

Passive Retention: A Creditor's Right or an Act to Exercise Control?

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Both consumers and businesses often depend on motor vehicles for their livelihood or, for consumers, access to health care, child care, or other essential services. A creditor's repossession of a motor vehicle can turn into an existential crisis that motivates a debtor's bankruptcy filing. The debtor will want to use the bankruptcy process to quickly and cheaply regain use of the motor vehicle and, towards this end, might argue the automatic stay requires the creditor to return the motor vehicle. The creditor will respond that it has not committed any post-petition "act" and thus has not violated the stay. Whether it is a motor vehicle collateral, this type of dispute is the prompt to the Duberstein Moot Court Competition and leads to the questions of whether passive retention of property is a violation of the automatic stay. [Print Page](#)

To date, six circuit courts have heard and decided cases on whether the passive retention of collateral that was lawfully repossessed pre-petition is a violation of the automatic stay. Of these courts, the majority has held that § 362(a)(3)'s "exercise control clause" prohibits the passive retention of collateral.¹ On the other hand, two circuits have reached the opposite conclusion, finding that the passive retention of collateral does not violate this clause.²

Majority Interpretation

These majority courts cited the Supreme Court case *United States v. Whiting Pools*, which held that the bankruptcy estate, under § 541(a)(1), is intended to include "any property made available to the estate by other provisions of the Bankruptcy Code."³ The Court stated that several provisions of the Bankruptcy Code, including § 542(a), "bring into the estate property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced."⁴ Ultimately, the Court established that the bankruptcy filing brings all of the property that the debtor retains an ownership interest over into the estate. Thus, a creditor's failure to turn over the collateral would be an act to "exercise control over property of the estate" and a violation of the automatic stay.⁵

Furthermore, the majority courts have also maintained that the turnover provision is not conditioned by a requirement for adequate protection under § 363(e).⁶ When analyzing the issue of adequate protection, these courts maintain that the statutory obligation that the creditor "shall deliver" possession of property of the estate, under § 542(a) is not qualified by any additional statutory obligation or requirement. Thus, the turnover obligation is not defeated by any call for adequate protection.⁷

In addition to the interpretation and application of these statutes, another important consideration in deciding these passive retention cases is the policy implications. One concern is the number of remedies available to both parties and the ease and expediency for the parties to reach their desired outcomes. In these cases, a debtor who seeks to obtain a turnover order from the court must file a full-fledged adversary proceeding.⁸ These adversary proceedings require "a formal summons and complaint, and all of the normal timetables for full-blown all-out litigation, such as 30 days to answer the complaint."⁹ However, the asset the debtor may seek to have returned could be essential for the debtor to earn a living.¹⁰ In these circumstances, the time and costs of full-blown litigation could prove far too great for the debtor, pushing the debtor into even worse financial condition.

Alternatively, creditors are provided with multiple remedies to seek adequate protection, and they can obtain it in a much more expeditious manner. First, when seeking adequate protection under § 362(d), all a creditor must do is file a motion for relief from the automatic stay or for adequate protection.¹¹ The creditor does not need to commence a separate adversary proceeding.¹² In addition, § 362(e) of the Bankruptcy Code requires that there is an expedited resolution of these motions.¹³ This expedited termination of the stay, under § 362(e), can take thirty days, but can be extended further at a judge's discretion.¹⁴ However, if secured creditors are concerned about "irreparable damage" to the collateral, the creditors can seek an emergency resolution through § 362(f).¹⁵ In addition, under Rule 4001(a)(2), these emergency relief motions can be heard on an *ex parte* basis where the debtor does not need to be notified if "it clearly appears from specific facts . . . that immediate and irreparable injury, loss or damage will result to movant before the adverse party or the attorney for the adverse party can be heard in opposition."¹⁶

Minority Interpretation

The D.C. Circuit and the 10th Circuit have disagreed with the majority approach and ruled that passive retention of property is not an "act to exercise control over property of the estate" under § 362(a)(3).¹⁷ These courts also hold that the turnover provision in § 542(a) is not self-executing. A secured creditor does not have an automatic obligation to turnover property that may be used by the trustee upon the filing of bankruptcy. A secured creditor is only required to do so after the bankruptcy court has issued a turnover order.

The minority interpretation begins with a focus on Congress' intent to codify pre-Code turnover practices in § 542(a). The Supreme Court presumes continuity in bankruptcy law, absent a clear indication in the statutory language or legislative history and the Supreme Court recognized that § 542(a) was meant to codify turnover practices developed under "judicial precedent predating the Bankruptcy Code."¹⁸ Under these practices, the turnover powers were not self-executing. Further, if § 542(a) was self-executing, turnover orders would be entirely unnecessary. It would not make sense for a court to issue an injunction to enforce an already existing injunction. Injunctions are enforced by contempt sanctions, not further injunctions.¹⁹

In 1984, Congress amended § 362(a)(3) to also stay "any act to exercise control over property of the estate." The minority interpretation argues this amendment was not intended to alter well-established practices but rather further the policy goals of the original § 362(a)(3). The original language did not reach nonpossessory control of intangible property, and this additional language is precisely the type of clarifying amendment that would help achieve that goal. The legislative history of the amendment indicates it was meant to target nonpossessory control of intangible property. "[The stay] also encompasses acts to exercise control over such property without the need for actually obtaining possession."²⁰

The language used in the "exercise control" clause also indicates that Congress was targeting something other than retaining possession. Congress had already used the term possession in the first clause of § 362(a)(3), which stays any act to "obtain possession of property." In commercial law, there is a well-established distinction between "control" and "possession." Grant Gilmore stated "possession is a meaningless concept when applied to intangible claim."²¹ The UCC also distinguishes between the two terms, providing that security interests in many types of intangible property may be perfected by control²² and security interests in tangible property may be perfected by possession.²³ Additionally, the majority interpretation of the "exercise control" clause of § 362(a)(3) renders the "obtain possession" clause superfluous, because if "exercise control" means to retain possession, the obtain possession clause loses all of its power. It is impossible to obtain possession without also retaining possession.

Proponents of the minority interpretation also argue that the possessory interest in the collateral is not "property of the estate." The use of this phrase in § 362(a)(3) is a reference to the definition contained in § 541(a)(1), which adopts a legal understanding of property, commonly known as the "bundle of sticks" approach. Because the "possessory stick" is in the hands of the secured creditor at the time of filing, it does not become property of the estate until a turnover order is issued by the court. To reach this conclusion, proponents classify *Whiting Pools'* discussion of § 541(a)(1)'s scope as dictum. The Court states "§ 541(a)(1) is intended to include in the estate any property made available to the estate by other provisions of the Bankruptcy Code." However, this statement does not actually address the issue decided in *Whiting Pools*, which is the proper scope of the § 542(a) turnover power. Thus, proponents of the minority interpretation view this as confused dictum that is not meant to be interpreted so broadly.

Finally, proponents of this interpretation cite to the underlying purpose of the automatic stay, which is to maintain the status quo as of the petition date. This purpose demonstrates that § 362(a)(3) is only meant to prohibit affirmative acts that alter the status quo. The minority interpretation preserves the petition date status quo by keeping the collateral where it was on the petition date. The majority interpretation, on the other hand, alters the status quo and turns the automatic stay from a shield into a sword.

Conclusion

After arguing each side of this issue multiple times, we have concluded that the minority interpretation is a more plausible, coherent way to read § 362(a)(3). The legislative history, canons of construction, and pre-amendment practices all point in this direction. We agree with Professor Brubaker's thorough, compelling analysis of both § 542(a) and § 362(a)(3).²⁴ A secured creditor should not have to return collateral by a debtor merely filing a bankruptcy petition, absent a turnover order issued by a bankruptcy court. And a secured creditor does not violate the stay by merely retaining possession of the collateral after the bankruptcy petition has been filed.

[1] See generally *Weber v. SEFCU* (In re *Weber*), 719 F.2d 72 (2nd Cir. 2013); *Thompson v. GMAC, LLC*, 566 F.3d 699 (7th Cir. 2009); *Cal. Emp't Dev. Dep't v. Taxel* (In re *Del Mission Ltd.*) 98 F.3d 1147 (9th Cir. 1996); *Knaus v. Concordia Lumber Co.* (In re *Knaus*), 889 F.2d 773 (8th Cir. 1989).

[2] See generally *United States v. Inslaw, Inc.*, 932 F.2d 1467, 1473 (D.C. Cir. 1991), *In re Cowen*, 849 F.3d 943, 951 (10th Cir. 2017).

[3] *United States v. Whiting Pools*, 462 U.S. 198, 205 (1983).

[4] *Id.*

[5] See *Knaus v. Concordia Lumber Co.*, 889 F.2d 773, 775 (8th Cir. 1989) (holding that turnover was required and that a failure to turnover was an exercise of control over property of the estate in violation of the automatic stay).

[6] See *Transouth Fin. Corp. v. Sharon*, 234 B.R. 676, 683 (B.A.P. 6th Cir. 1999).

[7] *Weber v. SEFCU*, 719 F.2d 72, 81 (2nd Cir. 2013).

[8] Fed. R. Bankr. P. 7001(1).

[9] Ralph Brubaker, *Turnover, Adequate Protection, and the Automatic Stay (Part II): Who is "Exercising Control" Over What?*, 33 (No. 9) BANKR. L. LETTER 1, 8 (Sept. 2013).

[10] See Eugene R. Wedoff, *The Automatic Stay Under § 362(a)(3) – One More Time*, 38 (No. 7) BANKR. L. LETTER 1, 5 (July 2018) ("For debtors . . . they will be unable to use a vehicle (or other collateral) that may be needed for work, schooling and health care until the court rules on turnover . . .").

[11] Fed. R. Bankr. P. 4001(a).

[12] See Brubaker, *supra* note 5, at 9.

[13] 11 U.S.C. § 362(d).

[14] *Id.*

[15] 11 U.S.C. § 362(f).

[16] Fed. R. Bankr. P. 4001(a)(2).

[17] *Inslaw*, 932 F.2d at 1473; *In re Cowen*, 849 F.3d at 951.

[18] *Whiting Pools*, 462 U.S. at 208.

[19] Ralph Brubaker, *Of State Sovereign Immunity and Prospective Remedies: The Bankruptcy Discharge as Statutory Ex parte Young Relief*, 76 Am. Bankr.L.J. 461, 555 (2002).

[20] 126 Cong. Rec. 31,153 (1980) (statement of Sen. DeConcini).

[21] Grant Gilmore, *Security Interests in Personal Property* § 14.1, at 439 (1965).

[22] UCC § 9-314

[23] UCC § 9-313

[24] Ralph Brubaker, *Turnover, Adequate Protection, and the Automatic Stay (Part I): Origins and Evolution of the Turnover Power*, 33 Bankr. L. Letter No. 8, at 1 (Aug. 2013); Ralph Brubaker, *Turnover, Adequate Protection, and the Automatic Stay (Part II): Who Is "Exercising Control" Over What?*, 33 Bankr. L. Letter No. 9, at 1 (Sept. 2013); Ralph Brubaker, *Turnover, Adequate Protection, and the Automatic Stay: A Reply to Judge Wedoff*, 38 Bankr. L. Letter No. 11, at 1 (Nov. 2018).

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