

Chap 7..13

Bankruptcy Blotter

Bankruptcy Court

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THE PRUDENT PRACTITIONER

The 9th Circuit BAP gives Wells Fargo Freezer Burn!

By Rosemary E. Williams*

The Bankruptcy Appellate Panel for the Ninth Circuit¹ reversed Nevada Bankruptcy Judge Bruce Markell's denial of Debtors Eric Mwangi and Pauline Mwacharo's motion seeking sanctions. The motion argued that a violation of the automatic bankruptcy stay occurred when Wells Fargo Bank, N.A., refused to turn over property in which the Chapter 7 debtors claimed a 75% interest by virtue of a state exemption.

The property at issue was some \$17k in four prepetition bank accounts which Wells Fargo had retained after its

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From the Editor

Dear Chap 7..13 Subscribers,

We are in the midst of three important updates. You should have already received notice that version 9.8, containing district specific changes is available. Version 9.9, with updated means test figures, will be released prior to November first. Version 10 will be a CD which will contain official form updates and improvements to the exemptions' features in Chap 7..13. The CD will be arriving in the mail prior to December first.

Send your suggestions for future improvements to west.chap7dotdot13@thomsonreuters.com.

Cordially,

Your Chap 7..13 Project Team

overnight computer matching program found the bankruptcy filing. This is was part of the bank's national policy of always freezing funds in every outstanding account of any debtor in bankruptcy. Wells then sent a letter to the trustee assigned to the debtors' case asking for an order or instructions as to the disposition of the money. Pending a response from the case trustee, Wells held the money. The debtors claimed an exemption under state law in 75% of the deposited funds, and no party made any objection. After demand by the debtors, and silence by the trustee, the debtors finally brought a motion seeking sanctions against Wells for violation of the automatic stay. Wells *still* held on to the money because (1) Wells claimed the debtors had no standing to bring the motion, and (2) the pending, never-forthcoming direction or order from the trustee.

What would you have done as Wells' attorney or advisor? A practitioner's first thought might be that the Supreme Court's decision in *Strumpf*² (finding a temporary administrative freeze of a creditor having a right to setoff was not a stay violation) would make the outcome of the contempt motion a walk for Wells Fargo since the bank was listed in the debtors' Schedules as the holder of an unsecured claim against the bankruptcy estate for \$50k in credit card debt, and a \$2k balance on an equity line of credit. Wells would notify the debtor and the trustee of the freeze, and promptly bring a stay relief motion or motion for abandonment to exercise a setoff right, or if not, a motion to get a judicial determination of who got what. This was what the creditor in *Strumpf* did, and it has been suggested or endorsed by other courts – including the Ninth Circuit BAP in the *Mwangi* case under discussion.

However, the noteworthy aspect of this case is that Wells Fargo, citing its "national policy," expressly

disavowed any claim against the deposit funds as a setoff to its prepetition debt, and by taking no action other than to send a letter to the trustee announcing a freeze on the funds until the trustee responded with a course of action. In the face of silence by the trustee, an allowed exemption claim by the debtors, and written demands by the debtors to turn over the exempt funds, Wells continued to hold the funds and allegedly await a response from the trustee. In response to the contempt motion, Wells argued that the debtors had no standing to request any judicial assistance, or do anything other than to join Wells in awaiting the trustee's response.

In confining *Strumpf*'s applicability to the narrow scope of SCOTUS' stated issue, the BAP panel used the same reading as the Court of Appeals for the Seventh Circuit,³ which noted in a 2009 decision that the *Strumpf* creditor prevailed because it had an "undeniable right" to a setoff. The *Strumpf* creditor promptly brought a motion seeking stay relief, and imposed only a temporary administrative freeze to preserve status quo pending the court's ruling. As the Seventh Circuit had done, the Ninth Circuit BAP placed particular emphasis on SCOTUS' holding in *Strumpf* that the creditor's *temporary* refusal to pay over funds it held on deposit did not constitute violation of the stay as it was not an exercise of control over the funds at issue. The BAP compared the actions of the creditor in *Strumpf* with the determined inaction of Wells and held that Wells Fargo exercised control over the funds by refusing to turn over the funds to either the debtor or the trustee. Wells pointed out that it had sent a letter to the case trustee stating it held the funds pending his order or response. The BAP noted that Wells thereafter

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continued to hold the money even after the contempt action was brought, stating it would not release the funds except under the terms described in its letter to the trustee. The BAP speculated in dicta that Wells' position, if upheld, would mean that it could keep the funds indefinitely until and unless the trustee – not the debtor – took action.

Wells argued that its freeze, when coupled with its letter to the trustee seeking instructions, was not a stay violation because it complied with the turnover provisions of Code § 542(b). Wells stood willing and able to pay the funds to the trustee on his order. The BAP commented that, in Wells' view, "[t]he trustee did not request turnover of the account funds. End of story ... What happened to the funds was up to the trustee, and therefore out of Wells Fargo's control."⁴ It was this insistence on the rightness of Wells' nonaction, apparently to continue indefinitely while it likewise continued to hold the money, that caused the BAP to find control by Wells of the funds. Because the bankruptcy judge has denied the motion, there was no finding regarding willfulness or evidence of damages. The case was remanded for those issues only.

There is no hint in the opinion or the briefs as to why Wells stood firm on what must have seemed to some a position unsupported by case law. What is clear is that Wells did not regard passive inaction as implicating any violation of the automatic bankruptcy stay. Before reaching this conclusion, Wells might have considered another decision by the Court of Appeals for the Seventh Circuit⁵ in which the Court considered whether a private university's refusal to provide transcripts to the debtor, both before and after her discharge, was equivalent to a bank's administrative freeze under *Strumpf*. The debtor offered to pay in advance for the transcript, but the university refused to act. In defense of the contempt action brought by the debtor, the university claimed that it had no contractual obligation to provide a transcript and, without that, a "passive refusal to deal" could not be construed as a stay violation. The Seventh Circuit noted – again – that nothing in *Strumpf* could be read as implying that a creditor could block an account or

maintain a freeze no matter what happened in the bankruptcy case, or after a discharge. The university could not set off money owed by a student against a transcript of grades, nor did its passive inaction prevent a finding of a stay violation.

One would think that holdings like that would at last prompt review of Wells' national policy, but perhaps Wells based its insistence on inaction on decisions such as *In re Calvin*⁶ by the Bankruptcy Court for the Southern District of Texas, and *In re Jiminez*⁷ by the District Court for New Mexico. In each of these decisions, Wells Fargo was the bank. In *In re Calvin*, the debtors had some \$8,320 in a bank account on the petition date and claimed the entire amount as exempt. The debtors continued to write checks against these funds, and Wells dishonored the checks because of the freeze. There was no debt owed to Wells, and therefore no setoff right. However, Wells argued that "its policy is a sound one that benefits the bankruptcy system because the freeze ensures that debtors will not use funds until the time has passed for the Chapter 7 trustee and any creditor to challenge any claimed exemption to the funds."⁸ Wells argued that it had complied with Code § 542 "and that by so doing, it cannot be in violation of the automatic stay ...".⁹ In a finding prophetic of *Mwangi*, the Texas bankruptcy judge held that "The plain meaning of [Code § 542(b)] is that the Bank, upon learning of the Debtors' bankruptcy, was required to: (a) immediately pay the funds in the account to the Trustee; or (b) if not immediately, then on the order of the Trustee."¹⁰ The bankruptcy judge found Wells' decision to notify the trustee and wait as actions that were "entirely in compliance" with Code § 542(b), but went on to hold that Wells "could not ... freeze and hold the funds and then look to the Trustee for direction. Delivery of the funds was required."¹¹ The bankruptcy judge went on to hold that a "tender" of the funds (i.e., freeze, hold and ask the trustee for instructions) was not the same as a "delivery" of the funds (i.e., a transfer of possession to the trustee), so that Wells failed to comply with Code § 542(a). However, this court held that the debtors had no

standing to pursue a contempt action against Wells because the funds belonged to the estate, not the debtors, at the time the checks were dishonored. The bankruptcy judge held that even if the debtors had standing, there was no stay violation, citing *Strumpf*. To put paid to anything the debtors might have to claim, the bankruptcy judge further held that, even if the debtors had standing to sue and Wells violated the stay, the debtors had no damages beyond \$75 in returned check fees for which Wells had already reimbursed the debtors. As the money was eventually returned to the debtors, and there was no evidence of attorney's fees before the court, it was a case of no harm, no foul.

In the bankruptcy court's decision in *Jimenez*, the bankruptcy judge analyzed *Calvin* and disagreed with its holding, finding that the fact that the funds were property of the estate did not mean that the debtors had no right to assert that the stay protects the property.¹² On review, the District Court followed the reasoning and decision in *Calvin*, holding that the debtor had no standing to pursue Wells for allegedly violating the automatic stay, but even assuming standing, the administrative freeze did not violate the automatic stay.¹³

Comment: Each of these decisions was politely criticized by the Ninth Circuit BAP¹⁴ as an "overbroad" reading of *Strumpf* and, of course, each is directly contradicted by the Seventh Circuit case.

In light of *Calvin* and *Jimenez*, the BAP turned to Wells' challenge to the debtors' standing to bring a motion for contempt against Wells. The BAP examined when the re-vesting of an interest in property claimed as exempt occurs to answer that issue. The panel held that, until an exempt property interest reverts in the debtor, the debtor holds an *inchoate interest* in that property and therefore had standing even before the exemption was allowed. As authority for this holding, the panel cited *Schwab v. Reilly*,¹⁵ a 2010 SCOTUS decision, in which the Supreme Court held that property does not cease to be "property of the estate" just because an exemption claim ripens.

As it had done in *Calvin* and *Jimenez*, Wells argued

that its obligation to turn over estate property was met when it offered to turn over the funds to the trustee. When the trustee did nothing about the funds, Wells had no further obligation. The debtors therefore had no right to compel turnover of the funds because § 542(b) has no reference to the debtors or their exemption rights, until the time period for objection to that exemption expired. To that argument, the BAP cited its earlier decision in *In re Abrams*¹⁶ holding that "the failure to return property of the estate with knowledge of the bankruptcy is a violation of both the automatic stay and of the turnover requirements of the Bankruptcy Code." Thus the mere knowing retention of estate property was proscribed by Code § 362(a)(3) and therefore a stay violation. The BAP agreed that Wells' actions (and its national policy) of freezing and holding estate funds in every bankruptcy case until requested by the trustee to release them was in "technical compliance" with § 542(b), but was, the panel held, irrelevant to the case before it given Code § 362(k)(1) permitting an award of damages to the debtor for a stay violation. Thus there was no conflict between Code § 542(b) and Code § 362(a)(3), and no need to decide whether one prevailed over the other.

To the question of whether Wells' actions constituted direct control over estate property, the BAP found that Wells could have paid the account funds to the trustee, and did not. It could have sought direction from the bankruptcy court regarding disposition of the funds, and did not. It chose instead to hold the funds [for use in the overnight market¹⁷ possibly] until a demand was made for payment "which it alone deemed appropriate. If that is not 'exercising control over' the funds, we don't know what is." And here's the core:

The impact of Wells Fargo's national policy is to turn on its head the balance between rights of parties legislatively created. As a result of the policy, every party, except Wells Fargo, whose rights are impacted by the administrative freeze will need to take action.

The panel then remanded the case to the bankruptcy court to determine (1) whether Wells' continued retention of the funds was "reasonable"

in the absence of instructions from the trustee, (2) whether its conduct constituted a willful violation of the stay, and (3) what damages are appropriate.

So what does a prudent (bank's) practitioner do?

- (1) Policies, national or otherwise, should not be followed blindly. Consider the possibility that (a) the policy may not account for or apply to the facts of a specific case, and (b) the policy is wrong/outdated/overtaken by judicial decision.¹⁸
- (2) Administrative freezes are protected by *Strumpf* for a limited period of time, but should be followed promptly by either delivery of the funds to the trustee, or if conflicting demands, an interpleader or other pleading asking for judicial direction. Yes interpleader costs some money, but there is an entitlement to recover fees and costs in such an action, where there is none in defending a motion for contempt.
- (3) Read more than the cases that agree with a desired result.
- (4) Put it kindly, but tell a client when they are wrong.
- (5) Urge the client not to use frozen funds in the overnight market.

So what does the debtor's practitioner do?

- (1) Do not leave money laying around when a filing is imminent. Consider that the debtor may face a lapse of time before getting access to funds, even with a clear right.
- (2) If the debtor is an individual, claim the exemptions concurrently with the petition or as soon after that as possible.
- (3) Contact the trustee about access to funds – don't just assume and don't let the debtor do it either.
- (4) Be sure the debtor understands that not telling you about all deposited money places those monies in jeopardy of loss or reduction if it is necessary to recover later, and that the cost of that recovery reduces the amount of money returned to the debtor.
- (5) If there is a possible setoff, identify it before filing and see what can be done to avoid it, or at least mitigate the loss.

- (6) Keep a file on any significant decision on contempt through administrative freezes, especially (but not exclusively) in the situs jurisdiction, so that you can respond quickly.
- (7) It profits nothing to change banks when both are owned by the same mega-entity.

Don't let a contemnor get away with it. Judges generally understand the stay is important to an orderly liquidation and are willing to punish those who disregard that importance. If the contemnor is profiting from a stay violation (overnight market), find out which is higher - that profit or interest on the account – and claim the higher as part of the damages.

NOTES

1. *In re Mwangi*, ___ B.R. ___ *In re Mwangi*, ___ B.R. ___, 2010 WL 2723204 (9th Cir. BAP (Nev.) 2010). No further appeal of this decision was taken.
2. *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995). The Court held that imposition of an administrative freeze of funds on deposit was not a stay violation where the institution was protecting its right of setoff.
3. *First In re Radcliffe*, 563 F.3d 627, 186 L.R.R.M. (BNA) 2357, 61 *Collier Bankr.Cas.2d* 1236, *Bankr. L. Rep.* P 81,471, 46 *Employee Benefits Cas.* 1897 (7th Cir.(Ind.) Apr 23, 2009) (NO. 08-2885), rehearing and rehearing en banc denied (Jun 15, 2009). The creditor was a pension fund which had obtained a judgment against the individual debtor, and after the bankruptcy was commenced, set off the debtor's right to his pension against the judgment amount. The Court found that even though it agreed with the district judge, who had noted that the debtor was a "four-flusher who 'didn't stand behind his personal guaranty and so he stiffed the fund.'" Unfortunately for the Fund, it "Fund went far beyond placing a temporary hold on the benefits so that it could promptly seek relief from the stay. Rather, it refused to pay the pension and did nothing about the stay until urged to do so by the court. The Fund's comparison of its situation to *Strumpf* is way off the mark." And lost the decision even though the courts recognized the result gave an undeserved windfall to the four-flushing debtor.
4. *In re Mwangi* at 6.
5. *In re Kuehn*, 563 F.3d 289 (C.A.7 (Wis.), 2009).
6. *In re Calvin*, 329 B.R. 589 (Bankr.S.D.Tex. 2005), declined to follow by *In re Adomah*, 368 B.R. 134 (S.D.N.Y. 2007); *In re Mwangi*, ___ B.R. ___, 2010 WL 2723204 (9th Cir. BAP (Nev.) 2010). Wells Fargo was the respondent in the civil contempt motion at issue.
7. *In re Jimenez (Wells Fargo Bank, N.A. v. Jimenez)*, 406 B.R. 935 (D.N.M. 2008), reversing the disagreement

- with *In re Calvin* described in *In re Jimenez*, 335 B.R. 450 (Bankr.D.N.M., 2005).
8. *In re Calvin*, 329 B.R. at 592-3.
 9. *In re Calvin*, 329 B.R. at 596.
 10. *In re Calvin*, 329 B.R. at 596.
 11. *In re Calvin*, 329 B.R. at 598.
 12. *In re Jimenez*, 335 B.R. at 455.
 13. *In re Jimenez*, 406 B.R. at 946.
 14. “We believe the *Calvin* and [the District Court in] *Jimenez* ... overlook the context and limited application intended by the Supreme Court in its decision in *Strumpf*.” *In re Mwangi* at 4.
 15. *Schwab v. Reilly*, — S.Ct. —, 2010 WL 2400094, 78 USLW 4598, 10 Cal. Daily Op. Serv. 7580, 2010 Daily Journal D.A.R. 9047, U.S., June 17, 2010).
 16. *In re Abrams*, 127 B.R. 239 (9th Cir. BAP 1991).
 17. Throughout the course of a banking day, banks transfer money to each other, to foreign banks, to large clients and other counterparties. At the end of each banking day, a given bank may have a surplus or shortage of money. Banks that have surplus funds may lend them to, or deposit them with, other banks, which borrow the money and pay a return to the first bank. Banks may lend funds for longer periods of time where the monies are unlikely to be demanded by the depositor (such as certificates of deposit). Use of a depositor’s funds therefore costs a bank nothing, and can be used to generate profits.
 18. “I beseech you, in the bowels of Christ, think it possible you may be mistaken.” Oliver Cromwell in a letter to the General Assembly of the Church of Scotland, 1650.

Our Most Recent Releases

Chap 7..13 Version 9.8 was released via our software download site (<http://west.thomson.com/software/chap7-13/default.aspx>) on October 1. It is specific to certain jurisdictions, and it contains updated administrative expense multipliers for North Carolina and Alabama. Also included are new or revised chapter 13 plans for Arkansas, the Northern District of California, Delaware, Hawaii, Kansas, Maryland, the Western District of Missouri, New Jersey, the Western District of North Carolina and the Eastern District of Oklahoma, 29 new or revised

local forms for the Central District of California, three new local forms for Rhode Island and updated exemptions for Alaska and Maryland. Version 9.7 was released on June 30. This release was also specific to certain jurisdictions, containing updated exemptions for Arizona, Minnesota, South Carolina, Tennessee, Wisconsin and Texas (family). 9.7 also contained updated local forms and/or updated chapter 13 plans for Idaho, the Western District of Michigan, Vermont, the Western District of Washington and the Eastern District of Texas.

Version 9.9 will contain updated means test figures and will be available in advance of their November first effective date.

Version 10 will be a CD arriving in the mail in late November. Among other program enhancements, it will contain improvements to the exemption system including automatic calculations of spillover exemptions.

Chap 7..13 Tips

How do I make my secured claim show as oversecured, or “under water?”

When entering the value of the claim in Creditor Information Window, be sure your “Type of Claim” is set to “Secured.” Clicking on the Claim Information Tab, you will see the template to enter the “Claim Amount.” Beneath this entry is a breakdown of secured and unsecured portions of the secured claim. If you need to allow for the claim to be oversecured, there is a box to the right you can check called “Allow Oversecured Claim.” Check-marking this box allows you to modify the secured and unsecured portions respectively. If you are filing a chapter 13 plan, these values will be imported accordingly into the Plan 13 for Windows.

How do I save individual files in Chap 7...13?

Many firms enhance their efficiency by using support personnel to do basic data-entry in Chap 7...13. As a result, you may be looking for an easy way to transfer Chap 7...13 files from your secretary, law clerk or paralegal’s computer to yours. If you follow

this process you will be able to move Chap 7...13 files quickly and effortlessly.

First, when looking at the Case List Window, select the “Copy/Save” option. Put a period in the radio dial in front of “Copy to Disk.” Then select “Next.”

You will see a list of cases from the current workspace. Highlight the ones you wish to transfer. You can highlight more than one by holding down the control (Ctrl) key on your keyboard. Then click “Next.”

Chap 7...13 will default to saving to your “A:” drive. Select the folder icon next to the disk drive box. You can choose where to save the file in the “Save In” box. An easy way to save it is to a USB flash drive which will show up under “My Computer.” If you do not have a flash-drive installed, than simply save it to your desktop. The file will save by default in .zip format.

If you saved it to a USB drive, simply remove the drive. If you saved it to your desktop, open your email program and attach it to an email with your address.

How do I retrieve files on Chap 7...13?

You must now either receive the file as an email, or hook the USB drive up to your recipient computer. If you have received the file as an email, save it to your desktop.

On the Case Explorer Window in Chap 7...13, click on “Retrieve” and select the file folder so you can navigate to the directory where you saved the information. Select the zip file and click “Open.” Then click “Next.” You will see a list of files. Highlight them with your mouse, holding down the Control key if you wish to retrieve more than one.

The “Copy Case Wizard” will copy the file into your new workspace.

How do I backup my entire workspace?

A recent experience one of our support people had with a computer virus reinforced the importance

of periodic backups of critical data. It is a good idea to buy a separate backup medium on which to save Chap 7...13 data.

From the “File” control at the top left hand corner of the screen select “Backup Entire Workspace.” In Version 10.0 you will select “Workspace Tools” on the “File” menu, then select “Backup Entire Workspace.” Use the controls on the “Select Destination” window to navigate to the place where you wish to backup.

Name your backup and press “Save.” You will receive a message: “Workspace backup was successful.” Since this step is so simple, you should do it every week. It is a good idea to store your backup in a secure location, such as your office safe.

How do I retrieve my backup?

Hopefully, you will never need to use this step, but the process of retrieving is very simple. From the “File” menu select “Restore Entire Workspace,” use the “open control” to select the file, and then click “Open.” Again, in Version 10.0 you will select “Workspace Tools” on the File menu, then “Restore Entire Workspace.”

Looking for a past issue of the Bankruptcy Blotter?

Have you read something interesting the Bankruptcy Blotter but then when you want to refer to it again you find that you’ve misplaced your printed copy? You don’t have to spend your valuable time looking for the Blotter when you can find all of the past editions of the Bankruptcy Blotter within Chap 7..13. Just open the program and click on the Help drop down menu, then click on “Bankruptcy Blotter” and choose the issue you’d like to view. You’ll see a pdf copy of that issue, which you can view, save and/or print.

Discover Why Now, More Than Ever, a Three-Bureau Credit Report is So Important

With Suite Solutions bankruptcy-specific credit report downloads, you can free your firm from typing creditor information and relieve your clients from one more headache.

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