

A yellow triangle pointing downwards, located to the left of the 'LEGAL UPDATES' header.

LEGAL UPDATES

Bankruptcy Court Protects Creditors And Banks Holding Garnished Funds

The Ninth Circuit Bankruptcy Appellate Panel recently held that merely freezing a debtor's bank account holding funds that had been garnished by a judgment creditor did not violate the automatic stay.

02/08/2022 | 2 minute read

The Ninth Circuit Bankruptcy Appellate Panel (BAP) recently held that merely freezing a debtor's bank account holding funds that had been garnished by a judgment creditor did not violate the automatic stay. This decision was based on the United States Supreme Court's ruling last year in *City of Chicago v. Fulton*, holding that retention of repossessed vehicles that were possessed before a bankruptcy was filed did not violate the automatic stay.

In *In re Stuart*, a judgment creditor garnished funds held in the judgment debtor's bank account. The bank froze the account, and before any other action took place in the state court, the debtor filed a chapter 13 bankruptcy case. The creditor promptly took action to stay the state court garnishment proceedings after the bankruptcy filing. The debtor argued that the automatic stay required the creditor and bank to release the garnished funds, and that the failure to do so was a violation of the automatic stay. The debtor filed a motion for sanctions against the creditor, requesting damages for physical and psychological distress, punitive damages, and attorney fees.

Most institutional creditors are aware of the automatic stay, which, true to its name, immediately goes into effect upon the filing of a bankruptcy petition, and which protects debtors from creditor actions to collect debts or take possession of the debtor's property. Prior law indicated that a creditor had an affirmative duty to return a debtor's funds that were garnished pre-petition. However, in a logical extension of the Supreme Court's ruling in *Fulton*, the BAP ruled that a judgment creditor, and the bank, holding funds that had been garnished before the bankruptcy was filed, did not violate the automatic stay by holding the funds until a determination could be made regarding the disposition of the funds. Merely preserving the status quo does not violate the automatic stay.

This ruling is a welcome development for both creditors and financial institutions, protecting them against claims for violation of the automatic stay, which could expose them to damages and sanctions. Once a creditor becomes aware that a bankruptcy has been filed, it should of course immediately cease any affirmative acts to collect pre-bankruptcy debts. However, under the holding of this case, maintaining the status quo will not be deemed a violation of the automatic stay.

Related Services

[Bankruptcy, Restructuring
& Creditors' Rights](#)

[Commercial Lending](#)

Related Sectors

[Financial Institutions](#)



Please contact our experienced team of creditors' rights attorneys to help with these and other bankruptcy issues.