No. 09-cv-1408

IN THE
UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE NINTH CIRCUIT COURT OF APPEALS

In re ERIC MWANGI AND PAULINE MWICHARO,
Debtors.

ERIC MWANGI AND PAULINE MWICHARO,
Debtors-Appellants
— v. —
WELLS FARGO BANK, N.A.,
Creditor-Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEVADA

BRIEF OF *AMICUS CURIAE* NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1(a), *amicus curiae*, The National Association of Consumer Bankruptcy Attorneys states that it is a nongovernmental corporate entity that has no parent corporations and does not issue stock.

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STATEMENT OF INTEREST OF NACBA

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 4,700 consumer bankruptcy attorneys nationwide.

NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors. NACBA has filed *amicus curiae* briefs in various courts seeking to protect the rights of consumer bankruptcy debtors. *See*, *e.g.*, *Kawaauhau v. Geiger*, 523 U.S. 57 (1998); *In re Scarborough*, 461 F.3d 406 (3rd Cir. 2006).

The NACBA membership has a vital interest in the outcome of this case. The turnover provision of 11 U.S.C. § 542 and the automatic stay provision found in 11 U.S.C. § 362 serve to protect debtors and creditors by establishing and maintaining the bankruptcy estate for appropriate distribution. By placing administrative holds on all accounts belonging to depositors who have filed bankruptcy petitions, and, as in this case, failing

to turn the funds over to the trustee or release them to the debtor, Wells Fargo has exercised impermissible control over funds which Debtor has claimed as exempt and which are necessary to Debtors' daily maintenance. Additionally, Wells Fargo's actions constitute a failure to comply with its statutory turnover obligation.

SUMMARY OF ARGUMENT

Wells Fargo's practice of placing administrative holds on its depositors' accounts when it learns that a depositor has filed bankruptcy constitutes an exercise of control over property of the bankruptcy estate in violation of 11 U.S.C. § 362(a)(3) and 542(a). The bankruptcy court erred in concluding that section 542(a) only applies to "tangible" property and that property claimed as exempt does not become property of the estate under section 541.

ARGUMENT

I. The "Puzzling" Practice of Wells Fargo

Wells Fargo is one of the nation's largest banks. Recently, it has adopted the practice of affirmatively seeking information about its depositors that have filed for bankruptcy. Upon learning that a depositor has filed for relief, Wells Fargo "freezes" the debtor's account, even when Wells Fargo claims no right to set off under section 553. Wells Fargo's account "freezes" do not distinguish between exempt and non-exempt funds, nor do they distinguish between pre-petition and post-petition deposits. As the bankruptcy court noted Wells Fargo's "puzzling" practice is unnecessary to protect Wells Fargo's interests.[1] Furthermore, Wells Fargo does not in fact turn over funds to the trustee. As a practical matter, it merely deprives the debtor of the use of funds necessary to daily subsistence, while serving no bankruptcy purpose.

I. Debtor Has Standing to Prosecute Violation of Sections 542 and 362.

Congress has provided that a debtor may bring an action for injury caused by violation of the automatic stay. Specifically, section 362(k)(1) states:

[1] The Bankruptcy Court noted that under section 542(c) Wells Fargo would not suffer repercussions for release of debtors' funds in the absence of notice of the bankruptcy filing.

> Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and in appropriate circumstances, may recover punitive damages.

Failure to comply with the turnover provision of section 542 constitutes an exercise of control over property of the estate in violation of section 362(a)(3). *See In re Del Mission Ltd,* 98 F.3d 1147, 1152 (9th Cir. 1996). Debtors have standing to challenge Wells Fargo's account freeze because it is an improper exercise over property of the estate and Wells Fargo failed to comply with its obligations under section 542(a).

Furthermore, while section 542 may not in itself confer standing on a debtor to prosecute its violation, standing is present under traditional constitutional precepts. A plaintiff has standing if he can show that: 1) he has an injury, 2) the injury is traceable to the alleged misconduct of the defendant, and 3) that a favorable outcome is likely to redress the injury. *Alcantra v. Citimortgage, Inc. (In re Alcantara),* 389 B.R. 270 (Bankr. M.D. Fla. 2008).

Because the turnover provision of section 542(a) is intended for the benefit of the debtor when that property is subject to a claim of exemption, it is the debtor who suffers the injury by reason of its violation, and it is the debtor whose injury will be redressed by intervention by the court. The estate suffers no injury by reason of a failure to turnover funds which will

not be distributed to creditors and therefore, the trustee has no incentive to pursue an action for violation of the turnover provision. Thus, Debtors have standing to challenge Wells Fargo's practice of freezing accounts and its failure to comply with section 542(a).

III. Wells Fargo's action in freezing debtor's account is an exercise of control over property of the estate that violates section 362(a)(3).

"In order to sustain an action for a violation of § 362(a)(3), three elements must be shown: (1) a property interest is involved; (2) the property interest is estate property; and (3) there occurred either an act to obtain possession of the estate property or there existed an act to exercise control over estate property." *Harchar v. United States (In re Harchar),* 393 B.R. 160, 167 (Bankr. N.D. Ohio, 2008).

A. Debtors have a property interest in their bank account.

The Supreme Court has long held that depositors have cognizable property interests in bank accounts. *See e.g., United States v. National Bank of Commerce,* 472 U.S. 713, 724 n.8 (1984) ("[W]e agree with the Government that as a matter of federal law, the state-law right to withdraw money from a joint bank account is a 'right to property.'"); *Anderson National Bank v. Luckett,* 321 U.S. 233, 246 (1943) (acknowledging that a bank account creates a property right to demand payment and resort to

courts if payment is refused); *North Georgia Finishing, Inc. v. Di-Chem, Inc.* 419 U.S. 601, 606 (1975) ("Here a bank account, surely a form of property, was impounded and, absent a bond, put totally beyond use during the pendency of the litigation on the alleged debt."); *Drye v. U.S.*, 528 U.S. 49, 58 (1999) ("[A] taxpayer's right under state law to withdraw the whole of the proceeds from a joint bank account constitutes 'property' or the 'right to property.").

Courts have consistently held that a bank account represents a depositor's right to payment in an amount equal to the account balance. *See, e.g., Barnhill v. Johnson*, 503 U.S. 393, 112 S.Ct 1386, 1389 (1992) ("[a] person with an account at a bank enjoys a claim against the bank for funds in an amount equal to the account balance."). The intangible nature of the asset does not preclude the depositor from having a property interest in the account. *See, e.g., United States v. Overman,* 424 F.2d 1142 (9th Cir. 1970) (interest of spouses in marital property is intangible asset constituting property right).

More importantly, however, Nevada law provides for a property interest in deposited funds. *See* Nev. Rev. Stat. § 100.085 ("When a deposit has been made in the name of the depositor and one or more other persons…the deposit is the property of the persons as joint tenants"); *see*

also Butner v. United States, 440 U.S. 48, 55, 99 S. Ct. 914 (1979)("Property interests are created and defined by state law.").

B. *Strumpf* does not override state law determination of debtors' property interests in bank accounts.

When read in context, the Supreme Court's ruling in *Citizens Bank of Maryland v. Strumpf,* 516 U.S. 16 (1995) does not alter the debtor's property interest in her bank account. In *Strumpf,* the Supreme Court framed the issue as: "whether the creditor of a debtor in bankruptcy may, in order to protect its setoff rights, temporarily withhold payment of a debt that it owes to the debtor in bankruptcy without violating the automatic stay imposed by 11 U.S.C. § 362(a)." In finding that the bank's freeze on debtor's account did not violate section 362(a)(7), the Court relied on the facts that the bank's freeze was temporary, that the bank immediately sought instruction as to disposition of the funds from the trustee, and that the bank promptly sought relief from stay in order to determine its right to setoff. The Court also held that that section 542(b) specifically excuses from turnover funds that the bankrupt's debtors claim as subject to setoff. It found that it would be an "odd construction" if section 542(b) excused from turnover amounts claimed as subject to setoff while section 362(a)(7) made it a violation of the stay not to turn over the funds.

The Court briefly addressed the applicability of two other automatic stay provisions: sections 362(a)(3) and (6), stating:

> Respondent's reliance on these provisions rests on the false premise that petitioner's administrative hold took something from respondent, or exercised dominion over property that belonged to respondent. That view of things might be arguable if a bank account consisted of money belonging to the depositor and held by the bank. In fact, however, it consists of nothing more or less than a promise to pay, from the bank to the depositor, . . . and petitioner's temporary refusal to pay was neither a taking of possession of respondent's property nor an exercising of control over it, but merely a refusal to perform its promise.

Id. at 21.

Perhaps unsurprisingly, some courts have erroneously interpreted this language to stand for the broad proposition that a debtor has no property interest in his checking account. Such misinterpretations arise from a failure to read the language from *Strumpf* in context and a failure to look to state law to determine debtor's interest in property.

Strumpf dealt specifically with a freeze placed on funds to protect the bank's right to setoff. The Court itself, immediately after making its broad declaration concerning the property interest in accounts, places its holding in its proper context, stating:

> In any event, we will not give §§ 362(a)(3) or (6) an interpretation that would proscribe what § 542(b)'s 'exception' and § 553(a)'s general rule were plainly intended to permit: the temporary refusal of a creditor to pay a debt that is subject to setoff against a debt owed by the bankrupt.

Id. at 21.

An interpretation of *Strumpf* to say that a debtor simply has no property interest in his bank account runs counter to numerous other Supreme Court cases recognizing that a person has a property interest in a bank account from which state law permits him to withdraw funds. *See, e.g., National Bank of Commerce,* 472 U.S. at 724 n.8; *Luckett,* 321 U.S. at 246; *Di-Chem,* 419 U.S. at 606. Language from the Supreme Court cannot be interpreted to overrule previous Supreme Court precedent without specific indication from the Court that such is its intention. *See In re Burr,* 8 U.S. 469, 481 (1807) ("It would, however, be expected that an opinion which is to overrule all former precedents, and to establish a principle never before recognized, should be expressed in plain and explicit terms."); *see also Valuepest.com of Charlotte, Inc. v. Bayer Corp.,* 561 F.3d 282, 288 (4th Cir. 2009) (Supreme Court does not typically overrule precedent *sub silentio*).

Other courts have rejected the claim that under *Strumpf* a bankruptcy debtor's interest in his bank account is not a "property interest." *See, e.g., Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. (Matter of USA Diversified Prods.),* 100 F.3d 53 (7th Cir. 1996) (finding that claim that under *Strumpf* a bank account is not "property" for purposes of section 542, "borders on the frivolous."); *Town of Hempstead Emples. Fed. Credit Union*

v. Wicks (In re Wicks), 215 B.R. 316 (E.D. N.Y. 1997) (applying *Strumpf,* court found four month hold constituted impermissible setoff).

On the basis of Supreme Court precedent, as well as its language in *Strumpf*, by which it confined its broad statement concerning the nature of a bank account to the facts before it, *Strumpf* cannot stand for the proposition that debtors' do not have property interest in bank accounts.

C. At the time of Wells Fargo's conduct, the property interest in the bank account was property of the estate.

The filing of a petition for relief under the Bankruptcy Code creates an estate comprised of "all legal or equitable interests of the debtor in property at the commencement of the case." 11 U.S.C. § 541(a)(1). This provision is very broad and includes all kinds of property both tangible and intangible. Accordingly, debtor's interest in a bank account becomes property of the estate upon commencement of a case. *See* COLLIER ON BANKRUPTCY ¶ 541.09 (A. Resnick and H. Sommer, eds. 16th ed.) ("Deposits in the debtor's bank account become property of the estate under section 541(a)(1)").

Section 522 of the Bankruptcy Code permits debtors to exempt certain property from the bankruptcy estate pursuant to the federal exemptions, listed in 11 U.S.C. § 522(d), or the applicable state exemptions. Subsection 522(b) of the Code and Federal Rule of Bankruptcy Procedure 4003 set forth

the method by which exempt property is withdrawn from the bankruptcy estate and revested in the debtor.

Section 522(b)(l), in turn, requires the debtor to file a list of property that the debtor claims as exempt under subsection (b). *See also* FED. R. BANKR. P. 4003(a). If no timely objection is made to the debtor's claimed exemptions, or if a timely objection is overruled, the exempt assets are withdrawn from the property of the estate by operation of law. 11 U.S.C. § 522(b)(l); *In re Cunningham*, 513 F.3d 318, 323 (1st Cir. 2008) (*citing Owen v. Owen*, 500 U.S. 305, 308 (1991)); *In re Bell*, 225 F.3d 203, 215 (2d Cir. 2000)("It is well-settled law that the effect of this self-executing exemption is to remove property from the estate and to vest it in the debtor."); *In re Smith*, 235 F.3d 472, 478 (9th Cir. 2000)("It is widely accepted that property deemed exempt from a debtor's bankruptcy estate revests in the debtor."); H.R. Rep. No, 95-598, 95th Cong. 1st Sess., 368 (1977)("[Section 541(a)(1)] includes as property of the estate all property of the debtor, even that needed for a fresh start. After the property comes into the estate, then the debtor is permitted to exempt it under proposed section 522 . . ."

The bankruptcy court erred in holding the bank account was not property of the estate. In reaching its conclusion, the bankruptcy court relied on the phrase "notwithstanding section 541" in section 522(b)(1). That

phrase simply means that even though all debtor's property (with limited exceptions) goes into the estate, exempt property may be removed post-petition. The majority of courts, including the Ninth Circuit Court of Appeals, have held that exempted property enters, but is then withdrawn from the estate. *See In re Casserino*, 379 F.3d 1069, 1075 (9th Cir. 2004)("By definition, exempted property is property that is removed from the bankruptcy estate"); *In re Smith*, 235 F.3d at 478.

Contrary to the bankruptcy court's holding, property that may be claimed as exempt first becomes part of the estate and is subsequently removed from the estate.

D. The freezing of Debtors' account by Wells Fargo constitutes an act to exercise control over estate property in violation of sections 362(a)(3) and 542(a).

Under section 362(a)(3), the filing of a bankruptcy petition acts as a stay of "any act…to exercise control over property of the estate." Section 362(a)(3) works in tandem with section 542(a) and 542(b), which impose a duty upon entities to turnover certain estate property. In relevant part, section 542(a) provides that:

> an entity, other than a custodian, in possession, custody, or control, during the case, of property…that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

Contrary to the bankruptcy court's holding, nothing in the plain language of section 542(a) limits its application to only tangible property. The bankruptcy court erred in finding that because a bank account is a "debt," that only section 542(b) applies. The fact that 542(b) may apply does not permit Wells Fargo to completely disregard section 542(a) when the debtor may claim the property as exempt. *See In re McDonald*, 402 B.R. 568, 569 (Bankr. W.D. N.Y. 2009) (turnover places the property in the hands of the trustee until such time as its exemptibility is determined). When the debtor claims an interest in a bank account as exempt and the bank is not claiming a right to setoff, section 542(a), which deals more specifically with exempt funds, should control. It makes no sense for 542(b) to apply, allowing the bank to hold funds indefinitely and await further instructions from the trustee, because in the case of exempt funds the trustee has no incentive to order their release. The administrative hold merely deprives the debtor of the use of funds necessary to daily subsistence, while serving no bankruptcy purpose.

In this case, the right to payment of the account balance could have been and was, in fact, claimed exempt by the debtors. Because the property falls within the plain meaning of the section 542(a), Wells Fargo had an

obligation to turnover funds,[2] rather than simply offer delivery, unless the funds were of inconsequential value or benefit to the estate. *See* 11 U.S.C. § 542(a). *Cf. Calvin v. Wells Fargo Bank, N.A. (In re Calvin),* 329 B.R. 589, 598-600 (Bankr. S.D. Tex. 2005)(bank would be required pursuant to plain meaning of § 542(a) to actually deliver funds to the Trustee). *See also In re Del Mission Ltd,* 98 F.3d 1147 (9th Cir. 1996) (funds representing debtor's right to tax refund were subject to turnover under section 542(a) and could not be held pending specific request by trustee).

In this case, the court need not determine whether Wells Fargo was obligated to turn over funds immediately to the trustee or whether the funds were of inconsequential value or benefit to the estate because under either scenario Wells Fargo improperly exercised control over estate property by placing an administrative hold on the debtors' account. If Wells Fargo was required to turnover funds, its failure to comply with 542(a) constitutes a violation of 362(a)(3). If Wells Fargo was not required to turnover funds because they were of inconsequential value or benefit to the estate, nothing in the Bankruptcy Code authorizes Wells Fargo to place an administrative hold on the account without asserting a right of set off.

[2] In a chapter 13, the debtor retains possession of estate property under § 1306 so funds would be released to the debtor in effect negating the need for turnover.

CONCLUSION

Wells Fargo's action in freezing debtors' account violated its obligation under section 542(a) and improperly exercised control over estate property in a violation 362(a)(3) for which debtors have standing to seek restitution. For these reasons, the decision of the bankruptcy court should be reversed.

Respectfully submitted,

/s/ Tara Twomey

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CERTIFICATE OF SERVICE

I hereby certify that on April 1, 2010, I electronically filed the foregoing document with the Clerk of the Court for the Bankruptcy Appellate Panel for the Ninth Circuit by using the CM/ECF system.

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