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Beware of the Automatic Stay! Bankruptcy Court Sanctions Law Firm and Client for "Willful" Violation of the Automatic Stay

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A recent decision of the United States Bankruptcy Court for the Eastern District of California provides important advice for lenders and their counsel. In *In re Dumace Leonard LeGrand*, Case No. 19-21198-C-7 (Bankr. E.D. Cal. Feb. 6, 2020) ("Op."), Bankruptcy Judge Christopher M. Klein sanctioned both judgment creditor and its legal counsel for violating the automatic stay, assessing actual damages of nearly $10,000 and punitive damages of $25,000. The decision addresses several issues which our lender clients should keep in mind. Since the automatic stay, which arises upon the filing of a bankruptcy petition, is one of the most important features of the Bankruptcy Code, we issued several alerts on this topic in 2019 which may be reviewed as refreshers (*Supreme Court to Decide Whether Creditor's Inaction Violates the Automatic Stay*; *Automatic Stay Violators and Prepetition Seizures*; *Yet Another Court Addresses Violation of the Automatic Stay*; *The Automatic Stay: Even Pre-Petition Seizures May Be Covered*; *Bank Freezes and the Automatic Stay*)

The basic facts of the most recent case are fairly straightforward. The individual debtor, married with three children and a modest income, was having his income garnished as a result of unpaid child support. Another creditor, through its attorneys, also attempted to garnish the debtor's wages in connection with a nearly $21,000 judgment. Under California law, the debtor was not earning sufficient income to require his employer to withhold wages for both child support and the judgment. Although the second garnishment was not being applied against the debtor's earnings, it was retained by the employer and "remained potentially effective." Op., p. 3.

The debtor subsequently filed a chapter 7 bankruptcy petition, which triggered the automatic stay. The debtor gave notice of the bankruptcy filing to the judgment creditor and its law firm and made numerous requests to withdraw the garnishment. Nevertheless, the law firm did not withdraw the garnishment. During the pendency of the bankruptcy case (and before receiving his discharge), the debtor began working overtime and his income increased such that, the debtor's employer began to withhold debtor's wages on account of the second garnishment. Debtor's wages ended up being garnished on account of the judgment before and after the debtor

obtained his discharge. After the law firm ignored calls and messages from the debtor's attorney seeking withdrawal of the garnishment and return of garnished funds, the attorney filed a motion seeking sanctions against the judgment creditor and its law firm.

Bankruptcy Judge Klein excoriated the law firm, which advertised itself as "the premier creditors' rights firm in California," Op., p. 6, finding the law firm's actions were not in good faith and in contravention of the provisions of the automatic stay. The Court found that the law firm, in its papers responding to debtor's motion, "materially misstate[d] key facts" and "materially misstate[d] the law." Op., p. 17-18. Substantively, the Court found that the law firm failed to explain the delay in withdrawing the garnishment after receiving requests from debtor's attorney while acknowledging that it was aware of the bankruptcy and discharge. *Id.*

Addressing the issue of whether the Court could apply remedies under section 362(k)(1) of the Bankruptcy Code (dealing with automatic stay violations) even after discharge was granted, Judge Klein held that he could do so because when, as in the case, "a violation of the discharge injunction is merely continuation of pre-discharge conduct that violated the automatic stay, § 362(k)(1) continues to provide stronger, more explicit, and more definite statutory remedies that are more adequate to the task than the least-possible-exercise-of-power restriction on civil contempt." Op., p. 14. Section 362(k)(1) of the Bankruptcy Code allows the Court, upon a finding of a "willful" violation of the automatic stay to award "actual damages, including costs and attorneys' fees," as well as punitive damages "in appropriate circumstances." 11 U.S.C. § 362(k)(1). Accordingly, after finding that the violation of the automatic stay was "willful," the Court applied section 362(k)(1) of the Bankruptcy Code and awarded the debtor actual damages of nearly $10,000 (including $5,500 for attorneys' fees and $3,500 for emotional distress), and punitive damages of $25,000. Op., p. 25.

Lastly, addressing the argument that the judgment creditor should not be held liable because it was the law firm that failed to timely terminate the garnishment, the Court held both the judgment creditor and its law firm jointly and severally liable. Referencing several cases, Judge Klein held that "[i]t is . . . long settled law that clients are held accountable for the acts and omissions of their attorneys." Op., p. 25.

We bring to the attention of our clients three axiomatic rules highlighted by this case. First, the filing of a bankruptcy petition by your debtor immediately ends all collection efforts. Creditors unsure of their obligations vis-à-vis the automatic stay should always err on the side of caution and confer with knowledgeable counsel to avoid potential violations and sanctions. Second, common sense and communication with counsel, including debtor's attorney, are absolutely necessary to avoid negative outcomes. Judge Klein's opinion expressly notes the importance of a "good faith response" to debtor's notice of the automatic stay being violated, which would have limited the amount of damages for attorneys' fees and lowered the likelihood of punitive damages being awarded. Op., p. 15-16. Lastly, creditors should make sure to keep themselves informed of their obligations, including questioning the process and inquiring of their counsel as to their obligations. Attorneys will be happy to explain the process and creditors' obligations which will assist creditors in planning their case strategy.

Practices

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