

Repossessions and bankruptcy: What the Fulton decision means for turnover

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The February **Supreme Court** decision in *City of Chicago v. Fulton* was widely celebrated in the lending community because the court found that a lender who repossesses a vehicle before a borrower files for bankruptcy is not in violation of the “exercise control” provision of the Bankruptcy Code’s automatic stay section. That provision was the only one at issue in *Fulton*, and the court held that provision does not require lenders to turn over a repossessed vehicle as soon as a bankruptcy petition is filed.

On its face, this is welcome news for auto lenders. However, *Fulton* left open a number of other areas of exposure for lenders who refuse to return repossessed collateral to borrowers who have filed for Chapter 13 bankruptcy. Given these areas of exposure, now is a good time for lenders to update their repossession and bankruptcy policies and procedures to avoid or mitigate a potential wave of new lawsuits taking advantage of the gaps left open by *Fulton*.

The process

Before examining the effects of the Supreme Court decision, let’s review the intersection of repossession and bankruptcy. In most states and jurisdictions, when a borrower falls behind on vehicle loan payments, a lender is authorized to repossess its collateral and have the vehicle seized and then sold to satisfy the loan.

Oftentimes, the borrower hires an attorney who advises them to declare Chapter 13 personal reorganization bankruptcy because, once a bankruptcy petition is filed, an automatic stay is placed on any actions against the borrower and the borrower’s property, which becomes property of the new bankruptcy estate.

The automatic stay prevents a lender from selling the vehicle, and the Chapter 13 debtor is authorized under the turnover section of the Bankruptcy Code to seek to reclaim possession of the vehicle. Repayment of the loan is dealt with later in the bankruptcy case in the debtor’s Chapter 13 plan.

Prior to the *Fulton* decision, several courts of appeal ruled that a lender violated the automatic stay because it “exercised control” over bankruptcy estate property when it did not immediately return the repossessed vehicle to the borrower after the bankruptcy case was filed. Those decisions subjected the lenders to damages, possibly even punitive damages, as well as attorney’s fees awards to the debtors.

The decision

In *Fulton*, the Supreme Court sided with the courts of appeal that had ruled that the failure to turnover did not violate the “exercise control” provision of the Bankruptcy Code.

However, the *Fulton* decision did not address three other provisions of Bankruptcy Code: two other automatic stay subsections and the turnover section itself. These all could impact a lender’s duties after bankruptcy is filed. The Supreme Court left open the possibility that a lender’s failure to turn over a vehicle could violate those other provisions.

So, *Fulton* did not close the door on a borrower’s actions to reclaim vehicle possession by filing for Chapter 13 bankruptcy, but simply encouraged debtors’ attorneys to bring different arguments in an attempt to recover possession. Because of *Fulton*, debtors will now file lawsuits in bankruptcy court, through complaints commencing turnover adversary proceedings, rather than by simply filing motions in their bankruptcy cases.

Unlike a stay violation motion, a turnover adversary proceeding is an ordinary lawsuit, which typically is very time-consuming. What we are seeing is that debtors’ counsel now are filing these turnover adversary complaints, but they also are attempting to short-circuit the normal timeline by including expedited motions to recover possession of repossessed vehicles in their adversary proceedings.

These motions often require vehicle finance lenders to make quick decisions on whether to relinquish possession of repossessed vehicles, or to contest turnover of the vehicle based on a lack of “adequate protection.” Even if the lender turns over possession of the vehicle, the litigation may not end, as debtors often seek damages from lenders for the failure to turnover possession, and seek to recover their attorney’s fees as well.

The upshot

Vehicle finance lenders should give thoughtful consideration to preparing for a potential wave of turnover adversary proceedings. For example, a lender may wish to establish a policy as to what constitutes a minimum level of “adequate protection” of the lender’s security interest in a repossessed vehicle prior to turning the vehicle over to the borrower. At a minimum, adequate protection includes appropriate insurance coverage on the vehicle to protect the lender against loss of its collateral during the bankruptcy case.

Based on particular circumstances, adequate protection also may include cash payments to be made prior to Chapter 13 plan confirmation that approximate the depreciation in the vehicle’s value resulting from its use by the debtor. If a debtor provides evidence satisfying the lender’s minimum level of protection, then the lender’s counsel may consider arranging for turnover of the vehicle with debtor’s counsel, consistent with local practice.

Importantly, however, lenders may seek to contest any automatic stay violation claims brought in a turnover adversary proceeding, or by separate motion in the main bankruptcy case, because such claims likely no longer are viable under the reasoning used by the Supreme Court in *Fulton*.

The rationale of *Fulton* is that the automatic stay freezes the status quo as of the date the borrower filed the bankruptcy petition. If the lender does nothing more than retain possession of the vehicle, and does not make

any attempt outside of the bankruptcy case to collect the loan or to enforce its lien, Fulton's rationale supports the position that the lender is not violating any provision of the automatic stay section of the Bankruptcy Code.

The Bankruptcy Code's turnover section should not be construed as compelling a lender to turn over a repossessed vehicle upon a debtor's demand without a ruling by a bankruptcy court in the course of a turnover adversary proceeding brought by the debtor. Therefore, without violation of such a court order compelling turnover, a lender should not be held to violate the turnover section simply by retaining possession of a repossessed vehicle.

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