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## Disallowance of Claims in Connection with an Award of Punitive Damages Under § 362(k)(1)



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The automatic stay is “a bedrock principle upon which the [Bankruptcy] Code is built”<sup>1</sup> and “one of the fundamental debtor protections provided by the bankruptcy laws.”<sup>2</sup> The importance of the automatic stay is underscored by the fact that Congress specifically provided a mechanism by which individual debtors may recover damages for willful violations of the automatic stay. Section 362(k)(1) provides that “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.”

Although the Code explicitly authorizes awards of punitive damages in certain circumstances, courts are divided on the scope of the authority conferred. Several courts have held that § 362(k)(1), by permitting awards of punitive damages, authorizes courts to impose non-monetary sanctions, including the disallowance of a creditor’s claim when the creditor willfully violates the automatic stay.<sup>3</sup> At least one court has disagreed with this interpretation, holding that “[t]he Code does not authorize a bankruptcy court to disallow a claim for an alleged violation of an automatic stay.”<sup>4</sup> The language of § 362(k)(1) merely provides for the award of “punitive damages” but does not define the term, and the term is not defined elsewhere in the Bankruptcy Code. In such instances, as the U.S. Supreme Court recently instructed, “[w]hen a statutory term is obviously transplanted from another legal source, it brings the old soil with it.”<sup>5</sup> So, what is the old soil on the meaning of punitive damages?

### Courts Authorized to Award Damages, Not Impose Sanctions

The concept of punitive damages is not exceptional to bankruptcy; it has an understood meaning

in other contexts as well. Punitive damages are “a specific variety of monetary damages imposed to punish egregious wrongdoing and prevent its repetition by the same malefactor as well as to deter others from taking similarly wrongful actions.”<sup>6</sup> According to the *Restatement (Second) of Torts*, “[p]unitive damages are damages, other than compensatory or nominal damages, awarded against a person to punish him for his outrageous conduct and to deter him and others like him from similar conduct in the future.”<sup>7</sup> *Black’s Law Dictionary* defines “punitive damages” as “[d]amages awarded in addition to actual damages when the defendant acted with recklessness, malice, or deceit; specifically, damages assessed by way of penalizing the wrongdoer or making an example to others.”<sup>8</sup> *Black’s Law Dictionary* further defines the general term “damages” as “[m]oney claimed by, or ordered to be paid to, a person as compensation for loss or injury.”<sup>9</sup> Unlike compensatory damages, which redress concrete losses, “punitive damages serve a broader function; they are aimed at deterrence and retribution.”<sup>10</sup> Punitive damages “are aimed not at compensation but principally at retribution and deterring harmful conduct.”<sup>11</sup>

In contrast to § 362(k)(1), other rules imbue the courts with broader and express authority to impose monetary and non-monetary sanctions. For example, when a party fails to comply with a discovery order, Rule 37 of the Federal Rules of Civil Procedure authorizes courts to impose a variety of monetary and non-monetary sanctions.<sup>12</sup> When a court determines that an attorney or party has violated Rule 9011(b) of the Federal Rules of Bankruptcy Procedure, the court has broad authority to impose a variety of monetary and non-monetary sanctions, including “directives of a nonmonetary nature, an order to pay a penalty into court, or, if imposed

1 *In re Wright*, 608 B.R. 648, 652 (Bankr. W.D. Va. 2019) (quoting *In re Seaton*, 462 B.R. 582, 591 (Bankr. E.D. Va. 2011)).

2 *Midlantic Nat’l Bank v. New Jersey Dep’t of Envtl. Prot.*, 474 U.S. 494, 503 (1986) (internal quotations and citations omitted).

3 See *In re Johnson*, 601 B.R. 365 (Bankr. E.D. Pa. 2019); *In re Adams*, 516 B.R. 361 (Bankr. S.D. Miss. 2014); *Credit Nation Lending Servs. LLC v. Nettles*, 489 B.R. 239 (N.D. Ala. 2013); *In re Andrus*, No. 04-00061, 2004 WL 2216493 (Bankr. D. Idaho Sept. 23, 2004); *In re Meeks*, 260 B.R. 46 (Bankr. M.D. Fla. 2000); *In re Cepero*, 226 B.R. 595 (Bankr. S.D. Ohio 1998).

4 *In re Innovation Instruments Inc.*, 228 B.R. 313, 316 (Bankr. N.D. Fla. 1998).

5 *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1801 (2019) (internal citations and quotations omitted).

6 Anthony Michael Sabino, “Punitive Damages in Bankruptcy Cases: A Mixed Past, an Uncertain Future, but a Sure Need for Reform,” 2009 *Ann. Surv. of Bankr. Law* 1.

7 *Restatement (Second) of Torts* § 908(1) (1979).

8 “Damages,” *Black’s Law Dictionary* (11th ed. 2019).

9 *Id.*

10 *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 416 (2003) (citations omitted).

11 *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 492 (2008); see also *In re Lansaw*, 853 F.3d 657, 670 (3d Cir. 2017) (“[O]ne of the purposes behind punitive damages is to deter future misconduct.” (citing *Campbell*, 538 U.S. at 416)).

12 Fed. R. Civ. P. 37(b)(2), made applicable in bankruptcy by Fed. R. Bankr. P. 7037 and 9014, authorizes “sanctions” that may “include” deeming matters established, excluding evidence or defenses, striking pleadings, dismissing an action, rendering default judgment, or awarding reasonable expenses and attorneys’ fees.

on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation."<sup>13</sup>

Similar to § 362(k)(1), other statutory provisions, such as 28 U.S.C. § 1927, limit the remedies that a court may impose. Under § 1927, an attorney who "multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct."<sup>14</sup> In *United States v. Llanez-Garcia*, the district court found that Debra Migdal, an assistant federal public defender, violated § 1927 by issuing certain subpoenas.<sup>15</sup> In considering the appropriate sanction to impose against Migdal, the district court noted that "any form of monetary sanction would effectively result in little more than money being shifted from one government entity to another."<sup>16</sup> Accordingly, the district court issued a public reprimand of Migdal.<sup>17</sup> On appeal, the U.S. Court of Appeals for the Sixth Circuit considered "whether § 1927 authorizes a district court to issue a public reprimand."<sup>18</sup> The court of appeals determined that "[o]n its face, § 1927 does not permit the court to publicly reprimand an attorney or, for that matter, to impose any other non-monetary sanctions."<sup>19</sup> Therefore, the Sixth Circuit reversed, holding that "[t]he district court misapplied the law when it ignored the clear language of the statute and issued a non-monetary sanction under § 1927."<sup>20</sup>

Bankruptcy courts have come to differing conclusions interpreting the scope of permissible remedies under § 362(k)(1). In *Innovation Instruments*, the Internal Revenue Service (IRS) filed a proof of claim, which was based, at least in part, on employment taxes owed by the corporate debtor.<sup>21</sup> The IRS's claim included two post-petition assessments of interest and penalties. The debtor objected to the IRS's claim, arguing that the "post-petition assessments of interest and penalties violate[d] the automatic stay provisions of 11 U.S.C. § 362(a)."<sup>22</sup> The court held that the IRS's post-petition assessments of interest and penalties did not violate the automatic stay. However, the court noted, "[e]ven if the automatic stay were violated, the punishment for such violation would be to pay damages, including costs and attorneys['] fees."<sup>23</sup> The court reasoned that § 502(b) enumerates certain grounds for disallowing claims, and a creditor's violation of the automatic stay is not one of those grounds. Therefore, the court concluded that the Bankruptcy Code "does not authorize a bankruptcy court to disallow a claim for an alleged violation of an automatic stay."<sup>24</sup>

Two courts sought to simplify matters and avoid the practical and logistical difficulties associated with the dual payment of an award of punitive damages under § 362(k)(1) and a creditor's secured claim. In *Andrus*, the debtors filed a chapter 13 petition on Jan. 9, 2004.<sup>25</sup> At the time of the filing, the debtors owned a 1999 Pontiac Grand Am, which secured a purchase money security interest.<sup>26</sup> Although the lienholder on the vehicle received notice of the debtors' bankruptcy in mid-January 2004,<sup>27</sup> the vehicle was repossessed on Feb. 18, 2004.<sup>28</sup> The lienholder ultimately returned the vehicle four months later.<sup>29</sup>

The court held that the lienholder, among others, willfully violated the automatic stay by repossessing the vehicle post-petition and holding it for four months.<sup>30</sup> In addition to actual damages, the court awarded punitive damages of \$8,000 against the lienholder.<sup>31</sup> In connection with its award of punitive damages, the court directed the lienholder to release its lien, which secured a claim in the amount of \$5,690, thereby reducing the amount of punitive damages owed by the lienholder to \$2,310.<sup>32</sup> The court determined that "[i]t would be ironic indeed if [the debtors] were to collect actual and punitive damages from [the lienholder] (which may require further investment of time and legal expense) only to return some portion in payment on a secured claim under the chapter 13 plan."<sup>33</sup> Although the court did not explain its authority to order the release of the lien, the court cautioned that it would "entertain a supplementary order from [the debtors] expunging the lien" if the lienholder "[did] not cooperate in releasing the lien on the vehicle."<sup>34</sup>

In *Adams*, the debtors filed a chapter 13 petition in February 2014.<sup>35</sup> Approximately two months later, the lienholder on the debtors' Ford Expedition repossessed the vehicle.<sup>36</sup> The lienholder did not return the vehicle to the debtors until May 21, 2014.<sup>37</sup> In June 2014, the secured creditor filed "a proof of claim ... in the amount of \$6,766.11."<sup>38</sup> The secured creditor subsequently "filed an amended proof of claim ... in the amount of \$5,354.75."<sup>39</sup> After determining that the lienholder willfully violated the automatic stay, the court awarded the debtors actual damages of \$18,834.67, including attorneys' fees and costs of \$17,634, and punitive damages of \$6,600.<sup>40</sup> Because "[t]he \$6,600.00 in punitive damages exceed[ed] the value of [the secured creditor's] Proof of Claim plus any accrual of interest," the court ordered that the secured creditor "release his lien on the Ford Expedition and deliver the certificate of title to the [d]ebtors in accordance with MISS. CODE ANN. § 63-21-49."<sup>41</sup> The court described

25 *Andrus*, 2004 WL 2216493, at \*2.

26 *Id.*

27 2004 WL 2216493, at \*3.

28 *Id.* at \*1.

29 *Id.* at \*5.

30 *Id.* at \*8-12.

31 *Id.* at \*15.

32 *Id.* at \*16.

33 *Id.* at \*15.

34 *Id.* at \*16.

35 *Adams*, 516 B.R. at 365.

36 *Id.*

37 *Id.* at 366.

38 *Id.*

39 *Id.* at 367.

40 *Id.* at 377.

41 *Id.* at 376.

13 Fed. R. Bankr. P. 9011(c)(2). See also *In re Dental Profile Inc.*, 446 B.R. 885, 903 (Bankr. N.D. Ill. 2011) ("Among the sanctions that may be imposed for violating the Rule are fines payable to the court clerk, an award of attorneys' fees and costs to the sanctioned party's opponent, the disgorgement of fees paid to the sanctioned attorney, an injunction prohibiting specific types of future filings, mandatory legal education, stricken pleadings, referrals to disciplinary bodies, and reprimands either on or off the record.")

14 28 U.S.C. § 1927.

15 *United States v. Llanez-Garcia*, No. 1:11-CR-00177, 2012 WL 1571522, at \*3 (N.D. Ohio May 3, 2012), *rev'd*, 735 F.3d 483 (6th Cir. 2013).

16 *Llanez-Garcia*, 2012 WL 1571522, at \*6.

17 *Id.*

18 *United States v. Llanez-Garcia*, 735 F.3d 483, 491 (6th Cir. 2013).

19 *Id.* at 492.

20 *Id.*

21 *Innovation Instruments*, 228 B.R. at 314.

22 *Id.*

23 *Id.* at 316.

24 *Id.*

continued on page 72

# Dicta: Disallowance of Claims in Connection with Punitive Damages Award

from page 37

the cancellation of the secured creditor's security interest as "a form of punitive damages for [the secured creditor's] willful violation of the automatic stay."<sup>42</sup>

Recognizing the difficulties discussed in *Andrus*, one court relied on the operation of state law to effectuate the disallowance of a claim through a set-off of the award of punitive damages. In *Johnson*, the City of Philadelphia sold the debtor's residence due to the debtor's property tax delinquency.<sup>43</sup> The debtor sought to redeem the property, and the state court entered an order authorizing the debtor to redeem the property for \$32,891.73.<sup>44</sup> On the last day of the redemption period, the debtor filed a chapter 13 petition,<sup>45</sup> and debtor's counsel immediately notified the purchaser of the debtor's bankruptcy case and informed the purchaser that he "could take no action to recover the [p]roperty unless he filed a motion for relief from the stay or the case got dismissed."<sup>46</sup> The debtor's proposed chapter 13 plan provided the purchaser with a secured claim for the redemption amount plus interest.<sup>47</sup>

Under the debtor's proposed chapter 13 plan, the purchaser would receive \$35,461.28.<sup>48</sup> Approximately one month after the debtor filed his chapter 13 petition, the purchaser went to the debtor's property and demanded that the debtor leave.<sup>49</sup> After the debtor refused to leave, and over the course of several days, the purchaser called the police several times, removed all of the debtor's personal property from the home and had the electrical company disconnect the home's electrical service.<sup>50</sup> The court held that the purchaser willfully violated the automatic stay and awarded the debtor actual damages of \$50,458, including attorneys' fees

and costs of \$24,279, property damages and lost wages of \$11,179, and emotional distress damages of \$15,000.<sup>51</sup> In addition, the court awarded punitive damages of \$20,000.<sup>52</sup>

The court ordered that the damages awarded "be applied to reduce [the purchaser's] claim ... with the remainder to be paid directly to [the debtor]."<sup>53</sup> The court, citing *Andrus*, determined that it would be appropriate to apply the damages award to reduce the purchaser's secured claim to \$0.<sup>54</sup> The court observed that § 553(a) allows a creditor to exercise set-off rights, but it noted that there is not a similar Code provision that allows a debtor to exercise set-off rights.<sup>55</sup> Because the Code is silent as to a debtor's set-off rights, the court applied Pennsylvania law, which "has long recognized a common law right to set off mutual debts between parties."<sup>56</sup>

## Conclusion

Section 362(k)(1) does not expressly authorize courts to impose non-monetary sanctions against an individual or entity who willfully violates the automatic stay. Therefore, some courts have couched the disallowance of a claim — which, after all, is a right to payment as defined under the Bankruptcy Code<sup>57</sup> and therefore has merely a monetary value — as a form of punitive damages, not a non-monetary sanction. Unlike a public reprimand of an attorney, which bears no connection to the monetary sanctions authorized under § 1927, the disallowance of a claim could be viewed as integrally connected to an award of punitive damages under § 362(k)(1). Nevertheless, the amount of the claim being disallowed or offset should be considered when the court is exercising its discretion in determining the total amount of any appropriate punitive damages. **abi**

42 *Id.* at 377.

43 *Johnson*, 601 B.R. at 370.

44 *Id.* at 371.

45 *Id.*

46 *Id.*

47 *Id.*

48 *Id.*

49 *Id.*

50 *Id.* at 371-74.

51 *Id.* at 384-85.

52 *Id.* at 384.

53 *Id.* at 385.

54 *Id.* at 385, n.1.

55 *Id.*

56 *Id.*

57 11 U.S.C. § 101(5).