Stay Violators Now Face Strict Liability In 9th Circ.

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Steven F. Werth

On Oct. 14, 2015, the U.S. Court of Appeals for the Ninth Circuit addressed, in the reported decision America's Servicing Co. v. Schwartz-Tallard (In re Schwartz-Tallard), 803 F.3d 1095 (9th Cir. 2015), a split in the circuits regarding the application of 11 U.S.C. §362(k). That section states that a debtor injured by a willful violation of the automatic stay "shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages" in a lawsuit against a third party. The Ninth Circuit stated that with one exception, courts have uniformly held that that section authorizes an award of all attorneys' fees reasonably incurred to remedy a stay violation, including fees incurred in prosecuting a damages action.

That one exception was the Ninth Circuit. In Sternberg v. Johnston, 595 F.3d 937 (9th Cir. 2010), the Ninth Circuit faced a situation where the debtor owed a significant amount of spousal support to a third party, and on the day the debtor commenced his bankruptcy case, an attorney for the ex-spouse attended a contempt hearing. Upon learning that the debtor had just filed a Chapter 11 bankruptcy petition, the attorney pressed forward with the contempt hearing anyway, and obtained a minute order requiring the debtor to pay the full amount of his spousal support to his ex-wife, or be incarcerated.

The debtor in Sternberg v. Johnston then went on the attack. He filed a motion to set aside the minute order as a void due to the automatic stay (successful) and commenced an adversary action against the ex-spouse's lawyer to recover attorneys' fees relating to setting that minute order aside, as permitted by Section 362(k) (also successful). The bankruptcy court and district court both read Section 362(k) to provide that the debtor could recover his attorneys' fees incurred in prosecuting the adversary action against the attorney, even after the minute order was set aside. The Ninth Circuit, however, reversed. In doing so, it became the only circuit court to rule that Section 362(k) was limited solely to damages incurred by debtors from a stay violation only up until the point that the stay violation is remedied. Five years later, after noting that its ruling had been subject to "widespread criticism," the Ninth Circuit reconsidered.

That reconsideration is Schwartz-Tallard. There, a debtor faced a stay violation similar to that of the debtor in Sternberg. In Schwartz-Tallard, a loan servicing company violated the automatic stay by improperly foreclosing upon the debtor's house. After a brief round of litigation, the company recognized its error and reconveyed the property to the debtor. The bankruptcy court ordered not only that the foreclosure was void, but that the debtor was entitled to $20,000 in reimbursements of its expenses in prosecuting the litigation, including attorneys' fees, as well as $60,000 in additional damages. The loan company did not appeal the reconveyance order, but it did appeal the award of damages to the district court. The district court upheld the award and the loan company did not further appeal.

Subsequently, the debtor went back to the bankruptcy court and sought an additional approximately $10,000 in attorneys' fees to reimburse his expenses in defending the appeal. The bankruptcy court, citing Sternberg, denied that request because the appeal occurred after the stay violation had been remedied. The bankruptcy appellate panel reversed, and the Ninth Circuit upheld that ruling, expressly overruling Sternberg.

Schwartz-Tallard contains a thorough criticism of the court's prior analysis of Section 362(k) in Sternberg, noting that Congress hardly could have made the statutory language clearer: when a third party violates the stay, debtors can obtain attorneys' fees incurred relating to the collection of all damages, even if the stay violation has been remedied, including all costs of appeal necessary to collect those damages. That is now the law in all the circuits.

The Ninth Circuit in Schwartz-Tallard also discussed legislative intent and public policy for good measure, perhaps to head off any potential argument that the court should reverse itself again and go back to being the sole court to narrowly read Section 362(k). Or, perhaps because the Sternberg decision was so thorough in reaching the opposite conclusion. The dissenting opinion in Schwartz-Tallard by Judge Sandra Segal Ikuta disagrees that the statutory language permits the result obtained by the majority, and asserts that the analysis in Sternberg is a better reading of the statute. For those at odds with the result of Schwartz-Tallard, this dissenting opinion contains an analysis one can use to challenge the Ninth Circuit's approach in future actions.

With Schwartz-Tallard, debtors can more easily weigh the merits of litigating against a party engaging in a stay violation. Debtors must be aware, however, that while the language of Section 362(k) makes recovery of costs and attorneys' fees mandatory, risks remain in taking too aggressive a stance and commencing litigation when it is not necessary, or to drive up an award. The Schwartz-Tallard court noted that Section 362(k) only awards fees "reasonably incurred," and that courts retain the discretion to eliminate "unnecessary or plainly excessive" fees. Nevertheless, Schwartz-Tallard now clearly places the burden upon stay-violating parties to justify a strategy of litigation (as opposed to quick settlement) when such litigation will only increase a debtor's costs and fees ultimately to be borne by the nondebtor party.

For a corporate debtor, the cautionary language in Schwartz-Tallard could be interpreted by a bankruptcy court to require that the debtor notify the stay violating party by writing and attempt to engage in a meet-and-confer before commencing litigation. Corporate debtors may want to consider stating in that letter that pursuant to Schwartz-Tallard, the Ninth Circuit will allow all attorneys' fees to be recovered, without limitation, thus putting the violating party on notice of their potential liability. Future phone calls or other attempts to communicate with stay violating parties should be recorded for use in a future declaration in support of an award of attorneys' fees, as the only defense that a stay violating party appears to have under Section 362(k) is that the fees are unreasonably high.

Corporate counsel may consider further notifying the stay-violating party, as litigation proceeds, of the additional actions being taken, and fees being incurred, to counter any attempt by the stay-violating party later to reduce the fees awarded. Attorneys for corporate debtors in the midst of such litigation should consider billing to a segregated client task code to make identifying time spent specifically on the stay-violating litigation easy to identify, and attorneys should identifying, within those time entries, specific attempts by the attorneys to communicate to the stay-violating party its potential liability.

For corporate entities on the other side of such litigation, having received a notice from a debtor as to a stay violation, such entities should make the decision quickly as to whether a stay violation is or is not occurring. To the extent there is doubt, such entities should consider reaching a stipulated agreement with the debtor to mediate or otherwise decide the issue in a streamlined fashion, and attempt to place in that agreement a statement that the parties are to pay their own attorneys' fees. What the corporate entity must avoid is a situation where the debtor can justify incurring significant litigation expenses, as the Schwartz-Tallard decision essentially creates a strict liability regime where the only defense a stay-violating debtor has is to assert that the debtors' fees are unreasonable. The goal is to decide the issue quickly, as setting it aside for later decision will only expand a debtor's opportunity to incur fees in addressing the issue.

—By Steven F. Werth, SulmeyerKupetz

Steven Werth is an attorney in the Los Angeles office of SulmeyerKupetz, a business, financial

restructuring and litigation firm.