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Recent Developments: Citizens Bank of Md. v. Strumpf: A Creditor Bank May Temporarily Freeze a Bankrupt Debtor's Checking Account without Violating an Automatic Stay

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*Citizens Bank of
Md. v. Strumpf:*

**A CREDITOR
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In a unanimous decision, the United States Supreme Court in *Citizens Bank of Md. v. Strumpf*, 116 S. Ct. 286 (1995), held that a creditor in a bankruptcy action may, to protect its setoff rights, temporarily withhold payment of a debt that it owes to a debtor in bankruptcy without violating an automatic stay. The Court stressed that the requirement of an intent to permanently settle an account is implicit in Maryland's rule regarding setoff rights. In so ruling, the Court acknowledged that creditor banks may temporarily place an administrative freeze on a bankrupt debtor's checking account while seeking relief from the automatic stay.

When David Strumpf ("Strumpf") filed for relief under Chapter 13 of the Bankruptcy Code on January 25, 1991, he maintained a checking account with the Citizens Bank of Maryland ("Citizens"). Strumpf was also in default on the remaining balance of a \$5,068.75 loan from Citizens. On October 2, 1991, Citizens placed an "administrative hold" on Strumpf's checking account, claiming a right to setoff. As a result, Citizens refused to pay withdrawals from the account that would have reduced the account balance below the amount due on Strumpf's loan. Five days later, Citizens filed a "Motion for Relief from Automatic Stay and for Setoff" in the Bankruptcy Court under title 11, section 362(d) of the United States Code. In re-

sponse, Strumpf filed a motion to hold Citizens in contempt, claiming that Citizens' administrative hold violated the section 362(a) automatic stay.

The Bankruptcy Court held that Citizens' administrative hold constituted a setoff in violation of section 362(a)(7) and granted Citizens' motion for relief from the stay, authorizing the bank to set off Strumpf's remaining checking account balance against the unpaid loan. On appeal, the United States District Court for the District of Maryland reversed, finding that an administrative hold was not a violation of section 362(a). The United States Court of Appeals for the Fourth Circuit reversed, concluding that an administrative hold was equivalent to the exercise of a right of setoff, violating the automatic stay of section 362(a)(7).

The United States Supreme Court granted certiorari to address the issue of whether a creditor bank in a bankruptcy action may, to protect its setoff rights, temporarily withhold payment of a debt that it owes to a debtor in bankruptcy without violating an automatic stay. Citizens argued that the refusal to pay its debt to Strumpf was not an exercise of the setoff right in violation of the automatic stay. Conversely, the defense argued that the bank's administrative hold exercised dominion over property belonging to Strumpf and thus violated sections 362(a)(3), 362(a)(6), and 362(a)(7).

In an opinion written by Justice Scalia, the Supreme Court began its analysis by commenting that “the right of setoff allows entities that owe each other money to apply mutual debts against each other, thus avoiding the absurdity of making A pay B when B owes A.” *Citizens* at 289 (quoting *Studley v. Boylston Nat. Bank*, 229 U.S. 523, 528 (1913)). The Court explained that although the Bankruptcy Code does not create the right of setoff, section 553(a) provides that, with certain exceptions, bankruptcy preserves any existing setoff rights. *Id.* In addition, the Court noted that Maryland law allows *Citizens* to set off the defaulted loan against the checking account balance. *Id.* The Court maintained, moreover, that *Strumpf’s* bankruptcy filing stayed *Citizens’* exercise of their setoff right according to section 362(a). *Id.*

The court agreed with *Citizens* that the administrative hold was not a setoff within the meaning of section 362(a)(7), and stressed that *Citizens’* refusal to pay its debt was temporary while it sought relief under section 362(d) from the automatic stay. *Id.* According to the Court, the issue of whether the temporary refusal was wrongful was “a separate matter.” *Id.* The Court found that a requirement of an intent to permanently settle accounts is implicit in most state laws regarding setoff rights. *Id.* Maryland follows the majority rule that a setoff occurs when one (i)

makes a decision to effectuate a setoff, (ii) takes some action accomplishing the setoff, and (iii) enters a recording of the setoff. *Id.*

If state law differed, the Court stated that federal law determines whether a section 362(a)(7) setoff has occurred. *Id.* Consequently, the Court recognized that “other provisions of the Bankruptcy Code . . . would lead us to embrace the same requirement of an intent permanently to settle accounts.” *Id.* Because *Citizens’* freeze of *Strumpf’s* checking account was not intended to permanently reduce *Strumpf’s* account balance by the amount of the defaulted loan, the Court concluded that the administrative hold was not a setoff. *Id.*

Next, the Court examined the inconsistency between section 362(a)(7)’s right of setoff and section 542(b)’s provision concerning the turnover of property to the estate. *Id.* According to Section 542(b), a bankrupt’s debtor must “pay” to the trustee “any debt that is property of the estate . . . except to the extent that such debt may be offset under section 553 . . . against a claim against the debtor.” *Id.* (citing 11 U.S.C. § 542(b)). Section 553(a), in turn, provides that the Bankruptcy Code will not affect a creditor’s prebankruptcy setoff rights against the debtor “[e]xcept as otherwise provided in this section and in sections 362 and 363.” *Id.* On that account, the Court found it an “odd construction” of section 362(a)(7)

to require a creditor with setoff rights to pay a claim to which a setoff applies when section 542(b) unequivocally exempts such action. *Id.*

The court recognized that section 553 restricts the execution of an actual setoff during an automatic stay and held that section 553 “undoubtedly refers to section 362(a)(7).” *Id.* Furthermore, the Court stated that the section 553(a) “except” clause does not indicate that section 362(a)(7) requires the immediate payment of a debt subject to setoff. *Id.* For this reason, the Court mentioned that such an interpretation would render section 553(a)’s right of setoff meaningless because “forcing the creditor to pay its debt immediately . . . would divest the creditor of the very thing that supports the right of setoff.” *Id.*

With respect to *Strumpf’s* argument that the administrative hold violated sections 362(a)(3) and 362(a)(6), the Court emphasized that *Citizens* did not take property or exercise dominion over property belonging to *Strumpf*. *Id.* at 290. The court stated that a section 362(a)(3) bankruptcy filing automatically stays “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.” *Id.* (quoting 11 U.S.C. § 362(a)(3)). Section 362(a)(6) automatically stays “any act to collect, assess, or recover a claim against the debtor that arose before the commence-

ment of the case under this title.” *Id.* (quoting 11 U.S.C. § 363(a)(6)). The Court reiterated that Citizens’ temporary refusal to pay was neither a taking nor an exercise of dominion over Strumpf’s property. *Id.* Instead, Citizen’s refusal was merely a refusal to perform its promise to pay. *Id.* Therefore, the Court declined to extend an interpretation to section 362(a)(3) or 362(a)(6) that would prohibit “the temporary refusal of a creditor to pay a debt that is subject to setoff against a debt owed by the bankrupt.” *Id.*

In holding that the creditor bank of a bankrupt debtor may protect its setoff rights by temporarily withholding payment of a debt owed to the debtor, the United States Supreme Court in *Citizens Bank of Md. v. Strumpf* articulated the importance of protecting such rights in bankruptcy proceedings. In its basic form, the *Citizens Bank* decision held that an intent to permanently settle accounts is required when determining whether a setoff has occurred. *Citizens Bank*, however, derives its true impact by ensuring creditor banks a means of protect-

ing their setoff rights against bankrupt debtors without violating the automatic stay imposed by section 362 of the Bankruptcy Code.

- Mark L. Renbaum



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STEPPINGSTONE FARMHOUSE

Tucked away in the Susquehanna State Park, near Havre de Grace, Maryland, this cozy stone house is part of a farm museum complex. In humble style and formidable construction, its contents preserve the farm life heritage deeply rooted in Harford County.