Supreme Court of the United States

2021 CASE REVIEW

LOU JONES

December 9, 2021

Thomas L. Shriner, Jr.
Foley & Lardner LLP
777 East Wisconsin Avenue
Milwaukee, WI 53202
414-297-5601
tshriner@foley.com

Frank W. DiCastri
Reinhart Boerner Van Deuren, s.c.
1000 North Water Street, Ste 1700
Milwaukee, WI 53202
414-298-8356
fdicastri@reinhartlaw.com

CASE DECIDED IN THE LAST TERM

I. *City of Chicago v. Fulton*, 141 S. Ct. 585 (2021).

A. Issue: Does an entity that retains possession of property of a debtor's estate have an affirmative obligation under the Bankruptcy Code's automatic stay, 11 U.S.C. § 362, to return that property to the debtor or trustee immediately following the bankruptcy petition?

B. Facts:

1. Chicago's municipal laws authorize the city to impound a motor vehicle for multiple determinations of municipal liability, including parking and speeding violations, and once impounded, the vehicle is subject to the city's statutory possessory lien in the amount of the unpaid fines.

2. All four Chapter 13 debtors in these consolidated cases had their vehicles impounded shortly before they filed bankruptcy, and in each case, the bankruptcy court found that, by not returning a vehicle to the debtor upon post-petition request, the city violated Code § 362(a)(3) and should be sanctioned for its behavior.

3. In none of the cases did the debtors commence proceedings for turnover under Code § 542. Similarly, in none of the cases did the city file a motion for adequate protection of its interest under Code § 363(e).

4. On appeal, the city asked the Seventh Circuit to overrule its decision in *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009), which established the rule that "the act of passively holding onto an asset constitutes 'exercising control' over it, and such action violates Section 362(a)(3) of the Bankruptcy Code."

5. The Seventh Circuit refused to overrule *Thompson*, but instead reaffirmed it in every respect while concluding that the city violated Code § 362(a)(3), and should be sanctioned, for refusing to return

previously seized motor vehicles. *In re Fulton*, 926 F.3d 916 (7th Cir. 2019).

6. Affirming the decisions below, the Seventh Circuit focused its inquiry on the meaning of the phrase "exercise control," cited "bankruptcy's purpose" ("to group all of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts"), and analyzed the legislative history of Code § 362.

7. The Seventh Circuit also concluded that Code § 362(a)(3) is effective immediately upon the filing of a bankruptcy petition, and does not require a debtor to first bring a turnover action under § 542. Because the burden is on the creditor to seek adequate protection under § 363(e), and § 542 makes turnover mandatory, the latter works "in conjunction with" § 362(a) to draw back into the estate a right of possession.

8. "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 [Section] 542(a) to exercise control over debtors' vehicles." *Fulton*, 926 F.3d at 924-25.

C. Supreme Court Opinion:

1. The most natural reading of the terms "stay," "act," and "exercise control" is that § 362(a)(3) "prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed."

2. Saying that a person engages in an "act" to "exercise" his or her power over a thing communicates more than merely "having" that power. Something more than merely retaining power is required to violate § 362(a)(3).

3. Any ambiguity in the text is "resolved decidedly in the City's favor" by the existence of the turnover provision, § 542. Reading § 362(a)(3) cover mere retention of property creates at least two serious problems.

    a) It would render the "central command of § 542 largely superfluous" by making § 362(a)(3) a "blanket turnover provision."
    b) It would render the commands of both sections "contradictory" because § 542 excepts turnover of property that is "of inconsequential value or benefit to the estate" but § 362(a)(3) would command turnover all the same.

4. The history of the Bankruptcy Code confirms what its text and structure convey.

    a) The "exercise control" phrase was not added until 1984, and no one contends that § 362(a)(3) imposed a turnover requirement before that. A blanket turnover requirement would have been an important change, yet the choice of words, and the lack of a cross-reference to § 542 shows that this was not the intent.
    b) The better account of the statutory history is that the 1984 amendment simply extended the stay to acts that would change the status quo with respect to intangible property and acts that would change the status quo with respect to tangible property without "obtaining" such property.

5. Court does not decide how the turnover obligation in § 542 operates, nor does it settle the meaning of other subsections of § 362(a). (In at least one of the consolidated cases, the bankruptcy court determined that the city had also violated §§ 362(a)(4) and (6).)

D. Justice Sotomayor Concurrence:

1. Agrees that the phrase "exercise control over" does not cover a creditor's passive retention of property lawfully seized prebankruptcy.

2. Emphasizes that Court has not decided whether and when § 362(a)'s other provisions may require a creditor to return a debtor's property (citing *In re Kuehn*, 563 F.3d 289 (7th Cir. 2009)). Nor has the Court addressed how bankruptcy courts should enforce § 542(a).

3. The city may have satisfied the letter of the Bankruptcy Code, but not its "spirit." Principal purpose of the Code is to grant a "fresh start" to debtors. A chapter 13 debtor needs a car for employment, to earn income to pay creditors.

4. Bankruptcy courts are not "powerless" to facilitate the return of debtors' vehicles to their owners. They can use § 542, but turnover proceedings "can be quite slow." Rule 7001 treats them as adversary proceedings. Average turnover proceeding from 2019 to 2020 was pending for more than 100 days.

5. At least one bankruptcy court held that § 542(a)'s turnover obligation is mandatory, even without an order. Others have allowed turnover by motion. Or turnover may be granted as preliminary relief in an adversary proceeding.

6. It is up to the Advisory Committee on Rules of Bankruptcy Procedure to consider amendments to the rules, and Congress could also amend § 542.

E. *Fulton* Revisited: *Margavitch v. Southlake Holdings, LLC, et al. (In re Margavitch)*, No. 20-14 (Bankr. M.D. Pa., October 6, 2021)

1. Southlake obtains judgment against the debtor, files writ of execution against a credit union as garnishee, and debtor files chapter 13 bankruptcy petition shortly thereafter. Southlake refuses to withdraw the attachment.

2. Debtor seeks damages for willful violation of the stay under § 362(k), claiming violations of §§ 362(a)(1) – (6). Debtor contends that Southlake must take affirmative action to avoid violating the stay; argues *Fulton* does not apply because Southlake does not have possession of debtor's property.

3. Southlake contends it took no post-petition affirmative action as to the credit union accounts, thereby maintaining the status quo. Southlake argues that rationale of *Fulton* also applies to other subsections of § 362(a).

4. Applying *Fulton*, court concludes that Southlake did not violate § 362(a)(3). No post-petition affirmative action as to the garnished accounts. That Southlake did not possess debtor's property is "not particularly relevant" and perhaps weighs in Southlake's favor. Southlake maintained the status quo; withdrawing the attachment would have put Southlake in a more disadvantageous position than it was on the petition date.

5. Southlake did not violate §§ 362(a)(4) – (6) either. *Fulton* can be applied to other subsections of § 362(a). Because other subsections also start with the phrase "any act to," it follows that a post-petition affirmative "act" is necessary. Here, lien had already arisen prior to the bankruptcy filing; nothing was done to enforce it afterwards.

6. Southlake did not violate § 362(a)(1) because Pennsylvania law requires several affirmative steps before a garnishment judgment can be obtained, and none was taken here. Southlake did not "continue" the garnishment process.

7. Southlake did not violate § 362(a)(2) because Southlake took no action to "enforce" a pre-petition judgment. By passively maintaining a valid, pre-petition attachment lien, Southlake in no way changed the status quo.

8. *See also Stuart v. City of Scottsdale (In re Stuart)*, No. AZ-21-1063-FLS (B.A.P. 9th Cir., Nov. 10, 2021) (no violation of any provision of § 362(a) by declining to vacate pre-petition attachment)

PETITION PENDING

I. *Siegel v. Fitzgerald (In re Circuit City Stores, Inc.)*, 996 F.3d 156 (4th Cir. 2021)

A. Issue: Does the quarterly U.S. Trustee fee increase in the Bankruptcy Judgeship Act of 2017 (the "2017 Amendment") violate the Bankruptcy Clause's uniformity requirement?

B. Constitutional and Statutory Provisions at issue:

1. The Bankruptcy Clause (Article I, Section 8, Clause 4): "The Congress shall have Power * * * To establish * * * uniform Laws on the subject of Bankruptcies throughout the United States."

2. The 2017 Amendment (28 U.S.C. § 1930(a)(6)(B)): "During each of fiscal years 2018 through 2022, if the balance in the United States Trustee System Fund as of September 30 of the most recent full fiscal year is less than $200,000,000, the quarterly fee payable for a quarter in which disbursements equal or exceed $1,000,000 shall be the lesser of 1 percent of such disbursements or $250,000."

C. "Disbursements" under 28 U.S.C. § 1930(a)(6): *In re Cranberry Growers Coop.*, 930 F. 3d 844 (7th Cir. 2019)

1. Employs ordinary meaning of term "disbursement" to determine whether customer payments made directly to debtor's lender (proceeds of debtor's inventory sales) in order to pay down pre-petition debt were subject to U.S. Trustee quarterly fees.

2. "Disbursement" is an "expansive" term. It includes payments made in the ordinary course of business, whether made to secured or unsecured creditors, payments made on behalf of a debtor, whether made directly or indirectly, and payments made on revolving lines of credit.

3. Seventh Circuit concludes that customer payments were funds "paid out" to one of debtor's creditors on behalf of the debtor, and should have been included in calculation of debtor's quarterly fees.

4. Debtor's argument, raised for the first time on appeal, that the 2017 Amendment violated the Bankruptcy Clause's uniformity

requirement, was forfeited when debtor failed to raise it in bankruptcy court.

D. Factual Background:

1. Before 1978, bankruptcy judges were responsible for case administration, including appointing trustees and monitoring cases. Judges had administrative, supervisory, and clerical functions in addition to their judicial duties.

2. In 1978, Congress launched a trustee pilot program within the Department of Justice. The program was deemed sufficiently successful that it was made permanent in 1986. In 1986, Congress created the United States Trustee Program, overseen by the DOJ's Executive Office for United States Trustees ("EOUST").

3. But the UST Program only operates in 48 states. The six districts in Alabama and North Carolina fall under the Bankruptcy Administrator program, which is overseen by the Judicial Conference of the United States.

4. Key differences between the UST Program and the Bankruptcy Administrator program:

    a) Bankruptcy Administrator districts do not benefit from the centralized support and oversight of the EOUST. Each of the six Bankruptcy Administrator districts is independent, operating as a separate entity, headed by a Bankruptcy Administrator who is selected by the Court of Appeals for a 5 year term.
    b) The Bankruptcy Administrator program is funded by the judiciary's general budget, whereas debtors largely fund the UST Program through Chapter 11 quarterly fees based on quarterly "disbursements."
    c) Consequently, Bankruptcy Administrator districts were not required to pay quarterly fees.

5. In 1994, the Ninth Circuit holds that lack of uniformity in charging quarterly U.S. Trustee fees violates uniformity provision of the Bankruptcy Clause. *St. Angelo v. Victoria Farms, Inc.*, 38 F. 3d 1525 (9th Cir. 1994).

6. In response, Congress enacts 28 U.S.C. § 1930(a)(7), which empowers, but does not require, the Judicial Conference to set fees in Bankruptcy Administrator districts that are equal to those imposed in U.S. Trustee districts. The Judicial Conference eventually does so.

7. January 1, 2018, the 2017 Amendment takes effect. It is designed to shore up the U.S. Trustee program, which was no longer self-sufficient following years of decline in bankruptcy filings. Among other changes, the maximum quarterly fee rises from $30,000 to $250,000. The changes apply to any disbursements made in any calendar quarter that begins on or after the date of enactment.

8. But the 2017 Amendment only applies to U.S. Trustee districts. Nine months later, the Judicial Conference applies the increased fees to Bankruptcy Administrator districts, but only to cases filed on or after October 1, 2018. The result:

    a) For nine months, debtors in U.S. Trustee districts are paying substantially higher quarterly fees than those in Bankruptcy Administrator districts.
    b) The higher U.S. Trustee fees apply to cases filed both before and after the date of enactment because they are triggered by "disbursements" made on or after the date of enactment.
    c) Even after the higher fees are applied to Bankruptcy Administrator districts, those fees only apply to cases filed (not all disbursements made) on or after the effective date of the change.

E. Fourth Circuit Facts:

1. In 2008, Circuit City files Chapter 11 in Eastern District of Virginia, a U.S. Trustee district. Ten years later, when the 2017 Amendment takes effect, Circuit City's case is still pending.

2. Circuit City's liquidating trustee initially pays the increased fees ($632,000 in the first three quarters of 2018 alone, compared to $833,000 over the prior seven years), but changes course after Western District of Texas declares the 2017 Amendment unconstitutional on grounds that it violates the Bankruptcy Clause,

and is unconstitutionally retroactive. *In re Buffets, LLC*, 597 B.R. 588 (Bankr. W.D. Tex. 2019).

3. July 2019, Bankruptcy Court for the Eastern District of Virginia rules that 2017 Amendment violates both the Bankruptcy Clause and the Uniformity Clause, but rules that 2017 Amendment is "substantially prospective" rather than retroactive. The bankruptcy court relies substantially on the *Buffets* decision.

4. On certified direct appeal, the Fourth Circuit affirms in part (2017 Amendment is not unconstitutionally retroactive), and reverses in part (2017 Amendment does not violate the Bankruptcy Clause or the Uniformity Clause). Both decisions favor the U.S. Trustee.

F. Fourth Circuit Opinion:

1. Fourth Circuit notes immediately that the Fifth Circuit reversed the bankruptcy court's decision in *Buffets*, 979 F.3d 366 (5th Cir. 2020).

2. Because the Uniformity Clause only applies to taxes, and the U.S. Trustee fees are not taxes, the Uniformity Clause does not apply.

3. The 2017 Amendment is a substantive bankruptcy law, so the Bankruptcy Clause does apply.

4. To be constitutionally uniform, a law enacted pursuant to the Bankruptcy Clause must apply uniformly to a defined class of debtors, and be geographically uniform. *Ry. Labor Execs.' Ass'n v. Gibbons*, 455 U.S. 457 (1982). However, a bankruptcy law may be uniform "and yet may recognize the laws of the State in certain particulars, although such recognition may lead to different results in different States." *Gibbons*, 455 U.S. at 469. Congress may "take into account differences that exist between different parts of the country, and . . . fashion legislation to resolve geographically isolated problems."

5. As emphasized by the Fifth Circuit in *Buffets*, the Bankruptcy Clause forbids only "arbitrary" geographic differences. The 2017 Amendment does not draw an arbitrary distinction based on the residence of the debtors or creditors. "Instead, the distinction is simply a byproduct of Virginia's use of the Trustee program." 996 F.3d at 166. Congress was authorized to solve a shortfall in the program's funding with fee increases that apply solely to the underfunded districts.

6. Although the Ninth Circuit found that the establishment of separate Trustee and Bankruptcy Administrator districts was an "irrational and arbitrary" distinction for which there was "no justification," here the 2017 Amendment "does not suffer from any such shortcoming. Congress has provided a solid fiscal justification for its challenged action: to ensure that the U.S. Trustee program is sufficiently funded by its debtors rather than by taxpayers." 996 F.3d at 166-67.

7. The 2017 Amendment is not unconstitutionally retroactive. Congress intended the amendment to apply to all Chapter 11 cases, regardless of when they are filed. Even if this were unclear, the 2017 Amendment would have no "retroactive effect" because it applies only to future disbursements, which are triggered by conduct occurring after the law's effective date.

8. The Quattlebaum Dissent:

    a) The dual bankruptcy systems in the United States are "candidly and unapologetically nonuniform." Similarly, the imposition of quarterly fees in the two bankruptcy systems is not uniform. Many Chapter 11 debtors in U.S. Trustee Program districts pay more than similarly situated debtors in Bankruptcy Administrator districts. As a consequence, similarly situated creditors receive less in Trustee Program districts than in Bankruptcy Administrator districts.

    b) The majority's opinion "misses the forest for the trees." That the U.S. Trustee Program districts were the only underfunded districts is a consequence of Congress' having treated them differently in the first place, a decision that was based purely on geography.

    c) The 2017 Amendment is not a congressional attempt to "resolve geographically isolated problems," but rather is arbitrary and "financially damages unsecured creditors in every state other than Alabama and North Carolina." 996 F.3d at 175.

    d) "Accordingly, while the constitutionality of the two types of bankruptcy systems is not before the court, I would nonetheless hold that the [2017 Amendment], as applied

to the Liquidating Trustee, violates the Bankruptcy Clause." *Id.*

G. Petition for Writ of Certiorari:

1. There is a direct, intractable conflict over a significant constitutional question under the Bankruptcy Clause. The Second Circuit unanimously declared the 2017 Amendment unconstitutional. *In re Clinton Nurseries, Inc.*, 998 F.3d 56 (2d Cir. 2021). The Second Circuit rejected the holdings of the Fourth and Fifth Circuits in *Siegel* and *Buffets* and sided with the dissents in both cases.

2. As a result, the 2017 Amendment is now unconstitutional in some areas of the country but not others.

3. The question presented is exceptionally important and warrants review. This issue arises repeatedly in bankruptcy cases nationwide, and the practical stakes are significant: the Court must determine the proper allocation of tens or hundreds of millions of dollars in the major Chapter 11 cases during the affected period.

PENDING SEVENTH CIRCUIT CASE

I. *Archer-Daniels-Midland Co. v. Country Visions Coop. (In re Olsen)*, No. 21-1400 (7th Cir. 2021).

A. Appellee's Issues:

1. Whether a sale "free and clear" of Country Visions' right of first refusal (ROFR) actually occurred or could occur under the asset purchase agreement, the confirmation order, Wisconsin law or § 363(f)?

2. Whether the district court properly ruled that the confirmation order was partially void for lack of personal jurisdiction over Country Visions?

3. Whether the bankruptcy court properly ruled that the confirmation order was partially void for want of statutory and constitutional due process under the circumstances?

4. Whether the bankruptcy court properly ruled that ADM was not a "bona fide purchaser" of the Ripon Property?

B. Facts:

1. In 2007, Country Visions' predecessors/assignors acquired the ROFR on the Ripon Property. The ROFR was immediately recorded with the Register of Deeds for Fond du Lac County. It had a 10 year term.

2. The ROFR required the owner of the Ripon Property to promptly notify Country Visions, in writing, of any bona-fide third-party offer to purchase the Ripon Property. The notice had to include a copy of the offer, and be provided at least 15 days before the sale. When tendered, the notice constituted a written offer to sell to Country Visions. Country Visions could either exercise or waive its rights.

3. In December 2010, the Olsens—then-current owners of the Ripon Property—filed chapter 11 cases. In July 2011, certain creditors of the Debtors filed a Plan providing, among other things, for the sale of the Ripon Property "free and clear" of liens, claims and encumbrances pursuant to § 363(f). A confirmation hearing was ultimately set for August 30, 2011.

4. It is undisputed that Country Visions was never listed on Debtors' mailing matrix, and received no formal notice of the bankruptcy filings, the confirmation hearing or the proposed sale of the Ripon Property.

5. On August 12, 2011, a woman from "ADM Grain" sent an e-mail to ADM informing ADM that there was a ROFR on the Ripon Property. ADM took no action.

6. Country Visions learned that a sale of the Ripon Property was being considered. On August 19, it sent a letter to the Debtors and their counsel informing them of the ROFR and demanding notice of any proposed sale. The same correspondence was sent to bankruptcy counsel for the Debtors on August 23.

7. Also on August 23, counsel for Country Visions spoke with counsel for the Debtors. What they said to each other is disputed. Neither the Debtors nor ADM provided any formal notice to Country Visions after this correspondence and phone call.

8. Country Visions did not appear in the bankruptcy cases or attend the confirmation hearing. On August 30, 2011, the bankruptcy court entered the confirmation order without notice to Country Visions. The order purported to authorize sale of the Ripon Property "free and clear" of any liens, claims and encumbrances other than "Permitted Encumbrances" as defined in the APA.

9. Hours later, prior to the closing, counsel for the Debtors sent a title policy to counsel for ADM, which disclosed the ROFR. ADM took no action.

10. In 2015, ADM decided to sell the Ripon Property and other property to United Cooperative in a "package" deal. Upon learning of the sale, Country Visions contacted counsel for ADM, again alerting ADM of the ROFR and requesting a copy of the offer. In response, ADM and United attempted to separate the sale into two transactions, claiming that United offered $20 million for the Ripon Property alone, and $5 million for three other parcels and other assets.

11. Country Visions asserted that the $20 million offer was a "sham," artificially inflated to hinder Country Vision's right to purchase, and declined to meet the stated purchase price. ADM and United later closed on the sale.

12. Country Visions sued ADM in state court, seeking specific performance of the ROFR. Following a 2018 trial, the state court found in favor of Country Visions, holding that the $20 million offer "was a sham at an arbitrarily inflated price" and that the price "was inflated for the purpose of preventing Country Visions from exercising its ROFR."

13. ADM moved the bankruptcy court in 2016 reopen Debtors' long-closed bankruptcy cases, and thereafter asked the bankruptcy court to find that the ROFR was extinguished in the 2011 sale.

14. State court litigation proceeds to Wisconsin Supreme Court and back. Currently on remand to circuit court.

C. Bankruptcy Court opinion:

1. Upon a largely *sua sponte* Rule 60(b)(4) inquiry, the bankruptcy court found that Country Visions' right to due process was violated when the Debtors purported to sell free and clear without notice to Country Visions. Country Visions never received the statutory notice to which it was entitled, and any "actual notice" that Country Visions had was insufficient.

2. The information provided in the August 23 phone call was "ambiguous" in part because it included reference only to a "potential" sale, and one week's notice was insufficient.

3. ADM was not a "bona fide purchaser" because it had constructive notice of the ROFR, and twice received actual notice.

4. The confirmation order was void to the extent that it purported to sell free and clear of Country Visions' ROFR.

D. District Court opinion:

1. The district court affirmed, noting that ADM had only itself to blame for the result, and should have ensured compliance with the Bankruptcy Code and Rules if it wanted to ensure it was taking clean title.

2. District court criticizes ADM for its "stunning lack of candor" with the bankruptcy court.

E. 7th Circuit Oral Argument:

1. Judge Easterbrook presses ADM on bankruptcy court's findings that ADM had specific notice of the ROFR and failed to do anything

about it. Easterbrook sees no argument that these findings were clearly erroneous.

2. Judge Easterbrook presses ADM on whether Country Visions was ever made a party to the bankruptcy proceedings.

F. Potential Issues for Decision:

1. Did the bankruptcy court lack personal jurisdiction over Country Visions?

2. Did the Debtors and ADM ever intend to sell free and clear of the ROFR because of the "Permitted Encumbrances" clause?

3. Even if they did so intend, could the Debtors sell free and clear of Country Visions' ROFR under § 363(f) in any event?

4. Was Country Visions' right to due process violated? Was any "actual notice" of Country Visions sufficient to satisfy the minimum requirements of due process? Was ADM a "bona fide purchaser"?

6. What role does § 363(m) play, if any? *See Edwards*, 962 F.2d 641 (7th Cir. 1992).

7. Was the ROFR an executory contract that was rejected by Debtors' Plan?