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Bank freezes and the automatic stay

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A recent opinion issued by the United States District Court for the Southern District of New York focuses upon the interplay between the concepts of "property of the estate" and "violation of the automatic stay." *In re Weidenbenner*, 15-CV-244 (KMK), 2019 WL 1856276 (SDNY April 25, 2019). In this case, a married couple (the Debtors) filed a petition under Chapter 7 of the Bankruptcy Code.

Chapter 7 provides an opportunity for debtors to avoid paying almost all of their debts (those which are discharged) in exchange for submitting almost all of their assets (less exempt assets) to liquidation.

The proceeds of the liquidation are used to pay their creditors according to the priorities of the bankruptcy code and on a pro rata basis. Chapter 7 may be filed by individuals or by corporate debtors.

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Upon the filing of a bankruptcy case three things occur immediately:

- All the Debtors' property becomes property of the Bankruptcy Estate;
- A trustee is appointed to administer the Estate; and
- An automatic stay immediately is created to enjoin most actions against the Debtors or the property of the Estate, with certain limited exceptions.

A decision of the Bankruptcy Court held that the District Court in Weidenbenner addressed all three of these occurrences and gave comfort to Banks whose policies are designed to ensure that the forgoing principles were honored.

The facts of this case are not complicated. The Debtors had bank accounts at Wells Fargo totaling over $5000 collectively when they filed their petition under chapter 7.

The Bank had a policy when depositors filed bankruptcy requiring the freezing of the accounts pending instructions from the Trustee as to what to do with the money.

Not long after the Debtors' filing, a department store attempted to debit from the account, presumably from a pre-existing agreement, $75 owed to it by the Debtors.

Because of the chapter 7 filing and the subsequent administrative freeze of those accounts, the Bank refused to pay the department store as requested.

The department store charged the Debtors a $25 fee because of the failure of the Bank to allow the payment.

The Debtors claimed that the Bank had violated the automatic stay by controlling their bank accounts and that the Bank should pay the $25 fee as well as $15,000 of legal fees incurred in connection with the action to recover the $25, as provided under section 362 of United States Bankruptcy Code for the Bank's alleged violation of the automatic stay.

The Bankruptcy Court agreed with the Debtors and granted them the relief requested. The Bank appealed to the District Court, and the District Court reversed the decision. (Interestingly, the Debtors were not represented in the appeal because they said they had no money to finance legal fees and their counsel withdrew.)

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Relying upon several other cases including a seminal ruling by the United States Supreme Court and another by the Court of Appeals for the Ninth Circuit, Judge Karas issued a well-reasoned, articulate decision which may be summarized as follows:

- Upon the filing of the bankruptcy petition, the bank accounts no longer belonged to the Debtors but belonged to the Estate. (Although the Debtors wished to exempt the accounts from the Estate, that process had not yet been completed, so the accounts remained property of the Estate.)

- The Debtors could not be injured by any action the Bank took because the accounts no longer belonged to the Debtors.
- The Bank did not violate the automatic stay by refusing to allow the accounts to be debited but did quite the opposite by requesting instructions from the Chapter 7 trustee who was vested with all power and control over the assets.

In this specific situation, we are encouraged by the Court's ruling as we have always counseled our Bank clients to respond similarly when they learn of the filing of a petition under the Bankruptcy Code by account holders.

The Bank did not violate the automatic stay by refusing to allow the accounts to be debited but did quite the opposite by requesting instructions from the Chapter 7 trustee who was vested with all power and control over the assets.

In general, we also caution our clients to be wary of taking any steps which may violate the injunction of the automatic stay. (Our recent client alert addressed similar issues resulting from the repossession of an automobile).

When in doubt consult, legal counsel and consider the filing with the Bankruptcy Court of a motion for relief from the stay.

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