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2019 Northeast Bankruptcy Conference and Northeast Consumer Forum

Northeast Consumer Forum

Violations of the Automatic Stay and the Discharge Injunction

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Violations of the Automatic Stay in Bankruptcy

Legal Considerations

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I. Introduction

A. Before: The Automatic Stay...

Upon the filing of a voluntary bankruptcy petition, a stay arises automatically in favor of the debtor. Section 362 of the Bankruptcy Code provides, in pertinent part:

Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—

- (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
- (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
- (4) any act to create, perfect, or enforce any lien against property of the estate;
- (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
- (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
- (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

- (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

11 U.S.C. § 362(a). The purpose of the so-called “automatic stay” is to provide the debtor with a breathing spell, and to prevent a chaotic scramble by creditors for priority in the context of the debtor’s liquidation. *See, e.g., In re Rimsat Ltd.*, 98 F.3d 956 (7th Cir. 1996); *Dean v. Trans World Airlines, Inc.*, 72 F.3d 754 (9th Cir. 1995); *In re Siciliano*, 13 F.3d 748 (3^d Cir. 1994).

The automatic stay, however, does not stay all actions against the debtor. Section 362(b) enumerates a variety of actions which may proceed notwithstanding the bankruptcy filing:

- **Criminal** and certain regulatory proceedings (*but see In re Charter First Mortgage, Inc.*, 42 B.R. 380, 384 (Bankr. D. Or. 1984) (distinguishing between public purpose and private restitution);
- **Divorce** proceedings, including:
 - o Paternity suits;
 - o Determination of domestic support obligations;
 - o Custody and visitation matters;
 - o Dissolution of marriage;
 - o Domestic violence actions; and
- Various **tax** situations, including determinations of liability, and setoff against refunds, abatements, etc.

See 11 U.S.C. § 362(b). Debtors facing such issues or involved in such matters should be aware of the limitations of the automatic stay. While collection and liquidation efforts (e.g., for child support or taxes) might be stayed, determination of such liability typically is not. *See Charter First Mortgage*, 42 B.R. at 382; *In re Braniff Airways, Inc.*, 21 B.R. 181 (Bankr. N.D. Tex. 1982); *but see In re Glabb*, 261 B.R. 170, 174 (Bankr. W.D. Pa. 2001) (allowing collection

action on child support to proceed against debtor and debtor's postpetition salary (as non-estate property) under stay exception). And, of course, attendant costs of representation and appearances in pending suits places a further burden on debtors which may not be avoided by a bankruptcy filing.

Practical consideration must also be paid to the status of the stay based upon possible previous filings by the debtor. Although the stay ordinarily arises automatically under section 362, exceptions exist for repeat filers. *See* 11 U.S.C. § 362(c). If the debtor had a previous case pending in the one-year period prior to the new filing, the automatic stay enters, but then expires 30 days after the filing unless the debtor successfully moves the court to continue the stay. *See* 11 U.S.C. § 362(c)(3). Furthermore, for serial filers with two or more cases open in the prior year, the stay does not enter at all absent a successful motion by the debtor. *See* 11 U.S.C. § 362(c)(4).

B. ...and After: The Discharge Injunction

The automatic stay terminates upon entry (or denial) of the debtor's discharge, or dismissal or closure of the case. 11 U.S.C. § 362(c)(2). Section 727 provides for the discharge of debts (excepting, of course, nondischargeable debts):

Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title.

11 U.S.C. § 727(b). Giving teeth to the discharge, section 524 provides, *inter alia*, that the discharge:

operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset

any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived...

11 U.S.C. § 524(a)(2).

The discharge injunction is analogous to the automatic stay in terms of preventing action by creditors, and violations of both are similarly treated by the Bankruptcy Code and the Bankruptcy Court. The distinction is primarily one of timing—the automatic stay operating during the pendency of the bankruptcy case, and the discharge injunction remaining effective post-bankruptcy.

II. Violations of the Automatic Stay and/or Discharge Injunction

Section 362 not only creates the automatic stay, but also includes enforcement provisions for its violation:

...an individual injured by any willful violation of a stay provided for by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

11 U.S.C. § 362(k)(1). Note that section 362 states the debtor *shall* recover damages; the court has no discretion to deny damages in the event of a willful violation. *See, e.g., In re Ramirez*, 183 B.R. 583 (9th Cir. BAP 1995); *In re GeneSys, Inc.*, 273 B.R. 290 (Bankr. D.D.C. 2001). The violation must be willful. Willfulness typically includes any intentional act committed by the creditor with knowledge of the bankruptcy filing. *See, e.g., In re Sculky*, 182 B.R. 706 (Bankr. E.D. Pa. 1995); *In re Hudson*, 168 B.R. 449 (Bankr. S.D. Ga. 1994). Inadvertent or excusable violations will not give rise to sanctions. *See In re Nelson*, 994 F.2d 42 (1st Cir. 1993). And, of course, the debtor must demonstrate that damages were actually incurred. *See In re Williams*, 316 B.R. 534 (Bankr. E.D. Ark. 2004) (awarding no damages where debtor failed to demonstrate any actual damages sustained).

The analysis for violations of the discharge injunction of section 524 is similar. Courts typically remedy such violations by utilizing the inherent equitable powers provided under section 105(a). *See* 11 U.S.C. § 105(a).

III. Procedural Considerations

A. Contempt Motion

Violations of the automatic stay¹ may be addressed by motion. Debtors seeking sanctions against a violating party may file a motion for contempt to redress such conduct. *See, e.g., In re C.W. Mining Co.*, 625 F.3d 1240, 1246–47 (10th Cir. 2010). Rule 9014 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”) permits parties to request relief by motion generally absent specifically contradicting rule:

In a contested matter not otherwise governed by these rules, relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded by the party against whom relief is sought. No response is required under this rule unless the court directs otherwise.

Fed. R. Bankr. P. 9014(a). Bankruptcy Rule 9020 further provides:

Rule 9014 governs a motion for an order of contempt made by the United States trustee or a party in interest.

Fed. R. Bankr. P. 9020. Accordingly, a motion for contempt is sufficient to seek relief for stay violations, and a party in interest—including the debtor—need not file an adversary proceeding. *See C.W. Mining*, 625 F.3d at 1246–47. Indeed, some courts have gone so far as to hold that violations of the discharge injunction (and, presumably by extension, the automatic stay) *must* be brought by motion and *may not* be brought by adversary proceeding. *See, e.g., In re McLean*, 794 F.3d 1313, 1326 (11th Cir. 2015) (distinguishing between purpose and scope of contested matter and adversary proceeding); *Barrientos v. Wells Fargo Bank, N.A.*, 633 F.3d 1186, 1191

¹ For all intents and purposes, violations of either the automatic stay or the discharge injunction are treated similarly, and for simplicity’s sake, this section may be assumed to apply to both types of violation.

(9th Cir. 2011). On the other hand, many courts allow debtors to proceed through an adversary proceeding rather than by motion, recognizing that if anything adversary proceedings allow for *more* procedural safeguards for the parties and do not prejudice defendant creditors. *See, e.g., In re Beiter*, 554 B.R. 433, 438–39 (Bankr. S.D. Ohio 2016); *In re Bahnsen*, 547 B.R. 779, 785 (Bankr. N.D. Ohio 2016); *In re Ritchey*, 512 B.R. 847, 860 (Bankr. S.D. Tex. 2014).

Courts requiring redress of violation by motion for contempt have examined section 524(a)(2) to determine that the Bankruptcy Code does not establish a private right of action for violation of the discharge injunction. *See, e.g., In re Pertuso*, 233 F.3d 417, 421 (3^d Cir. 2000). The court in the *Pertuso* case maintained that the debtor did not have an affirmative right to recovery from the creditor as distinct from the court’s right to enforce the Code’s injunction. *See id.* at 421–23. The creditor was in contempt of the injunction; there was no independent claim of the debtor for relief. *See also In re Tenczar*, 466 B.R. 32, 36–37 (Bankr. D. Mass. 2012).

Contested matters are subject to many of the same procedural safeguards, including notice and opportunity for hearing, as adversary proceedings. Pursuant to Bankruptcy Rule 9014, many (indeed, virtually all) of the procedural rules set forth in Part VII of the Bankruptcy Rule, which mirror and make applicable the corresponding Federal Rules of Civil Procedure, apply to contested matters. *See Fed. R. Bankr. P. 9014(c); In re Kalikow*, 602 F.3d 82 (2^d Cir. 2010).

Motions for contempt, whether for violation of the automatic stay or discharge injunction, can include requests for actual damages, attorneys’ fees and costs, and punitive damages. *See C.W. Mining*, 625 F.3d 1240; *see also Espinosa v. United Student Aid Funds, Inc.*, 553 F.3d 1193, 1205 n.7 (9th Cir. 2008). Many courts also allow for compensatory damages for emotional distress on a contempt motion rather than an adversary proceeding. *See, e.g., In re Breul*, 533

B.R. 782, 796 (Bankr. C.D. Cal. 2015). A suit specifically for intention infliction of emotional distress, however, while functionally similar to the sort of distress claims asserted by motion, would likely require a separate adversary proceeding.

B. Adversary Proceeding

Where the debtor seeks specific relief of the kind identified in Bankruptcy Rule 7001, however, such relief may not be sought by motion. Bankruptcy Rule 7001 provides, in pertinent part:

- (1) a proceeding to recover money or property...;
- (2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property...;
- (3) a proceeding to obtain approval under § 363(h) for the sale of both the interest of the estate and of a co-owner in property;
- (4) a proceeding to object to or revoke a discharge...;
- (5) a proceeding to revoke an order of confirmation of a chapter 11, chapter 12, or chapter 13 plan;
- (6) a proceeding to determine the dischargeability of a debt;
- (7) a proceeding to obtain an injunction or other equitable relief...;
- (8) a proceeding to subordinate any allowed claim or interest...;
- (9) a proceeding to obtain a declaratory judgment relating to any of the foregoing; or
- (10) a proceeding to determine a claim or cause of action removed under 28 U.S.C. § 1452.

Fed. R. Bankr. P. 7001. Although most of these enumerated types of action are not applicable to stay or discharge injunction violations, any request for injunctive or equitable relief would necessitate the filing of an actual adversary proceeding. *See* Fed. R. Bankr. P. 7001(7).

In determining whether to pursue relief by motion or adversary proceeding, wholly apart from legal requirements, debtors must consider the additional expenses and procedural burdens

of an adversary proceeding over a request by motion. Adversary proceedings may involve more complex scheduling orders and requirements, increased expenses associated with discovery and related motion practice, and potential traps for the unwary. These issues vary greatly by jurisdiction, as many courts and local rules establish requirements for contested matters, including scheduling and “pre-trial” orders, that rival full-blown adversary litigation.

IV. Unintended Consequences

As discussed briefly above, the automatic stay does not stay all actions against the debtor. *See* 11 U.S.C. § 362(b). The ability of certain actions to proceed can lead to unintended (or at least unforeseen) consequences for the debtor. For instance, the appropriate state agency may be prohibited from suspending, revoking, or refusing to renew a debtor’s driver’s license due to nonpayment of tickets or traffic fines. Such efforts are clearly representative of attempts to collect the unpaid debt. Conversely, the debtor’s license *may* be suspended, revoked, or refused renewal for unsafe driving (e.g., failing breathalyzer test, reckless driving, etc.) or for nonpayment of domestic support obligations (which are nondischargeable and the collection of which, in some instances, is excepted from the stay). Courts distinguish such instances based upon the purpose of the state’s action (criminal proceedings to protect against unsafe conduct by debtor versus mere debt collection).

Similarly, the discharge injunction obviously only operates against debts subject to the discharge. Nondischargeable debts, whether by operation of section 523 of the Bankruptcy Code or order of the Bankruptcy Court, survive the debtor’s bankruptcy. Creditors holding such debts—including former spouses, taxing authorities, student loan lenders, and the like—are free to pursue the debtor, regardless of the discharge injunction, as soon as the automatic stay terminates. Remembering that the stay terminates upon entry or denial of the discharge,

creditors holding nondischargeable claims may be free to pursue their claims even while the debtor's bankruptcy case remains open. This is particularly true in a chapter 7 proceeding involving a suit to determine dischargeability pursuant to section 523. In such cases, the discharge typically enters notwithstanding the pending suit (which merely determines, at some later date, whether the individual creditor's claim is subject to the discharge). The debtor's bankruptcy case may remain open for months or years following entry of the discharge, although the automatic stay is no longer in effect during that time.

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CONTEMPT

Apart from 11 U.S.C. §362(k) violations of stay orders, bankruptcy courts have the power to hold parties in contempt (at least civil contempt) for violations of court orders other than stay orders. In addition, in a case that does not involve an individual, contempt powers provide a remedy for violations of court orders. 362(k) is only available for individuals not entities.

AUTHORITY

The Bankruptcy code does not contain a specific contempt provision. Rather the code vests the bankruptcy court with broad authority to issue any “order, process or judgment” that is necessary and appropriate to carry out the provisions of the bankruptcy code. This includes contempt orders. See 11 U.S.C. §105. See, e.g. First State Bank of Roscoe v. Stabler, 914 F.3d 1129, 1140 (8th Cir 2019). See also Federal Bankruptcy Rule 9020(b), comments. This appears to be settled law at least for civil contempt orders. Federal Bankruptcy Rule 9020(b) provides that contempt motions are governed by rule 9014. A practice pointer. It might be a good idea to put in your orders not only that the bankruptcy court has jurisdiction over the matter, but that it can enforce the order as well.

STANDARD FOR CONTEMPT

The Supreme Court is currently hearing a case on the standard for holding a creditor in contempt under the bankruptcy code. Taggart v. Lorenzen (no. 18-489). The issue before the court is whether a creditor can be held in contempt if he was aware of a discharge order and intentionally violated it even if the creditor had a good faith belief that the discharge order did not apply to his conduct. The facts involved litigation that continued post-discharge and the creditor's belief that attorneys fees could be awarded post-discharge since the litigation continued. The Supreme Court will decide the standard for holding a creditor in contempt will it be closer to strict liability or is there a good faith defense.

CIVIL VERSUS CRIMINAL CONTEMPT

There is a split of authority over whether a bankruptcy court has criminal contempt powers. Why is this important? The purpose of civil contempt orders are either coercive or remedial. In re Walters, 868 F.2d 665 (4th Cir. 1989). Civil contempt penalties do not seek to punish, but are designed to get a party to comply. Conversely, criminal contempt is designed to punish, such as ordering punitive damages or jail. Criminal contempt is a crime under 18 U.S.C. §401. The First Circuit in In re Charbono, 790 F.3d 80, 85 (1st Cir. 2015) has expressed the view that criminal contempt is within the bankruptcy court's inherent powers. However, in PHH Mortgage Corporation v. Beaulieu (16-256, 16-257, 16-258 (D. Vt. 2017) the Court struck down a punitive damages award on the grounds that the bankruptcy court does not have criminal contempt powers. This issue is unresolved. If you are asking for civil contempt make sure you couch your damages to coerce the creditor to comply or to provide for remedial damages, not to punish the creditor. To the extend the bankruptcy court cannot rule on criminal contempt, the remedy is to file in the district court.

STANDARD OF REVIEW

The standard of review for civil contempt is clear and convincing evidence. For criminal contempt it may be beyond a reasonable doubt and the creditor may be entitled to a jury trial and court appointed counsel. These issues are not very well developed.

DAMAGES

Damages for civil contempt are designed to coerce the defendant to comply with a court order and to compensate the movant for actual damages including attorneys fees. The Court can fine the creditor until they comply with the order and can even jail the creditor until they comply with the order. Courts routinely award attorneys fees and actual damages to the movant. See In re Zinn, No. 18-30066, Dkt. No. 146 (Bankr. W.D.N.C. Aug. 28, 2018), Dkt. No. 177 (Sept. 27, 2018)(Court ordered debtor incarcerated for violating a court order.). Punitive damages do not appear to be available through a civil contempt motion.

PLEADING POINTERS

Federal Bankruptcy Rule 9020(b) has changed over the last 30 years. It used to contain specific pleading requirements. In this regard, if you file a contempt motion against a creditor you should make the notice crystal clear that you are seeking sanctions against the creditor so they cannot argue they did not understand the purpose of the action. If you are suing a company, make sure you serve an officer and the registered agent. Civil contempt is a serious matter and you want to highlight the issues to the creditor as clearly as possible.