

A Blueprint for Damage Control for Bankruptcy Code Violations

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Recently, a bankruptcy judge in the United States Bankruptcy Court for the Eastern District of North Carolina issued a ruling that reminds lenders of the trouble that can befall them if they violate—even inadvertently—the automatic stay or discharge injunction in bankruptcy. At the same time, the ruling admonishes debtors who would attempt to use an inadvertent stay violation to manufacture unreasonable and avoidable damages. In the end, the ruling provides lenders with a blueprint for damage control in the aftermath of a Bankruptcy Code

violation.

The automatic stay provision of the Bankruptcy Code prevents a creditor from attempting to collect a debt while the debtor is under bankruptcy protection unless the creditor gets the prior approval of the bankruptcy court. Similarly, once a debtor is discharged in bankruptcy, the discharge injunction bars a creditor from collecting discharged debts.

In a case entitled [In re Ennis](#), the debtor filed a Chapter 7 bankruptcy petition. After the bank received notice of the filing, it coded the debtor's account as "bankruptcy" and activated a "no past due notifications" code in its computer system. Unfortunately, because of a computer glitch, the system continued to generate and send monthly statements to the debtor—even after he received his bankruptcy discharge.

After several months of statements, the debtor's attorney filed a motion for sanctions against the bank. When the bank received the motion, it investigated the issue, fixed the computer glitch, retained counsel, and offered to pay the debtor all damages he had incurred to that point.

Section 362 of the Bankruptcy Code provides for recovery by the debtor of actual damages incurred as a result of a "willful" violation of the automatic stay, including costs and attorneys' fees. Section 105 of the Bankruptcy Code also allows the court to sanction a party who "willfully" violates the discharge injunction.

Unfortunately for creditors, a good-faith mistake is not a valid defense. It is enough to establish the "willfulness" element of a violation if the court finds that the creditor has committed an intentional act with knowledge of the automatic stay or discharge. In [Ennis](#), the court found that the bank knew of the automatic stay and discharge, and, notwithstanding the computer glitch, intentionally sent the notices. This was enough to establish "willfulness" with respect to both the automatic stay and discharge injunction violations.

The debtor in [Ennis](#) sought damages for mental anguish and exacerbated medical problems resulting from receiving and dealing with the monthly statements. Although these could be legitimate damages under the right circumstances, the bankruptcy court held that the debtor had failed to produce evidence establishing

that the statements caused him physical or emotional harm. The court noted that "shock, disturbance, and annoyance" at receiving the statements do not rise to the level of real injury.

Section 362 of the Bankruptcy Code specifically allows for recovery of attorneys' fees and costs, and this is where a creditor can feel the sting of sanctions unless it remedies its violation as soon as it finds out about it.

In Ennis, the debtor's attorney sought almost \$12,000 in fees. Crucially for the bank in Ennis, the Local Rules for the Eastern District require the court to consider whether the debtor notified the creditor of the violation and gave the creditor an opportunity to cure it.

The court rejected the request for attorneys' fees because it determined that the debtor's attorney had not acted with "common sense and courtesy." He sent a lengthy form notification letter to the bank that did not specify the bankruptcy code violation, he never tried to contact the bank by phone or email before filing his motion for sanctions, and, even after filing the motion, he refused to tell the bank what damages he believed it owed to the debtor. Instead of trying to resolve the problem straightaway, he seemed to be spoiling for a fight. The court would have none of it, ultimately awarding costs and fees of only \$1,750.

For lenders, the lesson is clear. If a debtor alleges a violation of the automatic stay or discharge injunctions, a lender should do four things:

- Immediately search for any problem.
- If a problem is found, fix it.
- Retain counsel to negotiate a resolution or, if negotiations are unsuccessful, defend your conduct in court, and,
- Offer to pay the debtor's damages sustained as a result of the violation.

Taking these steps may not guarantee a speedy resolution of the matter, but it will put the lender in the best position to minimize any sanctions against it.

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