Seventh Amendment confers on petitioners a right to a jury trial in the face of Congress' decision to allow a non-Article III tribunal to adjudicate the claims against them."[70] Then, in conclusion, when stating its holding on the "sole issue" before it, that Court took pains to declare that it did not "express any view as to whether...Article III allows jury trials in [fraudulent conveyance] actions to be held before non-Article III bankruptcy judges subject to the oversight provided by the district courts pursuant to the 1984 Amendments. We leave [that] issue[ ] for future decisions."[71]

70 *Id.* at 50, 109 S.Ct. 2782.

71 *Id.* at 64, 109 S.Ct. 2782.

This reservation by the Supreme Court explicitly references the Article III issue before this Court today. When the Supreme Court refused to weigh in on the constitutionality of "the oversight provided by the district courts pursuant to the 1984 Amendments,"[72] they were refusing to weigh in on the Article III constitutionality of the statutory scheme that was codified, *inter alia*, in the familiar directives of 28 U.S.C. §§ 157 and 158.[73] In those sections of the U.S. Code, Congress deems certain matters "core" and certain matters "non-core," and grants this Court the power to issue final orders in "core" matters, subject to appellate review by the District Court:

> ***9** The district courts of the United States shall have jurisdiction to hear **appeals from *final* judgments, orders, and decrees...of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title**.[74]

72 *Id.*

73 King, *supra* note 50, at 679; 709 (describing the history, context, and codification of the 1984 Amendments).

74 28 U.S.C. § 158(a) (emphasis added).

Reading *Granfinanciera* in the context of the 1984 Amendments clarifies that the *Granfinanciera* Court intentionally and explicitly refrained from extending its opinion to the constitutionality of the entry of final orders by bankruptcy courts pursuant to 28 U.S.C. §§ 157-58—the very issue before this Court today.[75]

75 The 2nd Circuit issued a decision compatible with this analysis, although that decision was issued before *Stern*:

> ...§ 157(b)...gives bankruptcy judges the authority to conduct trials and issue final orders in core proceedings. *Granfinanciera* teaches that such proceedings, if legal in nature, are subject to the Seventh Amendment, *but that opinion does not alter Congress' intent that they be heard by a bankruptcy court with authority to issue final orders.*

In re Ben Cooper, Inc., 896 F.2d 1394, 1402 (2d Cir.), *vacated sub nom. Ins. Co. of State of Pa. v. Ben Cooper, Inc.*, 498 U.S. 964, 111 S.Ct. 425, 112 L.Ed. 2d 408 (1990), and opinion reinstated, 924 F.2d 36 (2d Cir. 1991) (emphasis added). *See also* Hart & Weschler's at 383 n.2 ("Justice Brennan noted two questions to be decided upon remand...whether it is consistent with...Article III, for non-Article III bankruptcy judges to conduct jury trials, subject to the oversight of federal district courts"). That "oversight" is appellate review by a District Court.

ii. Interpreting Stern v. Marshall: *Describing Without Deciding*

The story does not end with *Granfinanciera*, of course. The question remains whether *Stern*'s discussion of *Granfinanciera* has the result of extending *Granfinanciera*'s holding to the Article III context in a way that binds this Court today. After all, *Stern* was very much an Article III case, and it discusses the *Granfinanciera* holding at length.[76] The best answer seems to be that *Stern*, like *Granfinanciera*, does not bind lower courts on issues that were not directly before it. As this Court has previously noted, *Stern*, by its own lights, should be read narrowly; while its rhetoric may have been, at points, sweeping, its ultimate holding was not.[77] And, although it did discuss fraudulent conveyance actions, *Stern also* included a crystal-clear statement that "Congress, *in one isolated respect*, exceeded" its Article III power when passing the 1984 Amendments—and that "isolated" issue is not the issue before this Court today.[78]

76 *Stern v. Marshall*, at 487, 492, 492 n.7, 499, 131 S.Ct. 2594.

77 *In re USDigital, Inc.*, 461 B.R. 276, 290-92 (Bankr. D. Del. 2011).

78 *Stern v. Marshall*, 564 U.S. at 503, 131 S.Ct. 2594.

Furthermore, a close look at the text of *Stern* itself shows that while *Stern* characterizes (perhaps mischaracterizes) the *Granfinanciera* opinion repeatedly, it does not seem to rely on that opinion for its ultimate, narrow conclusion. Admittedly, the reasoning in *Stern* is not particularly direct. (In fact, Justice Scalia's concurrence in that case lists "seven different reasons given in the Court's opinion for concluding that an Article III judge was required to adjudicate this lawsuit" and notes that "[t]he multifactors relied upon today seem to have entered our jurisprudence almost randomly."[79]) It is also true that the 9th Circuit,[80] as well as multiple district courts,[81] have held that *Stern* extends *Granfinanciera* to the Article III context. However, that position on the matter is by no means inescapably correct. In fact, the Supreme Court itself, in a case in which a debtor pursued a fraudulent conveyance action against a non-claimant, indicated that there is ambiguity on the matter: "[t]he Court of Appeals held, and we assume *without deciding*, that the fraudulent conveyance claims in this case are *Stern* claims."[82] Perhaps *Stern* provides compelling evidence of how the Supreme Court *would* rule on this issue if it were to address it directly, but it does not decide it.[83]

79 *Stern v. Marshall*, 564 U.S. at 504, 131 S.Ct. 2594 (Scalia, J. concurring).

80 In *In re Bellingham Ins. Agency, Inc.*, the 9th Circuit held that: "Taken together, *Granfinanciera* and *Stern* settle the question of whether bankruptcy courts have the general authority to enter final judgments on fraudulent conveyance claims asserted against noncreditors to the bankruptcy estate. They do not." *In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553, 565 (9th Cir. 2012).

81 In *In re Lyondell Chem Co.*, Judge Cote rejected the argument laid out above, writing that :

> Under both *Stern* and *Granfinanciera*, then, it is axiomatic that a fraudulent conveyance claim against a person who has not submitted a claim against a bankruptcy estate, brought solely to augment the bankruptcy estate, is a matter of private right...[t]he basic rationale for [contrary] decisions is that *Granfinanciera* addresses fraudulent conveyance claims in a Seventh Amendment context, not an Article III context, and the comments in *Stern* comparing the claims in that case to those in *Granfinanciera* are *dicta*... This argument runs directly contrary to the clear language of *Stern*.

In re Lyondell Chem. Co., 467 B.R. 712, 720-21 (S.D.N.Y. 2012). That opinion was cited with approval in a decision by Judge Oetken, who criticized the characterization of *Stern*'s treatment of *Granfinanciera* as dicta, writing that: "...in reaching its conclusions in *Stern*, the Supreme Court specifically relied on *Granfinanciera*'s characterization of fraudulent conveyance actions as private rights where the creditor had filed no proof of claim..." *In re Arbco Capital Management, LLP*, 479 B.R. 254, 264 (S.D.N.Y. 2012). Similarly, in *Kirschner v. Agoglia*, Judge Rackoff critiques the narrow view of *Stern*, writing that:

> Beyond all else, the Bankruptcy Court relied on the Supreme Court's dictum that the holding in Stern was "limited" and "narrow," ...cautionary dicta and past practice do not overcome the logic of the Supreme Court's holding in *Stern*. This Court concludes that simple logic dictates unequivocally that fraudulent conveyance claims like those brought here are "private rights" claims that, under *Stern* and the Constitution, must be finally decided by an Article III Court.

Kirschner v. Agoglia, 476 B.R. 75, 81 (S.D.N.Y. 2012).

82 *Executive Benefits*, 573 U.S. at 37, 134 S.Ct. 2165 (emphasis added).

83 For example, in a 2012 memorandum opinion, Judge Walsh, after considerable analysis, determined that *Stern* should be read narrowly and that "*Stern* is not applicable to this [fraudulent transfer] action, as it does not involve a state-law counterclaim by the estate." *In re DBSI, Inc.*, 467 B.R. 767, 773 (Bankr. D. Del. 2012).

***10** Because neither *Stern* nor *Granfinanciera* control on this issue, Movants are not asking this Court to apply controlling precedents to the matter at hand. Instead, Movants are asking this Court to *extend* the holdings of those cases, in order to find that 28 U.S.C. § 157(a) is unconstitutional to the extent that it directs bankruptcy judges to enter final orders in fraudulent transfer claims against parties who have not filed claims against the bankruptcy estate. The Court declines to make that leap.

CONCLUSION

For the reasons discussed above, the Court DENIES the Motion to Determine and finds that Counts I-V are statutorily core claims which may be finally adjudicated by this Court. The Court further finds that Counts VII-VIII are non-core claims pursuant to 28 U.S.C. § 157(b)(2). Plaintiffs are hereby directed to provide the Court with a form of order conforming to this opinion within ten (10) calendar days of the date below.

All Citations

--- B.R. ----, 2019 WL 1112298

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926 F.3d 916
United States Court of Appeals, Seventh Circuit.

IN RE: Robbin L. **FULTON**, Debtor-Appellee.
Appeal of: **City** of **Chicago**
In re: Jason S. Howard, Debtor-Appellee.
Appeal of: **City** of **Chicago**
In re: George Peake, Debtor-Appellee.
Appeal of: **City** of **Chicago**
In re: Timothy Shannon, Debtor-Appellee.
Appeal of: **City** of **Chicago**
No. 18-2527, No. 18-2793, No. 18-2835, No. 18-3023

Argued May 14, 2019
Decided June 19, 2019

Synopsis

Background: Bankruptcy court issued rule to show cause why **city** should not be sanctioned for refusing to release Chapter 13 debtor's vehicle, which had been impounded because of unpaid parking tickets. The United States Bankruptcy Court for the Northern District of Illinois, Jacqueline P. Cox, J., 584 B.R. 252, entered judgment in favor of debtor, and **city** appealed. In separate Chapter 13 case, debtor moved to enforce automatic stay by requiring **city** to release vehicle, and the United States Bankruptcy Court for the Northern District of Illinois, Deborah Lee Thorne, J., 588 B.R. 811, granted motion. **City** appealed. In yet another case, debtor again filed motion to enforce stay against **city**, which motion was granted by the United States Bankruptcy Court for the Northern District of Illinois, Carol A. Doyle, J., 590 B.R. 467, and **city** appealed. Finally, **city** appealed from a grant of like relief by the United States Bankruptcy Court for the Northern District of Illinois, Jack B. Schmetterer, J., 2018 WL 2570109, and **city** appealed.

Holdings: Consolidating cases for purposes of appeal, the Court of Appeals, Flaum, Circuit Judge, held that:

[1] **city** violated stay by its continued postpetition retention of motor vehicles impounded prepetition;

[2] stay exception for "any act to perfect, or to maintain or continue the perfection of, an interest in property" did not permit **city** to continue to retain possession of motor vehicles; and

[3] "police or regulatory power" exception to automatic stay did not apply.

Affirmed.

West Headnotes (21)

[1]	**Bankruptcy** Moot questions

	Issues relating to creditor's alleged violation of automatic stay are not mooted by dismissal of underlying bankruptcy case. 11 U.S.C.A. § 362(a). Cases that cite this headnote

[2]	**Bankruptcy** Sanctions, in general
	Court must have the power to compensate victims for violations of automatic stay and to punish the violators, even after conclusion of underlying bankruptcy case. 11 U.S.C.A. § 362(a). Cases that cite this headnote

[3]	**Bankruptcy** Conclusions of law; de novo review **Bankruptcy** Clear error
	On appeal in bankruptcy case, the Court of Appeals reviews bankruptcy court's factual findings for clear error and its conclusions of law de novo. Fed. R. Bankr. P. 8013. Cases that cite this headnote

[4]	**Bankruptcy** Repossession
	Creditor "exercises control" over property of the estate in violation of automatic stay when, subsequent to filing of bankruptcy petition, creditor refuses to return property of debtor that it has repossessed prepetition. 11 U.S.C.A. § 362(a)(3). Cases that cite this headnote

[5]	**Bankruptcy** Notice to creditors; commencement

	Stay provision that bars creditor from exercising control over property of the estate becomes effective immediately upon filing bankruptcy petition and is not dependent upon the debtor first bringing a turnover action. 11 U.S.C.A. §§ 362(a)(3), 542. Cases that cite this headnote

[6]	**Bankruptcy** Repossession
	Creditor that has repossessed debtor's motor vehicle prepetition is required to turn over such property of the estate following commencement of debtor's bankruptcy case, prior to a court determination establishing debtor's obligation to provide adequate protection for creditor's interest in vehicle. 11 U.S.C.A. §§ 362(a)(3), 542. Cases that cite this headnote

[7]	**Bankruptcy** Collection and Recovery for Estate; Turnover
	Turnover of estate property by creditor in possession thereof is compulsory. 11 U.S.C.A. § 542(a). Cases that cite this headnote

[8]	**Bankruptcy** Acts excepted from stay

	City which, prior to commencement of debtors' Chapter 13 cases, had impounded motor vehicles belonging to debtors based on their unpaid parking and moving tickets improperly exercised control over property of the estate, in violation of automatic stay, by refusing to return vehicles postpetition in order to avoid losing its possessory lien interests in vehicles; while **city** argued that its passive retention of motor vehicles that it had lawfully impounded was not an "act" to exercise control over property of the stay, of kind barred by automatic stay, **city's** argument ignored fundamental purpose of bankruptcy, to allow debtors to regain their financial foothold and repay their creditors, something for which motor vehicle was necessary. 11 U.S.C.A. § 362(a)(3). Cases that cite this headnote

[9]	**Bankruptcy** Collection and Recovery for Estate; Turnover
	Turnover statute compels the return of estate property, including property in which debtor did not have a possessory interest at the time the bankruptcy proceedings commenced. 11 U.S.C.A. § 542(a). Cases that cite this headnote

[10]	**Bankruptcy** Adequate Protection
	It is obligation of creditor with possessory lien interest in debtor's property to come to court and ask for adequate protection of its interest, not the debtor's obligation to file adversary proceeding against every creditor holding her property at the time that she files for bankruptcy. Cases that cite this headnote

[11]	**Bankruptcy** Construction and Operation

	Courts construe the Bankruptcy Code liberally in favor of debtors and strictly against creditors. 11 U.S.C.A. § 101 et seq. Cases that cite this headnote

[12]	**Bankruptcy** Automatic Stay
	Automatic stay is one of the fundamental debtor protections provided by bankruptcy laws, and courts therefore narrowly construe exceptions to the stay in order to give the stay its intended broad application. 11 U.S.C.A. § 362(a). Cases that cite this headnote

[13]	**Bankruptcy** Acts excepted from stay
	Stay exception for "any act to perfect, or to maintain or continue the perfection of, an interest in property" did not permit **city** to continue to retain possession of motor vehicles that it had impounded prepetition for Chapter 13 debtors' unpaid parking and moving tickets; involuntary turnover of vehicles by **city** solely to comply with its obligations under the Bankruptcy Code would not result in loss of its possessory lien interest in vehicles. 11 U.S.C.A. § 362(b)(3). Cases that cite this headnote

[14]	**Bankruptcy** Acts excepted from stay

	By enacting stay exception for "any act to perfect, or to maintain or continue the perfection of, an interest in property," and by limiting trustee's power to avoid an unperfected lien by making that power subject to any nonbankruptcy law that permits perfection to relate back, Congress sought to prevent a trustee from avoiding the lien of creditor when only the intervening bankruptcy stopped creditor from perfecting or continuing perfection of its lien; purpose of these provisions is to prevent creditors from losing their lien rights due to debtor's bankruptcy filing, not to permit creditors to retain possession of debtors' property. 11 U.S.C.A. §§ 362(b)(3), 546(b). Cases that cite this headnote

[15]	**Bankruptcy** Administrative Proceedings and Governmental Action
	"Police or regulatory power" exception to automatic stay is 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 control of the res or property by bankruptcy court. 11 U.S.C.A. § 362(b)(4). Cases that cite this headnote

[16]	**Bankruptcy** Administrative Proceedings and Governmental Action
	City's retention of possession of motor vehicles which it had impounded prepetition for unpaid parking tickets and other monetary penalties assessed against Chapter 13 debtors, the vehicles' owners, and not against offending drivers, until such time as tickets and penalties were paid in full, was focused on debtors' financial obligations, not on public safety matters, and did not come within "police or regulatory power" exception to automatic stay. 11 U.S.C.A. § 362(b)(4). Cases that cite this headnote

[17]	**Bankruptcy** Administrative Proceedings and Governmental Action
	Courts apply two tests to determine whether a state's actions fall within the "police or regulatory power" exception to automatic stay, the "pecuniary purpose" test and the "public policy" test, and the satisfaction of either test is sufficient for the stay exception to apply. 11 U.S.C.A. § 362(b)(4). Cases that cite this headnote

[18]	**Bankruptcy** Administrative Proceedings and Governmental Action
	"Pecuniary purpose" test for whether an action comes within the "police or regulatory power" exception to automatic stay requires court to look to what specific acts the government wishes to carry out and determine if such execution will result in an economic advantage over third parties in relation to debtor's estate. 11 U.S.C.A. § 362(b)(4). Cases that cite this headnote

[19]	**Bankruptcy** Administrative Proceedings and Governmental Action
	If focus of the State's alleged exercise of its police power is directed at debtor's financial obligations, rather than at the State's health and safety concerns, then automatic stay is applicable. 11 U.S.C.A. § 362(b)(4). Cases that cite this headnote

[20]	**Bankruptcy** Administrative Proceedings and Governmental Action

	"Public policy" test for whether an action comes within the "police or regulatory power" exception to automatic stay considers whether the State's action is principally to effectuate public policy or to adjudicate private rights. 11 U.S.C.A. § 362(b)(4). Cases that cite this headnote

[21]	**Bankruptcy** Administrative Proceedings and Governmental Action
	Even if court assumed that **city's** adjudication of parking and minor moving violations against Chapter 13 debtors was result of **city**'s exercise of its police and regulatory powers, **city** could not enforce these final determinations of liability, which were in nature of money judgments, by retaining possession of debtors' vehicles until it was paid in full, without violating automatic stay; **city** had to seek satisfaction of any prepetition debts owed to it by debtors through bankruptcy process, just like any other creditor. 11 U.S.C.A. § 362(b)(4). Cases that cite this headnote

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

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

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

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

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Before Flaum, Kanne, and Scudder, Circuit Judges.

Opinion

Flaum, Circuit Judge.

***920** 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 ***921** 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** ***922** 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.

[1] [2]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

[3]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 ***923** 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"

[4]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, 103 S.Ct. 2309, 76 L.Ed.2d 515 (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, 103 S.Ct. 2309).

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.

***924** *2. Compulsory Turnover*

[5]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*.

[6]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.").

[7]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, 103 S.Ct. 2309 (emphasis added).

3. Thompson *Controls*

[8]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*, 590 B.R. 467, 477 (Bankr. N.D. Ill. 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*, 588 B.R. 811, 816 (Bankr. N.D. Ill. 2018), ECF No. 40 ("[T]he **City**'s conduct in retaining possession of the vehicle violates [§] 362(a)(3) as that section ***925** has been interpreted ... in *Thompson* ...."); *In re* ***Fulton***, 18-bk-02860, Mem. Op. at 2, 2018 WL 2392854 (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, 2018 WL 1830910 (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, 103 S.Ct. 2309.

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."

[9]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 creditors." *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, 103 S.Ct. 2309 ("[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, 103 S.Ct. 2309; *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 ***926** the debtors to pay their tickets. That is precisely what the stay is intended to

prevent.[1]

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.

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

[10]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 ***927 City** to ignore the automatic stay and hold captive property of the estate, in contravention of the Bankruptcy Code.

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.").

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 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

[11] [12]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, 106 S.Ct. 755, 88 L.Ed.2d 859 (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)

[13] 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 ***928** 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).

[14] 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*, 197 Ill.App.3d 67, 144 Ill.Dec. 890, 556 N.E.2d 568, 572 (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* ***929** *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)

[15] [16]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.

[17]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.

[18] [19]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 ***930** *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.

[20]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.

[21]But even if we assume that the adjudication of these violations is the result ***931** 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.

All Citations

926 F.3d 916, 67 Bankr.Ct.Dec. 100

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