13 NEWS©

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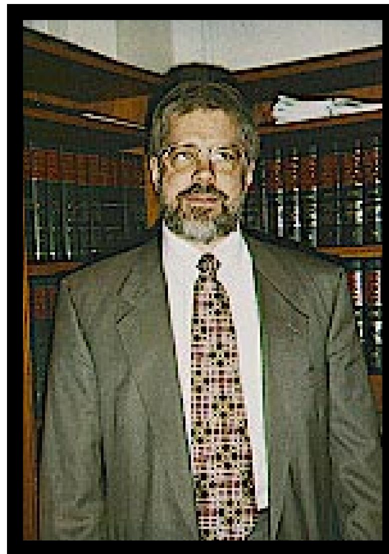
PRACTITIONER'S FORUM:

NO HOLDS BARRED - THE SUPREME COURT SPEAKS ON PRE-SETOFF "ADMINISTRATIVE HOLDS" - CITIZENS STATE BANK OF MARYLAND v. STRUMPF, 514 U.S. ____ (1995)

By David G. Hicks

On Halloween, 1995, the United States Supreme Court played a trick on the Fourth Circuit Court of Appeals - and gave a treat to certain banks, credit unions and other creditors in a position to take advantage of setoff rights - unanimously reversing its ruling in ***Citizens State Bank of Maryland v. Strumpf ("Strumpf")***.

This chapter 13 debtor maintained his checking account at Citizens State Bank of Maryland. He also had an unsecured loan through the bank which went into default. On the day that Mr. Strumpf filed his chapter 13 petition, the account balance exceeded the defaulted loan balance.



Sometime thereafter, the Bank placed an "Administrative Hold" on at least so much of the account that the bank claimed was subject to its setoff rights. In other words, the Bank did not honor any attempted withdrawals from the account that would result in the balance of the account dipping below the amount due on debtor's loan.

Five days after invoking the "administrative hold," the bank filed what was entitled "Motion for Relief From Automatic Stay and For Setoff Under Sec. 362(d)." Debtor responded by filing a counter motion seeking to have the bank held in contempt, alleging that the unilateral administrative hold violated the automatic stay provisions of sec. 362(a).

The first hearing scheduled and heard by the Bankruptcy Court was the debtor's contempt motion. The Bankruptcy Court held that the "administrative hold"

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constituted a "setoff." Moreover, this setoff had been undertaken without having obtained relief from the stay, and therefore was a violation of sec. 362(a)(7); the Court awarded sanctions against the Bank.

Several weeks later, the Bank obtained a hollow victory when the Bankruptcy Court heard its motion and granted it relief from the stay, authorizing a setoff from the remaining checking account balance against the unpaid loan balance. It was a hollow victory because, by this time, the debtor had reduced the account balance to zero.

The District Court reversed the Bankruptcy Court's first ruling that the administrative hold violated the automatic stay. The Debtor appealed to the Fourth Circuit Court of Appeals which, agreeing with the Bankruptcy Court's original decision, reversed the District Court, ruling that the "hold" was a violation. The Fourth Circuit said "an administrative hold is tantamount to the exercise of a right of setoff and this violated the automatic stay of sec. 362(a(7). ***Strumpf***, 37 F.3d 155, 158 (4th Cir. 1994) The Bank Appealed and the Supreme Court granted ***certiorari***.

The Supreme Court focused on a narrow issue which it defined as whether Bank's refusal to pay debtor the money from his account upon demand constituted a setoff. If it did, a violation of the stay occurred. If it did not, then this conduct was permissible under the Code.

As regular practitioners realize, Sec. 553(a) generally preserves a creditor's pre-petition setoff rights and Sec. 542(b) protects such creditor from turnover to the estate, to the extent of the setoff. However, as is also well known by most readers of this newsletter, any setoff right is stayed by Sec. 362(a). In other words, before exercising any setoff rights, the creditor must obtain relief from the stay.

The obvious dilemma this presents is quite familiar to creditor representatives; they call it the "bankers' dilemma." Do they "freeze" the account and risk being held in violation of the automatic stay, or do they file for relief and risk the debtor emptying the account before it can be setoff? The Courts were split at the circuit level.

In this case, Citizens Bank opted to risk the wrath of the court and "froze" the account with its "administrative hold." The Fourth Circuit Court of Appeals, in detailed reasoning and legislative history found such conduct constituted a setoff and concomitantly, a violation of the automatic stay.

Not so, said Justice Scalia writing for the unanimous high Court. The Bank's decision to place the account in an administrative hold was not a permanent and absolute refusal to pay debtor his funds, but was a temporary refusal while relief from the stay was sought. The Court said that a setoff has not occurred until three steps have been taken: "(I) a decision to effectuate a setoff, (ii) some action accomplishing the setoff, and (iii) a recording of the setoff." To constitute a setoff, the Bank's conduct must be an intent to "permanently ... settle accounts." The Court held that to conclude otherwise would render setoff "meaningless." The Court ducked the issue of the effect of confirmation of a plan upon this whole question of setoff rights, and left that for another day, another case.

Practitioners, in the meantime, need to be aware of this case in order to better advise their clients. Creditors' counsel should scrupulously include setoff rights when drafting contracts and loan documents, and upon receiving notice of the filing of a bankruptcy, place an "administrative hold" on the account up to the setoff amount, and then immediately file for relief from the stay. Debtors' counsel should engage in appropriate pre-bankruptcy planning to minimize the impact of this case upon their clients. Debtors can either avoid or minimize having hefty account balances at institutions where they have loans on the date of their filing bankruptcy, or alternatively build up the balance deliberately to ensure payment to a financial institution that debtor wishes to pay for one reason or another. Thought also needs to be given to the ramifications this decision has with respect to setoff claims by the IRS and chapter 13 debtors' ability to propose a cogent plan, obtain confirmation and effectively reorganize. It is not yet clear what impact this ***Strumpf*** decision will have on the process.

This month's article was contributed by David G. Hicks. Mr. Hicks graduated from University of Nebraska at Omaha in 1979 and received his law degree from Creighton University Law School in 1982. The author is a principal and shareholder in Pollak & Hicks, P.C., and practices bankruptcy extensively in Nebraska and Iowa. He is the author of numerous articles on bankruptcy and other legal topics. Mr. Hicks is Board Certified in Consumer Bankruptcy Law by the American Bankruptcy Board of Certification, and was recently elected Secretary of the Bankruptcy Section of the Nebraska Bar Assocation.

DID YOU KNOW? . . .

Acknowledgements have been prepared and mailed to each creditor who files a proof of claim by the Chapter 13 Trustee's office since April, 1986. The Trustee's database now exceeds 160,000 claims. The form advises the creditor that his claim has been received and how it has been recorded in the Trustee's records.

The Acknowledgement performs several functions:

1. It advises the creditor of how his name and address have been recorded for payment purposes, and if an error has been made, it affords him the opportunity of advising the Trustee of any necessary corrections.

2. It advises the creditor of the amount recorded for his claim and how his claim has been classified (i.e., secured, priority, unsecured, etc.). If an error has been made in either of these items, it affords the creditor an opportunity to so advise the Trustee's office.

3. It also serves to reduce creditor calls to the Trustee's office and the Court. The creditor now knows that his claim has been received by the Trustee and the legend printed on the front side of the Acknowledgement serves as an inducement to minimize telephone calls by the creditor as to the status of his claim.

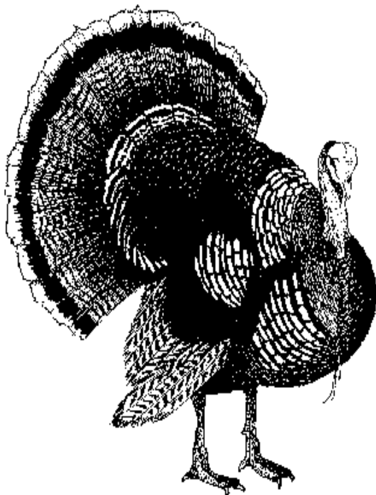
If the claim was filed by the debtor or by the Trustee, the Acknowledgement will contain a notation "This claim was filed on your behalf by the Debtor or Trustee." This is intended to serve the requirement of Bankruptcy Rule 3004 that the Clerk advise a creditor when a claim has been filed on its

behalf by a Debtor or Trustee.

The information on the Creditor's Acknowledgement is the "mirror image" of the information provided on the Trustee's Motion to Allow Claims which consolidates all filed proofs of claims.

Creditors may expect to receive an Acknowledgement of Claim approximately 30-45 days after they have filed their proof of claim. If a creditor has filed a proof of claim with the Clerk of the Bankruptcy Court and has not received an Acknowledgement, the creditor should contact the Chapter 13 Trustee's Office because we most likely have not received it.

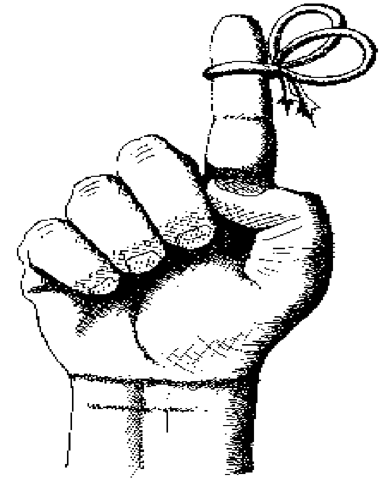
Happy Turkey Day



THE TRUSTEE PROUDLY INTRODUCES . . .

Nancy Claunch
Part-time Trustee Clerk

On December 16, 1995, our Nancy will graduate from the University of Nebraska at Omaha with a degree in Criminal Justice. She has worked for the Trustee for almost 7 years - since she was a junior at Millard North High School. We have enjoyed her lovely smile and sparkling personality ever since. For some of us, she has been the "little sister" we didn't have. She has performed numerous tasks including assisting the trustee get ready for meetings.



UPCOMING CLE SEMINAR

BANKRUPTCY FUNDAMENTALS

Friday and Saturday, December 1 and 2, 1995 Nebraska Center for Continuing Education, 33rd & Holdrege Streets, Lincoln, Nebraska

editor's comment

This newsletter is being published to facilitate communication between the Chapter 13 Trustee's Office and the many people we serve. The information is not meant to constitute legal advice or recommendations to individuals. If you would like to contribute an article, conference or program information, law review article, book review, comment, or question for further feedback from others, please call me directly or mail your item to:

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