No. 19-357

IN THE

Supreme Court of the United States

CITY OF CHICAGO,

Petitioner,

v.

ROBBIN L. FULTON, JASON S. HOWARD, GEORGE PEAKE, AND TIMOTHY SHANNON,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF FOR PETITIONER

MARK A. FLESSNER
BENNA RUTH SOLOMON
MYRIAM ZRECZNY KASPER
ELLEN W. MCLAUGHLIN
CITY OF CHICAGO
OFFICE OF CORPORATION COUNSEL
30 N. LaSalle Street
Suite 800
Chicago, Illinois 60602
(312) 744-7764

CRAIG GOLDBLATT
Counsel of Record
DANIELLE SPINELLI
JOEL MILLAR
WILMER CUTLER PICKERING HALE AND DORR LLP
1875 Pennsylvania Ave., NW
Washington, DC 20006
(202) 663-6000
craig.goldblatt@wilmerhale.com

ALLY M. PIERCE
WILMER CUTLER PICKERING HALE AND DORR LLP
250 Greenwich Street
New York, NY 10007
(212) 230-8800

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES AND RULES

OTHER AUTHORITIES

INTRODUCTION

Respondents admit that there is a square circuit split on the question whether a creditor's passive retention of property in which the estate has an interest violates §362(a)(3)'s automatic stay of acts to exercise control over estate property. That split has deepened since the petition was filed, with the Third Circuit expressly rejecting the Seventh Circuit's decision below and siding with the Tenth and D.C. Circuits in holding that passively retaining possession does not violate §362(a)(3). Respondents do not dispute that this split will not resolve itself and that the question is important, affecting thousands of bankruptcy cases every year in which creditors have impounded or repossessed collateral before the bankruptcy filing.

Instead, respondents argue that this case is a poor vehicle to decide the issue. Those arguments fail. Respondents claim that reversal of the Seventh Circuit's decision is "unlikely" to alter the judgments below because the City allegedly took other actions that might have violated the stay. But neither the Seventh Circuit nor the bankruptcy courts cited any of that alleged conduct as a basis for holding that the City violated §362(a)(3). Rather, the sole basis for those holdings was the City's passive retention of respondents' cars and failure to return them immediately upon the bankruptcy filings.

Also without merit is respondents' argument the Court should await the outcome of the Tenth Circuit's remand in *Cowen*. The fact-specific issue on remand there—whether the creditors should be sanc-

tioned for attempting to defraud the court—is irrelevant to the question presented here.

Respondents (perhaps understandably) devote most of their brief to arguing that the Seventh Circuit's decision is correct on the merits. Those arguments are unpersuasive. Respondents urge that requiring turnover immediately upon the filing of a bankruptcy petition would promote debtors' "fresh start" by sparing debtors the costs of bringing turnover proceedings. Such policy arguments provide no basis to disregard the statutory text. The automatic stay is a negative injunction that merely preserves the petition-date status quo by "stay[ing]" creditors from taking affirmative "acts" to exercise control over estate property. It does not bar mere passive retention of property already in a creditor's possession, nor require the creditor immediately to surrender property without the statutory protections inherent in the turnover process, including the creditor's right to obtain adequate protection of its interest in the property before relinquishing possession.

In short, the circuits are irreconcilably divided; the issue is important; the decision below is wrong; and the question is cleanly presented in this case. The Court should grant the petition.

I. RESPONDENTS ADMIT THE CLEAR CIRCUIT SPLIT

Respondents admit the circuits are openly divided over whether a creditor's passive retention of estate property violates §362(a)(3) and that the split has deepened since the City filed its petition.

In *In re Denby-Peterson*, 941 F.3d 115 (3d Cir. 2019), the Third Circuit acknowledged the circuit split and expressly rejected the Seventh Circuit's

reasoning and holding in the decision below. *Id.* at 123, 127-128 & nn.32, 62, 67. Disavowing the "majority position," it "join[ed] … the Tenth and D.C. Circuits" to "hold[] that a secured creditor does not have an affirmative obligation under the automatic stay to return a debtor's collateral … immediately upon … the debtor's bankruptcy because failure to return the collateral … does not constitute 'an act to exercise control'" over estate property. *Id.* at 119, 123.

The split is entrenched, and with the recent decisions of the Third and Tenth Circuits taking the opposite side from the Seventh, the split will not resolve itself. Moreover, as respondents acknowledge, the question is recurring and important, affecting "the thousands of individuals who file bankruptcy cases each year." Opp. 6. And as respondents also acknowledge, this case is a better vehicle than *Denby-Peterson* because the creditors there did not participate in the appeal. Opp. 31 n.3; Pet. 31.

Nonetheless, respondents urge the Court to wait for the appellate courts "to further clarify what acts violate §362(a)(3)." Opp. 9. But there is no ambiguity that requires any clarification. The majority holds that "a creditor must … return a debtor's vehicle upon her filing of a bankruptcy petition" because "passively holding the asset" "violate[s] … [§]362(a)(3)." App. 3a, 9a-10a; Pet. 15-17. The minority holding is precisely the opposite: "a creditor … does not violate [§362(a)(3)] by retaining the collateral post-bankruptcy petition" because "Congress did not intend passive retention to qualify as 'an act to … exercise control.'" *Denby-Peterson*, 941 F.3d at 126, 132; Pet. 17-18.

Nor should the Court wait to see "how the bankruptcy court rules" on remand from the Tenth Circuit's *Cowen* decision. Opp. 9. Needless to say, nothing the bankruptcy court could say on remand would alter the holding of the court of appeals. Whatever the bankruptcy court may conclude about the specific facts of *Cowen*, the Tenth Circuit's holding cannot be reconciled with the Seventh Circuit's decision below.

In *In re Cowen*, the Tenth Circuit held that "'passively holding onto an asset'" does not violate §362(a)(3) and reversed the lower-court judgments finding a stay violation and imposing damages on that basis. 849 F.3d 943, 946, 948-951 (10th Cir. 2017). In remanding the case, the Tenth Circuit observed that the creditors there might have taken *other* actions, aside from retaining the trucks, that may have independently violated the stay. *Id.* at 951. It noted the bankruptcy court's statements that the creditors "likely forged documents and gave perjured testimony" "in an 'attempt to convince the Court'" that the creditors had taken title to the repossessed trucks before the bankruptcy filing (and hence the debtor had no interest protected by §362(a)(3)). *Id.* The Tenth Circuit stated that the damages award therefore "may" be sustainable on remand because such actions would constitute acts to exercise control over estate property in violation of the stay and sanctionable under 11 U.S.C. §105(a) as "'conduct abusive of the judicial process.'" *Id.*

But so what? A decision by the bankruptcy court in *Cowen* upholding the sanctions on some other basis would not affect the law in the Tenth Circuit (like that in the Third and D.C. Circuits) on the question presented in this petition and the conflict with the

law in the Seventh Circuit and four other courts of appeal.

Respondents attempt to minimize this conflict by arguing that the Tenth and D.C. Circuit decisions are distinguishable because the creditors there claimed title to the property. Opp. 3-4, 11-12. But again, the factual distinctions respondents cite have nothing to do with the holdings of those cases. Neither decision relied on the dispute over title in holding that the creditors did not violate the stay. *See Cowen*, 849 F.3d at 946, 948-950 (noting bankruptcy court rejected creditors' claim of title); *United States* v. *Inslaw, Inc.*, 932 F.2d 1467, 1472-1474 & n.2 (D.C. Cir. 1991) ("it does not matter whether [the creditor] has possession … under a claim of outright title" or instead "possess[es] … an asset in which the bankrupt has an interest"). And *Cowen*, decided after the "majority rule" emerged, expressly rejected the majority courts' reasoning. 849 F.3d at 948-950. In any event, respondents do not even try to distinguish *Denby-Peterson*; there, as here, the bankruptcy court's conclusion that the car was estate property was not challenged on appeal, 941 F.3d at 121, 123 n.31, yet the Third Circuit squarely split with the Seventh on whether passively retaining such property violated §362(a)(3). *Id.* at 119-120, 124-132.

II. THIS CASE IS A CLEAN VEHICLE TO RESOLVE THE QUESTION PRESENTED

As a last resort, respondents attempt to find a vehicle problem. But there is none.

Respondents argue this case is a "poor vehicle" because even if the Court reversed the Seventh Circuit's holding that passive retention of repossessed

property violates §362(a)(3), that ruling would be "unlikely" to alter the judgments below because the City allegedly engaged in other conduct that purportedly violated the stay. Opp. 1-3, 8-11.

Neither the Seventh Circuit's decision, nor those of the bankruptcy courts in the four cases consolidated below, cited any of the conduct respondents allege as a basis for holding the City violated §362(a)(3). Rather, they simply held that the City's failure to turn over the cars immediately upon respondents' bankruptcy filings violated §362(a)(3). Those rulings were based on the circuit's precedent in *Thompson* v. *General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009), which held that "passively holding onto an asset … violates section 362(a)(3)," thus "requir[ing] that a creditor immediately return a seized asset … upon … [the debtor's] filing of … bankruptcy." *Id.* at 700, 703.

In the decision below, the Seventh Circuit reaffirmed *Thompson* (App. 8a-13a) and concluded that "*Thompson* [*c*]*ontrols*": "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." App. 12a.

The bankruptcy courts' decisions were to the same effect. App. 44a-46a, 49a-51a (*Fulton*) ("The City must comply with the requirements of *Thompson*," App. 45a); App. 64a-67a, 100a (*Peake*) ("the City's conduct in retaining possession of the vehicle violates section 362(a)(3) … as … interpreted by … *Thompson*," App. 65a-66a); App. 31a-32a, 40a-41a (*Howard*) ("The City['s] … fail[ure] to return the ve-

hicle as required by the *Thompson* ruling since this case was filed" "violat[ed] … the automatic stay," App. 40a-41a); App. 109a-113a (*Shannon*) ("*Thompson* require[s] [creditors] to return vehicles … as soon as [bankruptcy] petitions are filed"; "by refusing to give back Shannon's car, the City has violated § 362(a)(3)," App. 113a).

Respondents claim the City "engaged in affirmative misconduct" by requesting payment before returning respondents' cars. Opp. 2-3, 9-10. Not only was that not a basis for the holdings that the City violated §362(a)(3), but it also mischaracterizes both the record and established law.

For example, in *Fulton*, the bankruptcy court simply noted that, after the debtor requested her car, the City amended its proof of claim; the court never cited that as a basis for any stay violation. App. 45a, 49a-51a. In *Peake*, the bankruptcy court noted the debtor alleged that, after requesting his car, the City requested payment of its claim in a court-approved plan or an interim payment for earlier release; again, the court never cited the debtor's allegation as a basis for any stay violation. App. 64a-67a, 100a. And in *Howard*, the bankruptcy court noted the City was unwilling to return the debtor's car absent payment in a modified plan; here too, the court never cited that as a basis for a stay violation, instead simply denying modification of the plan. App. 31a-32a, 40a-41a.

None of this is surprising. While the automatic stay prohibits creditors from collecting their claims *outside* the bankruptcy process, 11 U.S.C. §362(a)(6), the law is clear that creditors may negotiate with debtors over how their claims will be paid *in* the

bankruptcy process. Creditors thus do not violate the stay by filing (or amending) proofs of claim, *Campbell* v. *Countrywide Home Loan, Inc.*, 545 F.3d 348, 355-357 (5th Cir. 2008), or requesting other relief within the bankruptcy proceeding, *Inslaw*, 932 F.2d at 1474. The Bankruptcy Code contemplates that creditors and debtors may seek to negotiate a consensual treatment of a creditor's claim, including treatment that creditors would "accept" in a plan or as "adequate protection" of their interests in property the debtor seeks to use. *See, e.g.*, 11 U.S.C. §§363(e), 1325(a)(5)(A); Fed. R. Bankr. Proc. 4001(d); *In re Jamo*, 283 F.3d 392, 398-403 (1st Cir. 2002).

Here, the City asserted that it was entitled to retain possession of the cars (even under *Thompson*) absent a turnover proceeding, including because courts had held at the time that the City could retain possession of impounded cars under the automatic-stay's exception in §362(b)(3). Pet. 13 n.5. When asked to return the cars, the City simply attempted to negotiate a consensual resolution of a potential turnover dispute by explaining what "adequate protection" it would accept for relinquishing possession.

To be sure, in one of the four cases below (*Shannon*), the bankruptcy court concluded that the City violated *other* stay provisions (§362(a)(4), (a)(6)) by amending its proof of claim and requesting payment in a modified plan. App. 102a-103a, 113a-116a. While that ruling is flatly wrong, it presents no obstacle to this Court's review of the question presented here. The Seventh Circuit expressly did not reach that issue, App. 14a n.1, and the court's ruling was in any event premised on the legal conclusion the City is challenging here—that §362(a)(3) requires

immediate turnover. App.113a-115a. At most, if this Court reverses the Seventh Circuit on the question presented, the creditor in *Shannon* could argue on remand (quite incorrectly, in the City's view) that the sanctions award might nevertheless be upheld on a different basis. The creditors in the other three consolidated cases have no such argument. None of this presents any obstacle to this Court's review.

III. THE SEVENTH CIRCUIT'S DECISION IS WRONG

Respondents' efforts to defend the merits of the Seventh Circuit's decision fail.

1. *Text*. Respondents' argument (Opp. 23-24) that retaining possession of estate property violates §362(a)(3) disregards its text. It operates to "stay" only "act[s]" to exercise control over estate property and thus "requires a post-petition affirmative act." *Denby-Peterson*, 941 F.3d at 125-126. *Failing* to act by "passively retain[ing] … possession" of property seized pre-petition thus does not violate §362(a)(3) because "the requisite post-petition affirmative 'act … is not present.'" *Id.* at 126.

Respondents counter that retaining possession violates §362(a)(3) because creditors purportedly have no right to keep possession of estate property, on the theory that §542(a) is "self-executing." It is not at all clear what the term "self-executing" means as applied to a statute. If it means that the statute itself has injunctive language (like the automatic stay) that permits violations of the statute to be punished by contempt in the absence of a separate court order, respondents' argument is factually incorrect—§542(a) contains no such language. And if it means that even without injunctive language, violations of

the statute can be punished by contempt in the absence of a court order directing compliance, respondents' argument is legally incorrect—contempt is available only for violations of an injunctive decree. In any event, "there is still no textual link between [§]542 and [§]362." *Denby-Peterson*, 941 F.3d at 132. Simply doing nothing and remaining in possession—thus failing to turn over the property—still "is not an affirmative act; rather, it is inaction." *Id.* at 126 & n.53.

2. *Purpose*. Respondents also disregard §362's purpose "to maintain the status quo" existing on the petition date. *Denby-Peterson*, 941 F.3d at 126 (italics omitted). Respondents argue "the status quo is that the debtor should be in possession and control of *all* estate property." Opp. 25. But as they acknowledge, the Code achieves that objective through *other* provisions, including "the turnover requirement of §542(a)" (*id.*), that enable the estate to regain property held by others on the petition date. The stay, in contrast, is designed simply to preserve the petition-date status quo, staying creditors from taking any further action to seize or liquidate property, but otherwise leaving the parties where it found them.

3. *History*. Nor does "§362(a)(3)'s legislative history" (Opp. 25-27) help respondents.

As one author of respondents' brief has acknowledged, "[b]efore the 1984 expansion of § 362(a)(3), if a creditor was unwilling to return collateral, the debtor would have to seek a court order requiring turnover under § 542(a), and in response the creditor could request adequate protection under § 363(e)." Wedoff, *The Automatic Stay Under*

§ 362(a)(3)—One More Time, 38 No. 7 Bankr. L. Letter NL 1, at 2 & n.12 (July 2018); Pet. 22-23.

Respondents' contention that the 1984 amendment to §362(a)(3) overturned that well-established practice disregards the principle that the Bankruptcy Code should not be "'read … to erode past bankruptcy practice absent a clear indication'" of such intent. *Cohen* v. *de la Cruz*, 523 U.S. 213, 221 (1998); Pet. 22-24. There is no such indication here.

The 1984 amendment, which originated in a technical-amendments bill, did not amend the *turnover* provision, but rather the *stay* provision. And "[§]362(a)(3)'s scarce legislative history" "gave no explanation of [Congress's] intent." *Denby-Peterson*, 941 F.3d at 126-127. Nothing in that history supports the inference that §362(a)(3)'s "exercise control" language was intended to compel immediate turnover, contrary to longstanding bankruptcy practice.

4. *Structure.* That contention also disregards the Code's structure. Reading §362(a)(3) to compel immediate turnover would gut the statutory protections that §542(a)'s turnover process affords creditors, including the opportunity to assert defenses to turnover and to seek adequate protection of creditors' property interests before relinquishing possession. Pet. 24-26.

In response, respondents wrongly claim that §542(a)'s turnover obligation is "self-executing" because §542(a) says creditors "shall" turn over property. Opp. 15-22, 27-28. But §542(a) also "includes numerous explicit conditions that must be satisfied before a property is subject to turnover." *Denby-Peterson*, 941 F.3d at 129. Thus, "[i]t is only after

the Bankruptcy Court determines whether those requirements are met that the debtor's right to turnover is triggered." *Id.* at 128.

Respondents similarly misread (Opp. 20-22) *United States* v. *Whiting Pools, Inc.*, 462 U.S. 198 (1983). It did not hold that §542(a) is "self-executing." Rather, it addressed the antecedent question "whether §542(a) … authorizes the turnover of … property seized by a secured creditor" at all. 462 U.S. at 202. And in holding that repossessed property does indeed "fall[] within" §542(a)'s scope, *id.* at 203-206, the Court never suggested that turnover is required immediately upon the bankruptcy filing, without a turnover proceeding. To the contrary, *Whiting Pools* stated, "The issue before us is whether § 542(a) authorized the Bankruptcy Court to subject the IRS to a *turnover order* with respect to the seized property." *Id.* at 199 (emphasis added). Reading §362(a)(3) to command immediate turnover, on pain of sanctions, in the absence of such a turnover order and opportunity for creditors to secure the statutory protections afforded their interests in the property would upend Congress's carefully designed statutory scheme.

CONCLUSION

The petition should be granted.

Respectfully submitted.

MARK A. FLESSNER
BENNA RUTH SOLOMON
MYRIAM ZRECZNY KASPER
ELLEN W. MCLAUGHLIN
CITY OF CHICAGO
OFFICE OF CORPORATION
COUNSEL
30 N. LaSalle Street
Suite 800
Chicago, Illinois 60602
(312) 744-7764

CRAIG GOLDBLATT
Counsel of Record
DANIELLE SPINELLI
JOEL MILLAR
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Ave., NW
Washington, DC 20006
(202) 663-6000
craig.goldblatt@wilmerhale.com

ALLY M. PIERCE
WILMER CUTLER PICKERING
HALE AND DORR LLP
250 Greenwich Street
New York, NY 10007
(212) 230-8800

NOVEMBER 2019