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Effect of the Automatic Stay on Repossessed Collateral

Earlier this year, the Supreme Court of the United States resolved an issue that has divided the lower courts. By way of background, the filing of a bankruptcy case triggers the imposition of the automatic stay. The stay prevents creditors from taking steps to recover from the debtor, even if the creditor is not informed of the bankruptcy filing. The scope of the stay is extremely broad, and includes “any act ... to exercise control over property of the estate.”

The question has arisen as to whether this language requires a secured creditor that has repossessed collateral to return that collateral to the debtor. In the common situation of a repossessed automobile, if the car was not sold prior to the bankruptcy filing, must the creditor return it to the debtor? For decades, bankruptcy courts have been divided as to whether continuing possession of the vehicle constitutes an act to exercise control over property in violation of the stay.

The Supreme Court finally put the matter to rest in a case where the city of Chicago impounded the debtor’s vehicle for failure to pay fines for motor vehicle infractions. The Court decided that mere retention of the collateral was not an act to exercise control over the property. However, Justice Sotomayor suggested in her concurring opinion that other provisions of the bankruptcy statute might require a creditor to return the collateral, leaving the door open for debtors’ lawyers to try other avenues.

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

Bankruptcy Limit on Charging Orders

A charging order is a method under Maryland law by which a judgment creditor may collect its judgment from the economic interest of the judgment debtor in a partnership or limited liability company. For these purposes, Maryland law

distinguishes between an LLC member’s economic interest in the LLC, the right to receive payments from the LLC, and the member’s management interest in the LLC, the right to determine the LLC’s actions. The charging order “requires the limited liability company to pay over to the creditor only any distributions that would otherwise be payable to the debtor whose economic interest is charged.”

A Maryland bankruptcy court recently clarified the meaning of the phrase “distributions that would otherwise be payable to the debtor.” The LLC which received the charging order was operating under a confirmed Chapter 11 plan. That plan required payments to a trust against which a judgment has been entered. The judgment creditor obtained a charging order against the LLC to reach the distributions to be made to the trust under the plan.

Because there were multiple unresolved claims against the trust in the bankruptcy case itself which the plan provided would be paid from LLC distributions, the bankruptcy judge did not permit the LLC make any payments pursuant to the charging order until all potential offsets to the distributions in the bankruptcy case were resolved and paid.

In re TSC Dorsey Run Road Jessup, LLC, 2020 Bankr. LEXIS 2480 (Bankr. D. Md. 2020).



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