CARLTON FIELDS

# Can Doing Nothing as a Creditor Get You Sanctioned?

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Most experienced creditors know that once a debtor files bankruptcy the automatic stay imposed by Section 362 of the Bankruptcy Code generally precludes various actions to recover debt. However, less clear is whether a creditor who seizes a debtor's property before the debtor files bankruptcy is required to release or return that property once the debtor files bankruptcy, and if the creditor can be sanctioned for failing to do so. In fact, there is a significant split among the federal circuit courts on this issue, which the Supreme Court may now be poised to resolve.

The U.S. Supreme Court has granted certiorari to hear an appeal from the Seventh Circuit regarding whether an entity that is passively retaining possession of bankruptcy estate property has an affirmative obligation to return that property to the debtor or the trustee upon the filing of the bankruptcy petition. The Second, Seventh, Eighth, Ninth, and Eleventh Circuits have all said yes, while the Third, Tenth, and District of Columbia Circuits have said no, finding that the retention of property is a passive act that merely maintains the status quo.

*In re Fulton*, the case on appeal to the Supreme Court, arose from a consolidation of four similar cases in which the debtor-appellees' cars were impounded by the city of Chicago due to traffic/parking citations. Each of the appellees, at some time after having their cars impounded, filed for bankruptcy. After the city refused to return their cars following the bankruptcy petitions, the appellees moved for sanctions arguing that the cars were required to be turned over to each respective debtor. The debtors relied on the Seventh Circuit's prior decision in *Thompson v. General Motors Acceptance Corp.* in which the court held that a creditor must comply with the automatic stay and return a debtor's vehicle upon the filing of a bankruptcy petition. In *Fulton*, the Seventh Circuit followed its prior precedent and concluded that the city's primary objective in retaining possession of the vehicles was not ownership of the vehicles but rather "to put pressure on the debtors to pay their tickets . . . precisely what the stay is intended to prevent."

A bankruptcy court in the Eastern District of Virginia also recently faced this issue. In *In re Nimitz*, the debtor's former divorce counsel (the creditor), prior to the debtor filing bankruptcy, obtained a $10,310.75 judgment against the debtor and then successfully garnished the debtor's wages. The

debtor filed for bankruptcy and sought a release of the garnishment. The creditor refused, stating that it was not aware of any requirement to terminate the garnishment. The debtor then filed a motion for sanctions for violation of the automatic stay, as the debtors in *Fulton* had done, and the bankruptcy court reached the same conclusion as the court in *Fulton*, finding that the creditor violated the automatic stay by continuing to exercise control over the garnished funds post-petition. The bankruptcy court also notably found that the creditor's actions, or arguably inactions, constituted a willful stay violation and the debtor was entitled to damages in the form of sanctions.

The Supreme Court's decision in *Fulton* will likely have a significant impact on the availability of various creditor prepetition remedies, including not only seizures, repossessions, and garnishments, but also potentially other remedies such as setoffs. Until that time, creditors should carefully consider what steps they might be required to take upon a debtor's bankruptcy filing, informed by the prevailing law in the various districts.

We will provide further reporting and analysis when the Supreme Court hears and decides the case.

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