Chapman and Cutler LLP

Chapman Client Alert

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Current Issues Relevant to Our Clients

It's Just Not Yours Anymore: Southern District of New York Holds That a Bank's Post-Petition Administrative Freeze of a Debtor's Bank Account Does Not Violate the Automatic Stay

On April 25, 2019, the U.S. District Court for the Southern District of New York reversed a bankruptcy court's finding that a bank's imposition of a freeze on a married couple's bank account upon the filing of their Chapter 7 bankruptcy petition, pending instructions from the Chapter 7 trustee, violated the automatic stay.[1]

The district court held that it was not a violation of the automatic stay to deny the debtors access to funds in the account because, among other things, the funds became "property of the estate" as a result of the bankruptcy filing and were therefore subject to the control of the Chapter 7 trustee — not the individual debtors.

The district court's decision is important in that it protects retail banks from the Catch 22 of having to release funds to individual debtors in order to avoid exercising "control" over estate property as prohibited by Section 362(a)(3), while at the same time being required to comply with the obligation under Section 542(b) to turn over property of the estate to the Chapter 7 trustee.

Background

The facts in *Weidenbenner* are straightforward. Wells Fargo & Co. maintained an internal policy known as the administrative pledge policy. Under the policy, if an individual account holder at the bank filed for bankruptcy and the holder's aggregate balances exceeded $5,000, the bank would place an "administrative pledge" on the accounts so that the Chapter 7 trustee can "control payment of account balances that are property of the bankruptcy estate."

Rodney Wayne Weidenbenner and Michele Ann Weidenbenner, the debtors, both customers of the bank, filed a Chapter 7 bankruptcy petition on March 7, 2014. At the time of the debtors' filing, they maintained four bank accounts with a combined balance exceeding $5,000. As such, pursuant to the policy, the bank placed an administrative pledge on the accounts and informed the debtors' counsel of this action.

On March 13, 2014, a $75 payment from a third-party retailer was presented to the bank, but because of the administrative pledge, the bank declined the transaction. As a result, the debtors incurred a $25 fee. On March 17, 2014, the bank received a letter from the Chapter 7 trustee instructing it to release the entire amount in the accounts to the debtors and the bank complied the same day.

On April 23, 2014, the debtors filed a motion with the bankruptcy court under Section 362(k)[2] seeking damages, attorneys' fees, costs and disbursement against the bank as a result of the bank's alleged violation of the automatic bankruptcy stay. In their motion, the debtors argued that the bank's application of the administrative pledge improperly seized funds that were claimed as exempt assets under Section 522 of the Bankruptcy Code.[3]

On Dec. 30, 2014, the bankruptcy court entered orders finding the bank had violated the automatic stay and awarded the debtors damages of $25, and attorneys' fees and costs of approximately $15,000. The bank filed a timely notice of appeal.

The Opinion

On appeal, the court first addressed the bankruptcy court's conclusion that the bank "clearly exercised control over property of the estate in violation of the automatic stay" by unilaterally making the decision to place the administrative pledge. The court observed that an entity's obligation to turn over property of the estate to the bankruptcy trustee under Section 542(b) of the Bankruptcy Code is "in tension" with Section 362(a)(3), which prohibits an entity from exercising control over property of the estate, because the very act of turning over property to a particular entity is itself a form of exercising control.

The court cited to *Citizens Bank of Md. v. Strumpf*,[4] where the Supreme Court held that an "administrative hold" placed on an account to permit a bank to seek authority to vindicate its setoff rights "was not a setoff within the meaning of [Section] 362(a)(7)." The court also cited other subsequent decisions

applying *Strumpf* to temporary holds on bank accounts even where the bank held no setoff rights — including the bank's administrative pledge at issue in this case.

The key consideration in determining whether an administrative hold constitutes an impermissible exercise of control violating the automatic stay was, in the court's view, whether the hold is temporary and serves to maintain the status quo and preserve property of the estate.[5]

The court also found the U.S. Court of Appeals for the Ninth Circuit's decision in In re Mwangi,[6] to be persuasive. In that case, the Ninth Circuit, reversing the bankruptcy appellate panel beneath, held that a debtor cannot establish an injury under Section 362(k)(1)[7] as a result of an administrative pledge because upon the filing of a bankruptcy petition the subject bank account becomes property of the estate and the debtor no longer has any right to possess or control estate property. Thus, the court concluded, the debtors were not injured by the implementation of the policy because the debtors lost their possessory interest in the accounts once they sought bankruptcy protection.

The court also was mindful of the bank's apparent good-faith intention to avoid running afoul of Sections 362(a) and 542(b). In conformance with its policy, the bank immediately sought instruction from the bankruptcy trustee regarding the payment of the frozen funds, which according to the court meant that the bank did not "exercise control" over estate property within the meaning of Section 362(a)(3).

As an additional factor (although likely not essential to the outcome) the court noted that the bank did not even deny a request from the debtors to withdraw funds, but rather a demand on estate property by a third-party retailer. Had the bank honored the demand from the third party it may have violated Section 542(b), which requires entities owing a debt to the estate to turn over estate property only to, or on the order of, the trustee.

The court also rejected the debtors' argument that the bank impermissibly froze assets claimed as exempt under Section 522(b). First, at the time the accounts were frozen the 30-day period to object to asserted exemptions under bankruptcy rule 4003(b) had not lapsed and as such the accounts were not yet exempt property, but rather remained property of the estate.

The court noted that although the bankruptcy court suggested the bank could have immediately turned over the funds in the accounts to the trustee, placed the funds in a bank account in the trustee's name, or filed a motion for relief from stay, Section 542(b) does not require that turnover to a trustee occur immediately upon learning of a stay.

As to whether the $25 fee charged by the third-party retailer due to the freeze constituted an "injury" for purposes of establishing an automatic stay violation, the only entity entitled to direct reimbursement was the trustee — not the debtors. The court agreed with the "overwhelming majority" of courts holding that there is no cognizable injury to a debtor in circumstances such as those presented in *Weidenbenner* because a debtor has no right to possess or control property of the estate after filing a Chapter 7 petition.

Finally, the court addressed the bankruptcy court's unease that public policy concerns require a finding that the bank violated the automatic stay because a debtor must be able to utilize their bank accounts to purchase basic items such as food, household goods and other necessities even though the exemption process is not final.

Rejecting this concern, the court explained that the Bankruptcy Code already includes an exemption process under Section 522 that facilitates the debtor's "fresh start" and protects the debtor's dependents, but observed that estate property does not become exempt until expiration of the 30-day period set forth in Bankruptcy Rule 4003(b).

Thus, it was not the court's role to create additional protections where the law already contemplated the concerns outlined by the bankruptcy court and provided a solution that balances the interests of all parties involved.

Analysis

Weidenbenner is an important decision for large retail banking institutions, because it confirms that, consistent with the weight of authority in jurisdictions throughout the country, banks may establish policies to address bankruptcies of their customers that are protective of bank interests and their customers' bankruptcy estates, and that are relatively straightforward to implement, all without risking a violation of the automatic stay.

The bankruptcy court that originally found a stay violation to have occurred was, by its own admission, swayed by the "practical realities of debtors' lives," such as debtors' needs to "eat" and "drive to work" that require access to funds in an account. However, that concern is hard to square with the bankruptcy court's effective concession in its same decision that debtors (as opposed to their estates) have no right to funds in such accounts once a Chapter 7 petition is filed.[8]

And while the bankruptcy court was "sympathetic" with the bank's argument regarding its duty to turn over proceeds to the trustee under Section 542(b) of the Bankruptcy Code, its proposed solution, which suggested "simply waiting for the chapter 7 trustee to ask for the balance of any deposit

accounts to be turned over," seems uniquely unsatisfying given the resulting risk of liability to an estate by the bank that could result from allowing monies belonging to a trustee to instead be withdrawn by an individual debtor.

Finally, the court's decision brings the U.S. District Court for the Southern District of New York in line with nearly all other courts in the country that have considered similar issues, and therefore promotes the interests of uniformity and consistency among courts as well.

For More Information

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1 *In re Weidenbenner*, 15-CV-244 (KMK), 2019 WL 1856276 (S.D.N.Y. Apr. 25, 2019).

2 Section 362(k)(1) of the Bankruptcy Code (the "Code") provides in relevant part that "an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages."

3 Section 522(b) of the Code allows a debtor to designate certain of their property as exempt from administration by the bankruptcy trustee.

4 *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 19 (1995).

5 The District Court also quoted *Strumpf* for the proposition that an administrative hold is not truly a "hold" of anything at all — because a bank account is "nothing more or less than a promise to pay," rather than an actual corpus of particular funds.

6 *In re Mwangi*, 764 F.3d 1168 (9th Cir. 2014).

7 Section 362(k)(1) requires that a debtor be "injured by any willful violation of a stay" in order to recover damages.

8 *In re Rodney Wayne Weidenbenner and Michele Ann Weidenbenner*, 14-35443 (S.D.N.Y. Dec. 12, 2014) (Memorandum Decision), available at: http://www.nysb.uscourts.gov/sites/default/files/opinions/247747_44_opinion.pdf (last visited May 2, 2019).

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