

## [ By-Lined Article ]

### Offset of Non-Estate Property Constitutes Willful Violation of Automatic Stay

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In the case of *In re Radcliffe*, the U.S. District Court for the Northern District of Indiana held that a union pension fund violated the automatic stay when it offset pension benefit payments to the debtor against a judgment debt guaranteed by the debtor.

#### The Facts

Barry Radcliffe owned and operated Glass Service Inc. A collective bargaining agreement between Glass Service and International Painters and Allied Trades Industry Pension Fund, known in this article as International, an employee benefit pension plan for several employers, provided that Glass Service would make pension contributions to International for the benefit of Glass Service's employees, according to the opinion.

In early 2004, Glass Service became delinquent on its contributions to International. Shortly thereafter, Radcliffe signed a promissory note and a personal guarantee that obligated him to fulfill Glass Service's contribution obligations in the event of further default by Glass Service, the opinion noted. The guarantee provided that Radcliffe would be liable to International under the same terms and to the same extent as Glass Service for Glass Service's contractual and statutory obligations to International.

In December 2004, as the result of further delinquency in payment, International brought suit against both Glass Service and Radcliffe. A default judgment was entered against both defendants in April 2005, according to the opinion. Shortly after entry of the default judgment, Glass Service closed its doors. Several months later, Radcliffe submitted the initial paperwork necessary to receive his own pension benefits from International. On Oct. 13, 2005, the same day he filed a Chapter 7 petition for bankruptcy protection, Radcliffe completed and submitted additional forms required for the receipt of his pension benefits.

On Nov. 2, 2005, International informed Radcliffe of the approval of his benefit application. In the same letter, International communicated that it would withhold the pension benefit payments and apply such payments to the debt that Radcliffe owed to Glass Service under the default judgment, the opinion noted. In its letter, International acknowledged it had received notice of Radcliffe's bankruptcy petition but stated its belief that the pension assets in question were not property of Radcliffe's bankruptcy estate. Consequently, International determined that its right to offset was not impacted by the automatic stay provisions of the Bankruptcy Code. International gave Radcliffe 60 days to appeal its initial determination.

Within a week, Radcliffe's counsel responded, objecting to the setoff and pointing out that any debt to International was a prepetition debt, and any collection efforts would violate the automatic stay provided in § 362 of the Bankruptcy Code. When International did not respond to counsel's communication, Radcliffe commenced an adversary proceeding against International, according to the opinion. In a separate action, filed some six months later, International then requested nunc pro tunc relief from the automatic stay.

The bankruptcy court consolidated Radcliffe's adversary proceeding and International's motion for relief from the automatic stay and addressed both in its order of July 2007. That court found that International had violated the automatic stay and that the stay

should not be vacated. In addition, the court concluded that International could not offset the debt with Radcliffe's pension benefits because a setoff would violate the anti-alienation provisions of ERISA. The bankruptcy court awarded compensatory damages, interest, punitive damages, and attorney fees for International's willful violation.

## Analysis of the Court

On appeal, the district court noted that the automatic stay takes immediate effect upon the filing of a bankruptcy petition, and the stay prevents all pre-petition creditors from taking any action to collect their debts. While § 362 does not prohibit any communication with the debtor, the court found that International's correspondence with Radcliffe went far beyond a permitted communication. Rather, the letter was found to constitute an act to "collect, assess, or recover a claim against" the debtor insofar as it declared International's intent to set off the monthly pension benefits and a belief that Radcliffe's bankruptcy would not prevent such actions. International argued to the court that its letter was not coercive or harassing; the court found that argument to be "tough to swallow." International clearly had full control over Radcliffe's assets and "held all the cards: . . . International did not need coercive or harassing rhetoric to coax the money out of Radcliffe; they had the money and planned on keeping it, effectively telling him to buzz off."

The court acknowledged that the Bankruptcy Code generally does not restrict a creditor's right to offset. However, that right is subject to the restrictions of § 362, which are intended to give the bankruptcy court control over the debtor's estate and the bankruptcy case in general. In short, International would have been better served to immediately file a motion for relief from the stay in order to effect the setoff.

International also contended that its violation could not have been willful where its letter simply explained the basis of its setoff claim and invited discussion or appeal to resolve the matter. The court found that International was aware of the bankruptcy case and had explicitly rejected any assertion that the possibility that the automatic stay applied to its actions.

Lastly, the district court addressed whether it was proper to deny International relief from the automatic stay. The court agreed with the bankruptcy court's interpretation of the anti-alienation provisions of ERISA to conclude that International did not have the right to set off the debt against Radcliffe's pension benefits.

In this regard, International argued first that these anti-alienation provisions did not apply to offsets between plan debts and plan benefits, but rather were designed to restrict third party creditors of a debtor/ plan participant. The court rejected this argument, noting that the amendments to ERISA enumerate allowed set offs without creating any exception that would allow International to do what it did. Moreover, the court reasoned that a plain reading of the alienation restriction of ERISA did not reveal limitation of the restriction to third-party creditors.

International next pointed out an exemption to the ERISA anti-alienation provision, which allows offset when expressly provided by an order to pay for a judgment arising from a participant's breach of fiduciary duties. The district court noted that International had not alleged in its complaint that the debtor breached its fiduciary duty, nor did the default order entered against Radcliffe reference any such breach.

The district court affirmed the bankruptcy court's award of interest (which was higher than the rate provided in ERISA) and punitive damages of \$10,000. The court noted that while the bankruptcy court had consulted ERISA to determine whether to lift the stay, International's violation was one under the Bankruptcy Code, and the bankruptcy interest rate would therefore apply. While the

district court sympathized with the perverse irony of rewarding Radcliffe for "stiff[ing]" the pension fund, the bankruptcy court (which balanced Radcliffe's windfall with the need for deterrence), had acted well within its discretion.

## Conclusion

While the creditor in this case may have genuinely believed that the automatic stay did not apply to its actions, the automatic stay protections of the Bankruptcy Code do not provide a safe harbor for even good faith interpretation, e.g., advancing a non-frivolous argument for extending, modifying or reversing existing law or for establishing new law. Lawyers who act as counsel to creditors should take great care to inform their clients of the reach of the automatic stay and the dangers that await their clients who act without seeking court-ordered relief from the stay provisions of § 362.

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