Southeastern Bankruptcy Law Institute 2009

Current Developments Under 11 U.S.C. § 362

By Bruce A. Markell, Bankruptcy Judge, District of Nevada, and
John Eggum, Clerk to Judge Markell

I. AUTOMATIC STAY: THE BASICS

A. What the Automatic Stay Is

The automatic stay is often referred to as a statutory injunction. As far as it goes, that is accurate. But it is really more. Unlike a typical injunction, it operates without notice, and without any showing of its need or necessity. It is often broader than it needs to be. This expansive breadth bears repeating; here is the text of Section 362(a), which will be referred to often in this paper:

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of--
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> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
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> (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
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> (3) 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;
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> (4) any act to create, perfect, or enforce any lien against property of the estate;
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> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
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> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
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> (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
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> (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a corporate debtor's tax liability for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

As with almost any self-executing statute, the proper application of the automatic stay is subject to many different interpretations in many different contexts. One of the purposes of this paper is to review some of the common issues that arise with respect to the stay and survey common approaches that courts have taken on these issues.

B. Recent Issues Regarding the Automatic Stay

This paper looks at some of the decisions within the last few years regarding the automatic stay, and tries to situate them in the context of the statute. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") made several changes to section 362, which has created some of the issues addressed below, but others have arisen merely as a result of the broad reach of the automatic stay and wide variety of parties it affects.[1] In particular, this paper looks at the issues of:

- when the stay goes into effect,
- differences with repeat filings,
- the extent of stay imposed on the estate and the debtor,
- the use of section 105 to extend the stay to non-debtor parties,
- the effect of confirming a plan without the stay being in effect,
- whether acts in violation of stay are void or merely voidable, and
- remedies for stay violations.

II. When the stay goes into effect

Debtors often file bankruptcy at the eleventh hour, right before creditors take actions that would affect their interests. This raises the issue of exactly when the stay goes into effect, and what effect the stay has on the validity of actions taken in good faith, without knowledge of the stay, but in violation of it.

A. *In re* Schleier, 290 B.R. 45 (Bankr. S.D.N.Y. 2003)

1. Facts
   a. Mortgagee commenced a foreclosure action and obtained a judgment of foreclosure on August 31, 2001. A sale of the property was scheduled for June 28, 2002.
   b. Nine months and twenty-eight days passed between the day judgment was entered and the day of the foreclosure auction. The debtor waited until the morning of June 28 to file bankruptcy.
   c. The debtor arrived at the courthouse at or around 9:00 a.m., handed a "skeleton petition" to the clerk, and attempted to tender cash for the filing fee. The clerk explained to the debtor that the clerk's office did not accept cash, and then the debtor and the clerk had a discussion about what other papers the debtor needed to file. At the conclusion of the conversation, the clerk time stamped the petition: "June 28, 2002, 9:36 a.m."
   d. In the interim period between the debtor's arrival at the courthouse and the time-stamping of the petition, the sale had occurred. The auction began at or around 9:00 a.m. and was completed between 9:15 and 9:20 a.m. The bankruptcy court had to decide, *inter alia*, exactly when the automatic stay went into effect.
2. Resolution
   a. The court found that the clerk's time-stamp on a petition creates a rebuttable presumption of when it was filed.
   b. The presumption may be rebutted by the introduction of admissible evidence that shows the petition was filed at a different (i.e., earlier) time.

[1] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Public Law 109-8, 119 Stat. 23 (2005) (codified as scattered sections of title 11).

c. The court held that a petition is filed when it is received by a representative of the clerk's office (assuming that the petition is in "acceptable filing form").
d. In this case, the court found the presumption was rebutted, and that the petition was filed no later than 9:05 a.m. Therefore the automatic stay was in effect, and the sale was void.

3. Note
a. Although e-filing has become the standard for attorneys in bankruptcy courts, pro se debtors continue to file on paper and in person in many jurisdictions. Secured creditors and foreclosure sale purchasers may thus continue to be surprised to find a sale void for violation of the automatic stay, merely because a representative of a court clerk's office had the debtor's petition in hand before the final gavel strike.

B. <u>Bustamante v. Cueva (*In re* Cueva)</u>, 371 F.3d 232 (5th Cir. 2004)

1. Facts
a. Debtor filed bankruptcy a few hours before a foreclosure sale of his home was scheduled.
b. Notwithstanding the bankruptcy filing, the foreclosure sale was held. The property was purchased by two individuals, Mr. Bustamante and Mr. Campbell, each holding a one-half interest in the property. Mr. Bustamante brought an adversary proceeding, seeking a declaration that the sale was not in violation of the automatic stay.
c. Mr. Campbell had notice of the bankruptcy before the sale, but Mr. Bustamante did not.
d. Pursuant to section 549(c), the bankruptcy court found that Mr. Bustamante was a good faith purchaser and therefore the sale was valid.[2] The court held that Mr. Campbell's prior notice of the stay invalidated the sale as to him.
e. The district court reversed with regard to Mr. Bustamante. Appeal was taken.

2. Resolution
a. The Fifth Circuit affirmed the reversal. Actions taken in violation of the automatic stay "are invalid, whether or not a creditor acts with knowledge of the stay."
b. The court discussed section 549(c). It stated that this section does not allow a purchaser to commence a declaratory action to ratify a purchase that what would otherwise be a stay violation. Section 549(c) is a defense to certain avoidance actions initiated by the trustee, not an affirmative cause of action.
c. Although the sale was void, the court did acknowledge that section 362(d) permits a bankruptcy court validate a sale by granting retroactive relief from stay. The case was remanded to allow the bankruptcy court to consider retroactive relief.

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[2] Section 549(a)(1) permits the trustee to avoid a transfer of property of the estate that occurs after the commencement of the case, but section 549(c) provides that:

> The trustee may not avoid under subsection (a) of this section a transfer of an interest in real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of an interest in such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such real property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to such interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.

3. Note
    a. The Ninth Circuit has addressed the section 362/section 549(c) relationship and come to the same conclusion as the Fifth Circuit. See 40235 Wash. St. Corp. v. Lusardi, 329 F.3d 1076, 1081-82 (9th Cir. 2003) ("[T]he language and the structure of both section 362 and section 549 support the view that section 549(c) does not create an exception to the automatic stay provision. . . . Congress evidently saw fit . . . 'to afford greater protection to [bona fide purchasers] who purchase from debtors than to those purchasing at sales violating the automatic stay.'").

III. Differences with repeat filings

Congress made an effort to curb repeat filings by enacting sections 362(c)(3) and (c)(4) as part of BAPCPA. As one scholar has put it, "[t]he Congressional solution in BAPCPA to the problem of the too-automatic stay is to make it less automatic."[3] Section 362(c)(3) limits the duration of the automatic stay for certain repeat filers. If a debtor has had a pending bankruptcy case within one year of their current case and the prior case was dismissed, the stay terminates automatically with respect to the debtor 30 days after the filing of the later case (unless the prior case was dismissed pursuant to section 707(b)). The court may extend the stay only if a party in interest files a motion that shows that the filing of the later case is in good faith as to the creditors to be stayed. Such a motion must be not only filed, but *heard* within the 30 day period. Section 362(c)(3)(C) creates a presumption that the case was not filed in good faith in certain circumstances.

Section 362(c)(4) eliminates the stay completely for a debtor who is an individual under title 11 and had two or more single or joint cases that were pending within the previous year but were dismissed (other than a case refiled under a chapter other than chapter 7 after dismissal under section 707(b)).[4] This subparagraph permits the court to enter a stay, but even if the court makes such an order, the stay is only effective from the date of the entry of the order; it is not retroactive to the date of commencement of the case. Section 362(c)(4) creates a presumption that the case was not filed in good faith upon certain circumstances.

The following cases illustrate issues that have arisen with the application of these provisions.

A. Jumpp v. Chase Home Fin. (*In re* Jumpp), 356 B.R. 789 (B.A.P. 1st Cir. 2006)

1. Facts and Issue
    a. Debtor's prior dismissed case was pending within a year, so section 362(c)(3)(A) applied.

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[3] Laura B. Bartell, *Staying the Serial Filer-Interpreting the New Exploding Stay Provisions of § 362(c)(3) of the Bankruptcy Code*, 82 AM. BANKR. L.J. 201, 203 (2008).

[4] Section 362(c)(4) uses the phrase "other than a case refiled under section 707(b)," but as the Ninth Circuit Bankruptcy Appellate Panel has noted, this phrase is ambiguous and likely a drafting error, as section 707(b) does not provide for refiling. Reference to section 362(c)(3), a parallel provision, supplies the proper meaning. See Nelson v. George Wong Pension Trust (*In re* Nelson), 391 B.R. 437, 447 n.11 (B.A.P. 9th Cir. 2008).

b. Does section 362(c)(3)(A) provide for termination of the automatic stay with respect to only the debtor and property of the debtor, or does this section also terminate the stay with respect to property of the estate?

2. Resolution
   a. The First Circuit Bankruptcy Appellate Panel ("B.A.P.") began be examining the statutory language of section 362(c)(3)(A) and considering whether this section was ambiguous. Section 362(c)(3)(A) provides that if a debtor had a prior case dismissed within a year:

      > (A) the stay under subsection (a) with respect to any action taken with respect to a debt or property securing such debt or with respect to any lease shall terminate **with respect to the debtor** on the 30th day after the filing of the later case.

   b. The B.A.P. found the phrase "with respect to the debtor" to be unambiguous when interpreted with reference to section 362(a), which distinguishes between the debtor, property of the debtor, and property of the estate.
   c. Citing to other cases discussing this issue, the B.A.P. pointed out that Congress distinguished between property of the estate and property of the debtor in section 541(a)(6), which was also enacted by BAPCPA. Therefore, it concluded that Congress used the phrase "with respect to the debtor" on purpose, intending only a partial termination of the stay.
   d. The B.A.P. declined to look to the legislative history behind section 362(c)(3), stating that "general legislative intent cannot overcome specific, unambiguous statutory language."
   e. The B.A.P. also assessed whether a "literal application of section 362(c)(3)(A) would produce an absurd result or one that is 'demonstrably at odds with the intentions of its drafters.'" (citing United States v. Ron Pair Enters., Inc., 489 U.S. 235, 242 (1989)). It concluded as follows:

      > While a complete termination of the automatic stay would also have made sense, that is not what the statute provides. . . . Section 362(c)(3)(A) provides for a partial termination of the stay, which, although a lesser penalty than complete termination, nonetheless discourages abusive filings and, therefore, is a result that is neither absurd nor demonstrably at odds with the intention of the drafters.

3. Notes
   a. The majority of courts agree with the proposition that section 362(c)(3) does not terminate the stay with respect to property of the estate. See *In re* Graham, 2008 WL 4628444, *2 (Bankr. D. Or. 2008) (slip opinion) ("I find that the better approach is the one taken by the majority of courts that have ruled on this issue, and hold that § 362(c)(3)(A) terminates the automatic stay with respect to the debtor and property of the debtor, but leaves the stay in place respecting property of the estate.").[5]
   b. This interpretation has not gained universal adherence however. See *In re* Curry, 362 B.R. 394, 398, 401 (Bankr. N.D. Ill. 2007) ("[Section 362(c)(3)(A) has no 'plain and unambiguous meaning,' . . . [I]ts language must be interpreted with reference to both the statutory wording and the broader context of BAPCPA changes. . . . It is evident from legislative history that

[5] See also Holcomb v. Tardeman (*In re* Holcomb), 380 B.R. 813, 816 (B.A.P. 10th Cir. 2008) ("[W]e see no ambiguity in the language of the statute. . . . [W]e conclude that the language of § 362(c)(3)(A) terminates the stay only as to the debtor and the debtor's property."); *In re* Stanford, 373 B.R. 890, 895 (Bankr. E.D. Ark. 2007) ("This Court agrees . . . that the phrase 'with respect to the debtor' is perfectly clear, and therefore . . . finds[s] that the automatic stay terminates only with regard to the debtor and property of the debtor, not property of the estate."); Bartell, *supra* note 3, at 206-07 (collecting cases).

the drafters intended to terminate the automatic stay in its entirety."); *In re* Jupiter, 344 B.R. 754, 759 (Bankr. D. S.C. 2006) ("[T]he Court believes that the operative and controlling wording in § 362(c)(3)(A) is that the stay under subsection (a) 'terminates.' . . . The Court construes the remaining language of 'with respect to the debtor' to define which debtor is effected by this provision, with reference to § 362(c)(3)."). Additionally, the next case, *In re* Nelson, suggests that the Ninth Circuit B.A.P. does not agree with the majority of courts' "partial termination" view.

B. Nelson v. George Wong Pension Trust (*In re* Nelson), 391 B.R. 437 (B.A.P. 9th Cir. 2008).

1. Facts
   a. Debtors' first chapter 13 case was dismissed for failure to obtain credit counseling. They refiled, but their case was dismissed for failure to confirm a plan. The debtors filed a third case, seeking to prevent foreclosure of their home. The third case was filed within one year of the pendency of the first chapter 13 case.
   b. The debtors' home was sold at auction. Debtors alleged that the automatic stay was in effect and the sale was void.
   c. The debtors argued that section 362(c)(4)(A)(i) only prevented the stay from arising with respect to the debtor, and had no effect on the stay with respect to property of the estate. This argument was based not on the language of that subsection, which states "the stay under subsection (a) shall not go into effect upon the filing of the [third case within a year of the pendency of the first case]," but on the fact that courts that have made such a debtor/estate distinction when interpreting section 362(c)(3)(A).
2. Resolution
   a. The Ninth Circuit B.A.P. found section 362(c)(4)(A)(i) to be unambiguous. The court noted that section 362(c)(4)(A)(i) clearly prevented the automatic stay from arising in a debtor's third case within a year, and declined to draw a distinction as to the extent of the automatic stay.
   b. The court's opinion cites to several other circuits which have come to the same conclusion regarding the unambiguous nature of section 362(c)(4)(A)(i), including:
      i. Dixon v. Fed. Nat'l Mortg. Ass'n (*In re* Dixon), 2006 WL 3371500, *2, No. 06-31692 (S.D. Tex., Nov. 20, 2006) (unreported);
      ii. *In re* Curry, 362 B.R. at 399-400 ("Section 362(c)(4)(A)(i) thereby provides in no uncertain terms that the automatic stay does not come into effect at all upon the filing of a debtor's third bankruptcy case within a one year period.");
      iii. King v. Wells Fargo Bank, N.A. (*In re* King), 362 B.R. 226, 232 (Bankr. D. Md. 2007) ("Section 362(c)(4)(A)(i) is unambiguous on its face[.]");
      iv. *In re* Ferguson, 376 B.R. 109, 118 (Bankr. E.D. Pa. 2007);
      v. *In re* Schroeder, 356 B.R. 812, 812-13 (Bankr. M.D. Fla. 2006);
      vi. *In re* Murray, 350 B.R. 408, 413-14 (Bankr. S.D. Ohio 2006) ("There is no ambiguity in the relevant text of [section 362(c)(4)].
   c. The court acknowledged that some courts have drawn a distinction in cases interpreting section 362(c)(3)(A), but noted that "neither the Ninth Circuit, this Panel, nor any of the circuit Courts of Appeals has yet ruled that § 362(c)(3)(A) only operates to terminate the stay against the debtor, not the stay against property of the estate."

C. *In re* Lemma, 394 B.R. 315 (Bankr. E.D.N.Y. 2008)

1. Facts
   a. Prior to the filing of their joint chapter 13 petition, a judgment of foreclosure was entered with respect to the debtors' home.
   b. Section 362(c)(3) applied to the debtors because the current case was the debtors' second joint case within a year. Debtors sought to extend the stay, but their motion was denied.
   c. Debtors had a co-debtor with respect to their home mortgage.
   d. The bank sought to proceed according to state law, but the debtors filed a motion asserting that section 362(c)(3)(A) did not terminate the co-debtor stay of section 1301, and claimed the bank had violated the co-debtor stay.
   e. The court granted the debtors' motion and the bank moved for relief from stay pursuant to sections 1301(c)(1) and (c)(2).
2. Resolution
   a. The court found that the bank had violated the co-debtor stay.
   b. The bank's request for relief from stay was denied. The court found that the loan was primarily for the benefit of the debtors, and the bank's claim would be paid in full under the terms of the plan. No grounds existed to lift the co-debtor stay.
3. Notes
   a. Other cases have agreed that the co-debtor stay is not affected by the limitations imposed by either section 362(c)(3) or (c)(4). See King v. Wells Fargo Bank, N.A. (*In re* King), 362 B.R. 226, 232 (Bankr. D. Md. 2007) (noting that Congress clearly considered section 362 and 1301 as imposing separate and distinct stays, and referencing section 365(p)(3) for the proposition that Congress would have explicitly terminated both stays in section 362(c)(4) if it so intended).

IV. Extent of stay imposed on the estate and the debtor

Although the automatic stay is extremely broad, Congress has imposed limits on the extent of the stay. Section 362(b) lists 28 categories of actions that are not affected by the automatic stay. These exceptions cover a wide range of subjects and do not single out or favor any particular type of debtor or creditor. This part considers two of these categories: domestic support obligations, and police/regulatory powers.

One of the goals of BAPCPA was to enhance the protections provided to ex-spouses and children of bankruptcy debtors to whom support obligations, such as alimony and child support, were owed.[6] The 2005 amendments expansively re-defined such obligations, labelling them collectively as "domestic support obligations." [7] Certain acts related to domestic support obligations are excepted

[6] Hon. Alan M. Ahart, *The Liability of Property Exempted in Bankruptcy for Pre-petition Domestic Support Obligations after BAPCPA: Debtors Beware*, 81 AM. BANKR. L.J. 233 (2007).

[7] 11 U.S.C. § 101(14A) defines the term "domestic support obligation" to mean:

> a debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is--

from the automatic stay. These exceptions are codified in section 362(b), which provides that the commencement of a case under title 11 does not operate as a stay:

> (2) under subsection (a) . . .
> (B) of the collection of a domestic support obligation from property that is not property of the estate;
> (C) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute; [or]
> (D) of the withholding, suspension, or restriction of a driver's license, a professional or occupational license, or a recreational license, under State law, as specified in section 466(a)(16) of the Social Security Act.

Section 362(b)(2)(C) and (D) are BAPCPA additions to the Code. No reported case has analyzed the application of subsection (b)(2)(D), so it is unclear what effect this section will have on bankruptcy debtors. The next case and notes that follow illustrate an ambiguity in subsection (b)(2)(C) that some courts have had cause to address.

A. *In re* Gellington, 363 B.R. 497 (Bankr. N.D. Tex. 2007)

1. Facts
   a. At the time of the filing of his chapter 13 petition, debtor was in over $18,000 in arrears on child support. The arrearage had been assigned to a division of the Office of the Texas Attorney General ("Texas").
   b. Pre-petition, Texas was garnishing the debtor's wages to collect the support obligation.
   c. Just prior to plan confirmation, Texas caused another garnishment order to be entered. Apparently, Texas thought the plan had already been confirmed.
   d. The confirmed plan provided for the payment of the arrearage in full. Thus, after the entry of the garnishment order, the debtor was paying double on his support arrearage each month, since his wages were being garnished and he was making payments on the arrearage through the plan.

(A) owed to or recoverable by--
(i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or
(ii) a governmental unit;
(B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;
(C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of--
(i) a separation agreement, divorce decree, or property settlement agreement;
(ii) an order of a court of record; or
(iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and
(D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

   e. The debtor thereafter alleged a willful violation of the automatic stay with regard to the short period between the entry of the post-petition garnishment order and plan confirmation.

2. Resolution
   a. Before BAPCPA, the post-petition commencement or continuation of a proceeding to obtain a garnishment order to collect a child support arrearage would generally violate the automatic stay.
   b. This was because 362(b)(2)(B) only excepted collection efforts with respect to property of the debtor, and in chapter 13 cases, until plan confirmation, post-petition wages are property of the estate. <u>See</u> 11 U.S.C. §§ 1306, 1327(b).
   c. BAPCPA's addition of section 362(b)(2)(C) changes this result, by allowing the holder of a domestic support obligation to obtain an income withholding order with respect to both property of the debtor and property of the estate, so long as the support obligation was created pursuant to a judicial or administrative order, or a statute.
   d. Therefore, Texas did not violate the stay by garnishing the debtor's wages post-petition.
   e. However, the court found that notwithstanding the section 362(b)(2)(C) exception, Texas' garnishment order was still impermissible, as it violated the terms of the debtor's confirmed plan. Because the arrearage was provided for by the plan, Texas had no right to seek a garnishment order. However, no sanctions were imposed because Texas' actions were not willful and the impermissibly garnished funds were refunded.
3. Notes
   a. Few cases have considered section 362(b)(2)(C), but these cases reveal that courts are somewhat divided about its meaning. Contrary to <u>Gellington</u>, some cases have found that section 362(b)(2)(C) requires a garnishment/withholding order to be in effect on the date of the petition. <u>See</u> <u>*In re* Taylor</u>, 2007 WL 1234932, *6, No. 07-31055-KRH (Bankr. E.D. Va., April 26, 2007) (unreported) (granting relief from stay for state court to conduct a review of a support obligation because the section 362(b)(2)(C) exception "does not appear on its face to extend to the commencement or continuation of civil actions or proceedings to enforce such orders"); <u>Reynolds v. Reynolds (*In re* Reynolds)</u>, 2008 WL 373521, *7 & n.30, No. 07-7117 (Bankr. D. Kan., Feb. 8, 2008) (unreported) (finding that 362(b)(2)(C) would only be invoked if the withholding order was already in effect prior to the filing of the chapter 13 petition).
   b. One case assumes that if such a withholding order was in effect, section 362(b)(2)(C) would insulate the order from the effects of confirmation. <u>Vasquez v. Georgia Dept. of Hum. Res. Office Child Support Servs.</u>, 2008 WL 4425304, *1, No. CV507-82 (S.D. Ga., Sept. 30, 2008) (slip opinion) (assuming, without deciding, that 362(b)(2)(C) permitted a pre-petition wage garnishment order to continue to operate, and that the confirmation of a chapter 13 plan that did not provide for the continuation of that order did not prevent a state from maintaining the garnishment post-confirmation).
   c. The legislative history sheds little light on the BAPCPA changes to section 362(b)(2). It merely states:

      > [Section 362] permits the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order as well as the withholding, suspension, or

restriction of a driver's license, or a professional, occupational or recreational license under state law, pursuant to section 466(a)(16) of the Social Security Act.

House Report on the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, H.R. Rep. No. 109-31, pt. I, at 61 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 129.

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A commonly invoked exception to the automatic stay allows governmental units (and certain other organizations) to exercise their police or regulatory powers without first obtaining relief from stay. This exception is codified as 362(b)(4), and states that the automatic stay does not operate as a stay:

> under paragraph (1), (2), (3), or (6) of subsection (a) of this section, of the commencement or continuation of an action or proceeding by a governmental unit or any organization exercising authority under the Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on Their Destruction, opened for signature on January 13, 1993, to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power . . . .

Although at least one court has read this section to apply only where authority is being exercised pursuant to the above-cited chemical weapons convention, the vast majority of courts read this exception more expansively.[8] The following cases demonstrate this section's applications.

B. *In re* Mystic Tank Lines Corp., 544 F.3d 524 (3d Cir. 2008)

1. Facts
   a. State of New York brought suit against Mystic Tank Lines in May of 2004 under a statute that allowed recovery against a shipper of petroleum products if, after delivery, that petroleum leaked and caused environmental damage. Mystic filed bankruptcy in June of 2004. New York filed a proof of claim in Mystic's case in October of 2004.
   b. In June of 2005, New York obtained a default judgment against Mystic.

[8] *In re* Finley, 237 B.R. 890 (Bankr. N.D. Miss. 1999). The facts in Finley were as follows. In connection with the debtor's third arrest for driving under the influence of alcohol, the debtor's vehicle was seized. Mississippi law provided a right of forfeiture with respect to the vehicle. At issue was whether the State of Mississippi needed to obtain relief from stay before proceeding with the forfeiture of the vehicle. The court held the section 362(b)(4) exception inapplicable to Mississippi's contemplated forfeiture because:

> From all indications, this revised subsection is applicable to governmental units or any organizations exercising authority under the Convention on the Prohibition of the Development, Production, Stockpiling, and Use of Chemical Weapons and on Their Destruction which would not include the Mississippi Department of Public Safety under the factual circumstances of this proceeding.

Id. at 894. Courts presented with the Finley "Convention" argument have rejected it. See, e.g., Suter v. D.C. (*In re* Suter), 2005 WL 2989336, *4-5, No. Civ.A.2005-2118 (D. Md., Nov. 7, 2005) (unreported); *In re* Dolen, 265 B.R. 471, 480 (Bankr. M.D. Fla. 2001).

c. Mystic alleged that New York had violated the automatic stay. After a procedurally tumultuous course, the case came before the Third Circuit Court of Appeals, with the issue framed as whether section 362(b)(4) excepted New York's state action from the automatic stay.

2. Resolution
   a. Mystic argued that New York was attempting to enforce a money judgment, which is excluded from section 362(b)(4) (referred to as "the exception to the exception"), by seeking a judgment for the money it expended on environmental cleanup.
   b. The court examined the legislative history of section 362(b)(4), and found that "both the Senate and House Committee Reports stated that an action by a governmental unit attempting to fix damages for violation of, *inter alia*, an environmental law, is not stayed under the automatic stay."
   c. The court noted that a governmental unit acting pursuant to a regulatory or police power is permitted to seek the entry of a money judgment, and may even take steps to enforce non-monetary portions of judgments (such as compelling a debtor to clean up an environmental hazard).
3. Compare
   a. W.R. Grace & Co. v. Campbell (*In re* W.R. Grace & Co.), 384 B.R. 678, 684 (Bankr. D. Del. 2008) (finding that a suit by the New Jersey Department of Environmental Protection ("NJDEP") violated the stay because "the purpose of the NJDEP action is solely to liquidate its monetary claim for penalties, notwithstanding NJDEP's reliance on its police and regulatory powers as the basis for its suit, inasmuch as the site as to which the report was filed has been cleaned up and the claim for cleanup belongs to the [Environmental Protection Agency].").

In disputes between debtors and local municipalities attempting to enforce ordinances affecting debtors' land, the local municipalities often prevail, so long as their enforcement efforts remain focused on obtaining compliance with the municipal code, and not on attempting to protect the municipality's status as a creditor. See Phillips v. City of South Bend (*In re* Phillips), 368 B.R. 733 (Bankr. N.D. Ind. 2007) (finding that levying fines to compel a homeowner to remove garbage from her property did not violate the stay); see also *In re* Cutting Edge Enterprises, Inc., 372 B.R. 255 (Bankr. M.D.N.C. 2007) (citing Safety-Kleen, Inc. (Pinewood) v. Wyche, 274 F.3d 846, 865 (4th Cir. 2001) for the proposition that "[t]he key to a correct application of the exception embodied in section 362(b)(4) is to distinguish between situations in which a governmental unit acts pursuant to its police or regulatory power and situations in which the state acts merely to protect its status as a creditor.").[9]

[9] Phillips also cited several other illustrative cases. See Javens v. City of Hazel Park (*In re* Javens), 107 F.3d 359, 363-64 (6th Cir. 1997) (finding that the demolition of property to enforce building and fire codes was excepted from automatic stay); *In re* Herrera, 194 B.R. 178, 184-85 (Bankr. N.D. Ill. 1996) (town's inspection of debtor's real property was not a stay violation; rather, it was an exercise of its police or regulatory power to protect the health, safety, and welfare of its citizens); State of Wis. v. Weller (*In re* Weller), 189 B.R. 467, 471 (Bankr. E.D. Wis. 1995) (issuing housing code violations excepted because it relates to public health and safety); *In re* Koeller, 170 B.R. 1019, 1022 (Bankr. W.D. Mo. 1994) (enforcement of sanctions, including ordinance providing for property demolition, did not violate automatic stay); *In re* Catalano, 155 B.R. 219, 221 (Bankr. D. Neb. 1993) ("A condemnation proceeding by a city to rid the city of a structure deemed unsafe is certainly the exercise of a police or regulatory power by a governmental unit."); Lux v. County of Spotsylvania Bd. of Supervisors (*In re*

The next case illustrates what may be the boundaries of "police and regulatory power" with respect to a municipality's regulation of land use.

C. Bevelle v. Jefferson County, Alabama (*In re* Bevelle), 348 B.R. 812 (Bankr. N.D. Ala. 2006)

1. Facts
   a. Debtor, Eddie Bevelle, owned three buildings. He had leased two of the buildings and operated a restaurant in the third for approximately 15 years. It does not appear that the buildings were in disrepair, the area was blighted, or that the debtor was in violation of any ordinances.
   b. Nonetheless, the county decided it needed to build a new county courthouse and administrative office, because the current facilities did not meet security standards recently established by the United States Marshal Service.
   c. After attempts to purchase Mr. Bevelle's property failed (because the county's price was not agreeable to Mr. Bevelle), the county decided to condemn the debtor's property using the State of Alabama's eminent domain powers (which it could exercise as a political subdivision of the state).
   d. Mr. Bevelle filed a chapter 13 petition after receiving the condemnation complaint. The city attempted to proceed with condemnation, and Mr. Bevelle alleged a stay violation.
2. Resolution
   a. The court found that a state's eminent domain power (and a county's condemnation action commenced pursuant to that power), is a general exercise of the police or regulatory powers described in section 362(b)(4).
   b. To reach this conclusion, the court cited Hawaii Housing Auth. v. Midkiff, 467 U.S. 229 (1984), for the proposition that "a state's eminent domain power is coterminous with its police powers."
   c. To support its conclusion that the condemnation action in the case was excepted from the automatic stay, the court cited cases where municipalities had demolished buildings that were themselves a public health and safety hazard. Therefore, the court reasoned, the fact that the current courthouse does not meet recognized security standards means that, by analogy, condemning Mr. Bevelle's buildings for the purpose of building a new courthouse is an action necessary to protect the safety of courthouse users, and is excepted from the automatic stay.
3. Compare
   a. Maricopa County v. PMI-DVW Real Estate Holdings, L.L.P. (*In re* PMI-DVW Real Estate Holdings, L.L.P.), 240 B.R. 24, 30-31 (Bankr. D. Ariz. 1999) ("The government's eminent domain power is different than the police or regulatory power, and actions to acquire property by eminent domain are not excepted from the automatic stay under 11 U.S.C. § 362(b)(4).").
   b. *In re* El Comandante Mgmt. Co., LLC, 358 B.R. 1 (Bankr. D. Puerto Rico 2006).

> The sovereign's eminent domain power is different than its police or regulatory power. The U.S. Constitution defines the confines of governmental power and its application. The power of eminent domain is inherent to the sovereign. The states

Lux), 159 B.R. 458, 461 (Bankr. E.D. Va. 1992) (finding that county's permanent removal of water meter and closure of water connection did not violate the stay).

> have such power. However, actions to acquire property by eminent domain are not excepted from the automatic stay under the police and regulatory power exception. Eminent domain may be used to implement the state's police power. In order for the eminent domain action to come within the police and regulatory exception, it must be done in furtherance of the stated purpose of public health, safety or welfare.

Id. at 13 (citations omitted).

V. The use of section 105 to extend the stay to non-debtor parties

The automatic stay does not prohibit the collection of debts from non-debtor parties, such as guarantors. 11 U.S.C. § 524(e). However, bankruptcy courts have the power, under section 105(a), to protect non-debtor parties from creditor action.[10] Some courts refer to this as "extending the stay," while other courts prefer to phrase such action as granting a preliminary injunction.

Regardless of terminology, the decision to extend the protections of the stay to third parties is clearly within the equitable discretion of the bankruptcy court. The following cases represent some of the approaches courts have taken.

A. Kreisler v. Goldberg, 478 F.3d 209 (4th Cir. 2007)

1. Facts
   a. Debtor corporation filed bankruptcy, and its wholly owned, non-filing subsidiary petitioned the court to stay a lawsuit in which the subsidiary was involved.
2. Resolution
   a. The Fourth Circuit reaffirmed its adherence to its "unusual circumstances" test, which permits the extension of the automatic stay to a non-debtor only in cases where "there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real-party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor."
   b. The court's example of unusual circumstances indicated a fairly restrictive approach. Citing A.H. Robins Co., Inc. v. Piccinin, 788 F.2d 994 (4th Cir. 1986), the court noted that an "illustration of such a situation would be a suit against a third-party who is entitled to absolute indemnity by the debtor on account of any judgment that might result against them in the case."
   c. Because the corporate veil was not pierced, the court refused to extend the stay to the state court proceeding against the non-debtor subsidiary.

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[10] 11 U.S.C. § 105(a) provides:

> (a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

B. Solidus Networks, Inc. v. Excel Innovations, Inc. (*In re* Excel Innovations, Inc.), 502 F.3d 1086 (9th Cir. 2007)

1. Facts
   a. Debtor corporation's former CEO was involved in a dispute with a company named Invidos.
   b. Debtor sought a preliminary injunction staying arbitration proceedings between the former CEO and Indivos, on the grounds that the arbitration could affect the debtor and the estate.
   c. The debtor argued it may be affected because, *inter alia*, the former CEO would demand indemnification for liability incurred for actions undertaken while acting as an officer and director of the debtor.
   d. The preliminary injunction was granted and Indivos appealed. The Ninth Circuit BAP affirmed, finding the standards for a preliminary injunction were met, and, alternatively, that the unusual circumstances test was met, necessitating the extension of the stay.
2. Resolution
   a. The Ninth Circuit held that the BAP erred in "treat[ing] the unusual circumstances doctrine and the usual preliminary injunction standard as separate and distinct bases for affirming the stay. . . . [T]he 'unusual circumstances' doctrine does not negate the traditional preliminary injunction standard."
   b. The Ninth Circuit explained that although courts often refer to "extensions of the automatic stay," these courts are actually issuing injunctions for the protection of the administration of the estate, on a showing of "unusual need."
   c. The court distinguished prior Ninth Circuit cases that could be interpreted as providing another standard. It expressly adopted the preliminary injunction test as the appropriate test for extending the stay under section 105.
   d. The court noted that the majority of circuits apply the usual standards for preliminary injunctions to requests for stays against non-debtors (citing cases from the Second, Third, Fourth, Fifth, Sixth, and Eighth Circuits, and noting that the Seventh and First Circuits have applied a less demanding test).[11]
   e. The court remanded for a proper consideration of the preliminary injunction criteria.

C. Winter v. Natural Res. Def. Council, Inc., 129 S. Ct. 365 (2008)

1. Test for Preliminary Injunctions
   a. "A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest."
2. Notes
   a. The Natural Resources opinion helpfully restates and explains the proper test for granting a preliminary injunction. To the extent that circuits have considered factors other than the ones stated above, those cases are likely no longer good law. Specifically, Natural Resources suggests that there is no "alternative test" for preliminary injunctions, as had been previously articulated by the Ninth Circuit. See Natural Res. Def. Council, Inc. v. Winter, 518 F.3d 658, 677 (9th Cir. 2008) (citing Freecycle Network, Inc. v. Oey, 505 F.3d 898, 902 (9th Cir. 2007)).

[11] The court did not address the fact that the Fourth Circuit's application of the unusual circumstances test appears to be more restrictive than the standard required for preliminary injunctions.

D. Queenie, Ltd. v. Nygard Int'l, 321 F.3d 282, 287 (2d Cir. 2003)

1. Facts
   a. Debtor was an individual that filed chapter 11. Debtor sought to have the protection of the automatic stay extended to his wholly owned and controlled corporation, which was a co-defendant in a lawsuit that debtor was involved in.
   b. The debtor also sought to have the automatic stay extended to two other co-defendants to prevent the later use of offensive collateral estoppel against the debtor or his corporation.
2. Resolution
   a. The court stated that, "[t]he automatic stay can apply to non-debtors, but normally does so only when a claim against the non-debtor will have an immediate adverse economic consequence for the debtor's estate."
   b. The court found that allowing the suit to proceed against the debtor's wholly owned corporation would have such adverse consequences.
   c. With respect to the other co-defendants, the court declined to extend the stay. It found that the threat of offensive collateral estoppel wasn't a sufficient. The court stated that if mere concern over the use of offensive collateral estoppel "could support application of the stay, there would be vast and unwarranted interference with creditors' enforcement of their rights against non-debtor co-defendants."

E. Homestead Holdings, Inc., v. Broome & Wellington (*In re* PTI Holding Corp.), 346 B.R. 820 (Bankr. D. Nev. 2006)

1. Facts and Resolution
   a. Steven and David Greenstein, the principals of the debtor corporation, were personally liable on some of the corporation's debts. The Greenstein's sought the protections of the automatic stay on the grounds that: (1) the reorganization process required the Greenstein's full attention, and being forced to defend against collection on the guarantee would interfere with the debtor's prospects for a successful reorganization; and (2) a judgment on the guarantee would have adverse consequences with respect to the debtor's challenge to the validity of the guaranteed debt.
   b. The court, applying the preliminary injunction standards, extended the stay to the Greensteins.
2. Irreparable Harm –Extending the Stay to Principals of the Debtors (Discussion and Cited Cases).
   a. The evidence in PTI Holding was that the debtor's reorganization efforts currently consumed all of the Greensteins' time, and were anticipated to require 70% of their time after a particular sale was consummated. Whether divergence of the Greensteins' time would be detrimental to the debtor's reorganization efforts goes to the "irreparable harm" prong of the preliminary injunction test.
   b. The court found that any "material diversion" of the Greensteins' time would result in a loss to the estate. The court cited several cases for the proposition that such loss may constitute irreparable harm.
      i. *In re* M.J.H. Leasing, Inc., 328 B.R. 363, 368-69 (Bankr. D. Mass. 2005) (collecting cases).

ii. Lomas Fin. Corp. v. Northern Trust Co. (*In re* Lomas Fin. Corp.), 117 B.R. 64, 66-67 (S.D.N.Y. 1990) (granting injunction as non-debtor third party who spent "in excess of 50%" of his time on the debtor's reorganization).

iii. Lazarus Burman Assoc. v. Nat'l Westminster Bank USA (*In re* Lazarus Burman Assoc.), 161 B.R. 891, 899-900 (Bankr. E.D.N.Y. 1993) ("Because the [two] Principals are the sole participants in the Debtors' rehabilitation, they should be free to devote their full efforts to the operation of the business and the formulation of a plan. Because the Debtors are general partnerships owned and controlled solely by the [two] Principals, the [two] Principals are clearly the only persons who can effectively formulate, negotiate and carry out the Debtors' plan or plans of reorganization.").

iv. TRS, Inc. v. Peterson Grain & Brokerage Co. (*In re* TRS, Inc.), 76 B.R. 805, 809 (Bankr. D. Kan. 1987) (granting temporary injunction against guaranty litigation given that sole managing officer had all personal assets tied up in reorganizing debtor, and was otherwise unable to respond to any judgment in favor of beneficiary of guaranty).

v. Kasual Kreation, Inc. v. Heller Fin., Inc. (*In re* Kasual Kreation, Inc.), 54 B.R. 915, 917 (Bankr. S.D. Fla. 1985) (granting temporary injunction for guarantors to allow them to focus on an upcoming retail season, the success of which was essential to debtor's reorganization).

vi. Northlake Bldg. Partners v. Northwestern Nat'l Life Ins. Co. (*In re* Northlake Bldg. Partners), 41 B.R. 231, 233-34 (Bankr. N.D. Ill. 1984) (injunction based on intimate connection between debtor's ability to reorganize and guarantor's critical management function with the debtor, and the lack of assets other than those committed to or bound up in the reorganization).

3. Adverse Effects of a Foreign Judgment (Discussion and Cited Cases)

   a. When deciding to grant a preliminary injunction under section 105, the claim or issue preclusive effect of an action proposed or currently being litigated outside of bankruptcy court may be considered.

      i. Adelphia Commc'ns. Corp. v. Associated Elec. & Gas Ins. Serv., Ltd. (*In re* Adelphia Commc'ns. Corp.), 302 B.R. 439, 451 & n. 30 (Bankr. S.D.N.Y. 2003) ("The courts in this and other districts have repeatedly recognized that section 105 may be used to enjoin litigation against non-debtors where there is the potential threat of the debtor being collaterally estopped from asserting defenses if an adverse judgment is entered against the non-debtors.").

      ii. Am. Film Techs., Inc. v. Taritero (*In re* Am. Film Techs., Inc.), 175 B.R. 847, 848-54 (Bankr. D. Del.1994) (finding the requisite identity of subject matter, issues, and parties, and finding that "[t]o avoid the collateral estoppel effect, [the debtor] must participate in the defense of the state court case [involving current and former directors of the debtor]. . . . That requires AFT to do precisely what the automatic stay is intended to excuse it from doing.").

      iii. MacDonald/Assocs., Inc. v. Stillwagon (*In re* MacDonald/Assocs., Inc.), 54 B.R. 865, 869 (Bankr.D.R.I.1985) ("A number of courts have enjoined litigation against non-debtor sureties to avoid the risk of collateral estoppel and the resulting prejudice to the absent party (the debtor).").

      iv. But see Portage County Bank v. Deist, 159 Wis. 2d 793, 798-801, 464 N.W.2d 856, 858-60 (1990) (determination that debt satisfied in bankruptcy proceeding was not binding on creditor in subsequent action involving guaranty of debt).

b. In PTI Holding, the creditor whom the guarantee benefited was threatening to commence an action against the Greensteins in England, pursuant to the terms of the agreement creating the debt. The debtor believed that the threatened litigation against the Greensteins' would be claim preclusive with respect to the proof of claim being litigated in the bankruptcy court.

c. The fact that officers, directors, or shareholders of a corporation are involved in litigation does not necessarily mean that claim or issue preclusion will be invoked. See:

   i. RESTATEMENT (SECOND) JUDGMENTS § 59(3)(a)(1982) ("The judgment in an action by or against the corporation is conclusive upon the holder of its ownership if he actively participated in the action on behalf of the corporation, unless his interests and those of the corporation are so different that he should have opportunity to relitigate the issue");

   ii. RESTATEMENT (SECOND) JUDGMENTS § 59(3)(b) (1982) ("The judgment in an action by or against the holder of ownership in the corporation is conclusive upon the corporation except when relitigation of the issue is justified in order to protect the interest of another owner or a creditor of the corporation.") (emphasis added);

   iii. Bartle v. Health Quest Realty VII, 768 N.E.2d 912, 918-21 (Ind. Ct. App. 2002) (guarantor of lease obligations bound to bankruptcy court's determination of amount owed under leases when guarantor owned 99% of the limited partnership interests in bankruptcy debtor); and

   iv. Christopher Klein et al., *Principles of Preclusion and Estoppel in Bankruptcy Cases*, 79 AM. BANKR. L.J. 839, 855-58 (2005).

d. In PTI Holding, the court ultimately determined that it was not conclusive that a judgment against the Greensteins would be either claim or issue preclusive with respect to claims against the debtor. However, given the particular circumstances of the case, the court found a showing that allowing such a proceeding to go forward would constitute irreparable harm.

4. Note

   a. PTI Holding was issued prior to both Winter, 129 S. Ct. 365, and Excel Innovations, 502 F.3d 1086. Accordingly, to the extent that PTI Holding is not consistent with those cases, it should be disregarded.

VI. Effect of confirming a plan without the stay being in effect

The post-BAPCPA changes that limit the stay or eliminate it altogether were discussed in Part III of this paper. A related issue is the effect of stay expiration/elimination on the debtor's ability to confirm and consummate a plan. The two cases below represent the majority and minority positions with respect to chapter 13 cases where the repeat filer provisions have terminated the stay. Note that the following cases assume that section 362(c)(3)(A) terminates the stay not only with respect to the debtor and property of the debtor, but also with respect to property of the estate (contrary to the "majority view" discussed in Part III).

A. *<u>In re</u>* <u>Fleming</u>, 349 B.R. 444 (Bankr. D. S.C. 2006)

1. Facts
   a. Chapter 13 debtors had a prior bankruptcy case pending within a year of their current case, and therefore, pursuant to section 362(c)(3)(A), the automatic stay was set to terminate within 30 days of filing.
   b. Debtors failed to set their motion to extend the stay for hearing within 30 days of the petition date, and the court denied their motion. The stay expired.
   c. Trustee objected to confirmation of the debtors' plan on the grounds that absence of the stay during the administration of the plan would expose property of the estate to collection efforts and disrupt the orderly distributions to creditors that the plan provided.
2. Resolution
   a. As a preliminary matter, the court discussed the requirements for confirmation of a chapter 13 plan, which are set forth in section 1325, and noted that the existence of the automatic stay is not a prerequisite to confirmation.
   b. The court relied on section 1327 for the proposition that confirmation would limit creditors' ability to exercise state law rights in derogation of the plan.
      i. Section 1327 states that "[t]he provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan."
   c. The court confirmed the plan, concluding that all creditors provided for in the plan would be unable to circumvent the plan's distribution scheme, even absent the automatic stay.
3. Notes
   a. The <u>Fleming</u> court noted that all bankruptcy judges in the District of South Carolina reviewed and concurred with its opinion.
   b. Other cases are in agreement with <u>Fleming</u>. In *<u>In re</u>* <u>Lemma</u>, 394 B.R. 315 (Bankr. E.D.N.Y. 2008), a repeat filer case mentioned in Part III, the bank scheduled a foreclosure sale, but before it could be held, the debtors were able to file and confirm a plan. The bank received notice, but did not object to confirmation. The court held that the bank must accept payments from the debtors and could not proceed with the foreclosure sale, even though no stay was in effect, relying on the ability of section 1327 to bind creditors.
   c. <u>See also</u> <u>Kurtzahn v. Sheriff of Benton County, Minn. (*In re* Kurtzahn)</u>, 342 B.R. 581 (Bankr. D. Minn. 2006) (coming to the same conclusion as <u>Fleming</u>); *<u>In re</u>* <u>Murphy</u>, 346 B.R. 79, 83 (Bankr. S.D.N.Y. 2006) ("If a debtor is able to propose and confirm a Chapter 13 plan before a foreclosure sale takes place, the secured creditor may be bound thereby, regardless of whether the stay has terminated.").

B. *<u>In re</u>* <u>Cline</u>, 386 B.R. 344 (Bankr. N.D. Ala. 2008)

1. Facts
   a. <u>Cline</u> is similar to <u>Fleming</u>, but reaches the opposite conclusion as to effect of confirmation where there is no automatic stay in existence.
   b. In <u>Cline</u>, the debtors' current chapter 13 case was debtor Kimberly Cline's seventh bankruptcy case, and co-debtor Jimmy Cline's fifth bankruptcy case. As co-debtors, their current case was their second case pending within a year.
   c. The debtors filed a motion to extend the stay. The court found that the debtors could not possibly succeed in repaying the arrearages on their home (which were in excess of $24,000, or more than 30 months worth of missed payments). Therefore, the court refused

to extend the stay as to Ameriquest, the debtors' mortgage company, but did extend the stay as to all other creditors. The order denying the motion specifically indicated that Ameriquest would be permitted to foreclose upon the expiration of the stay.

d. The debtors then filed a plan that provided for the repayment of arrearages owed to Ameriquest, and Ameriquest failed to object. The plan was subsequently confirmed – all prior to the expiration of the stay.

e. After the expiration of the stay, Ameriquest served the debtors with a notice of foreclosure. The debtors responded by filing a complaint alleging that Ameriquest violated the plan confirmation order, and sought damages. The debtors relied on a case similar to Fleming for the propositions that Ameriquest was bound by the terms of the confirmed plan, and that the plan's confirmation trumped the earlier order regarding the date when the stay would terminate.

2. Resolution

   a. The court disagreed with Fleming and Kurtzahn that section 1327 binds creditors notwithstanding the absence of the stay.

   b. The court stated:

   > Section 1327(a) should not be construed as elevating plan confirmation to super-priority status, providing relief tantamount to the automatic stay after bona fide stay protection was lost or never obtained under Sections 362(c)(3) and (4). . . . [O]nce a court finds there is no sufficient reason to justify an extension or imposition of the stay under Sections 362(c)(3) or (4), confirmation of a plan should neither change that finding nor interfere with the creditor's uninterrupted right to exercise its remedies post-confirmation without seeking additional relief from the court.

   c. The court held that section 1327 does not affect a pre-confirmation order allowing the stay to expire under section 362(c)(3). It also noted that confirmation would not prevent a creditor from exercising its state law remedies if section 362(c)(4) were implicated.

   d. Finally, the court addressed creditors that accept payments. The court held that if the stay is not in effect with respect to a particular creditor and the creditor accepts and retains payments under the plan, that creditor is estoppped from denying the binding and superseding effects of confirmation.

3. Notes

   a. Interestingly, the court in Cline noted that it was adopting a minority position on this issue. As few courts have cited these opinions or weighed in on this issue in reported opinions, it remains to be seen whether Cline will gain adherents, or if it is an isolated case.

VII. Acts in violation of stay being void or voidable

An issue that has confronted courts in every circuit is whether actions taken in violation of the automatic stay are "void" or merely "voidable." Some courts addressing this issue have taken the view that the terminology chosen could affect the ability of the court to retroactively ratify actions taken in violation of the stay. Courts have also shown concern about how the choice of terminology affects the burden of challenging actions taken in violation of the stay. As these cases below explain, the majority of court have determined that acts in violation of the stay are void, but may be retroactively ratified based on the equities of the case.

A. <u>Jones v. Cain</u>, 804 A.2d 322 (D.C. Cir. 2002)

1. Facts
    a. Debtor, Dr. Jones, filed for bankruptcy. Several months later, a trial was held in the Superior Court, District of Columbia, on a pre-petition dispute between Dr. Jones and Courtney Cain, a tenant in one of Dr. Jones' rental properties.
    b. The Superior Court entered judgment in favor of tenant. Appeal was taken to the District of Columbia Court of Appeals.
2. Result
    a. The Court of Appeals held the judgment was void. It discussed the majority view that actions taken in violation of the stay are void, and the minority view that such actions are merely voidable. For the court, the issue came down to where the burden of challenging stay violations ought to rest:

        > Treating an action taken in contravention of the automatic stay as void places the burden of validating the action after the fact squarely on the shoulders of the offending creditor. In contrast, treating an action taken in contravention of the automatic stay as voidable places the burden of challenging the action on the offended debtor. . . . [T]he former paradigm, rather than the latter, best harmonizes with the nature of the automatic stay and the important purposes that it serves.
3. The court agreed that such actions could be ratified, but held that the creditor/tenant must petition the bankruptcy court for that relief (and indicated that, based on the appellate record, it appeared the creditor could make a persuasive case for this equitable relief).

B. <u>*In re* Myers</u>, 491 F.3d 120 (3d Cir. 2007)

1. Facts
    a. Ms. Myers and her wholly owned corporation were defendants in a fraudulent conveyance action in Pennsylvania state court. Anticipating an adverse judgment, Ms. Myers, personally, filed for bankruptcy. The next day the state court, after being informed of the bankruptcy petition, entered judgment, stating judgment was entered against Ms. Myers "in her corporate capacity, and will be [entered against her] in her individual capacity when the stay is lifted, in the similar amounts."
    b. The state court then entered several orders against Ms. Myers and her corporation(s), in an attempt to prevent her from dissipating corporate assets. Ms. Myers violated these orders, and the state court entered a civil contempt order. Subsequently, the state court had Ms. Myers incarcerated until she could pay approximately $5,000 in sanctions to opposing counsel.
    c. Ms. Myers sought a temporary restraining order from the bankruptcy court, alleging that the state court had violated the automatic stay by entering judgment against her, holding her in contempt, and incarcerating her. Ms. Myers sought a finding that the state court's orders were void and therefore without effect when entered.
    d. The bankruptcy court declined to declare the state court judgment void, and instead retroactively annulled the stay and dismissed Ms. Myer's bankruptcy petition under section 1307(c), finding it was filed in bad faith. Ms. Myers appealed.

2. Resolution
   a. The Third Circuit agreed that using bankruptcy as a "mere tactic" to prevent an adverse judgment may be indicative of bad faith, and affirmed the "for cause" dismissal. It then addressed Ms. Myers argument that the state court judgment should have been declared void, along with the bankruptcy court's ratification by retroactive annulment.
   b. The court stated that in the Third Circuit, actions taken in violation of the stay were void, not voidable. However, the court explained that such actions, "although void, may nevertheless be reinvigorated through a retroactive annulment of the stay." Section 362(d) permits both "terminating" and "annulling" the automatic stay. The Third Circuit found that "[t]he use of the term 'annulling' would be redundant with 'terminating' if courts were not empowered to grant retroactive relief."
   c. The court stated that the most important factors when considering retroactively annulling the stay are "(1) whether the creditor was aware of the filing or encouraged violation of the stay; (2) whether the debtor engaged in inequitable, unreasonable, or dishonest behavior; and (3) whether the creditor would be prejudiced."
   d. The court found that refusing to ratify the state court's actions would reward Ms. Myers for her bad faith bankruptcy filing, and therefore it affirmed the retroactive annulment.
   e. The court concluded its opinion with a warning to creditors who encourage state courts to take actions in violation of the automatic stay (as Ms. Myer's creditors had done). It stated:

> As we noted at the outset, the Bankruptcy Court was faced with rewarding the inequitable conduct of either the creditor or the debtor. We will not gainsay the Bankruptcy Court's resolution of this question. We note, however, that it is appropriate for the Bankruptcy Court to impose damages under 11 U.S.C. § 362(h) against any parties that created, encouraged, or actively participated in violations of the automatic stay, even if those violations are later ratified by annulment of the stay.

C. Other Cases

1. The majority of circuits have chosen the "void" formulation with respect to the validity of acts done in violation of the automatic stay. <u>See</u> <u>Mann v. Chase Manhattan Mortg. Corp.</u>, 316 F.3d 1, 3 (1st Cir. 2003) (using the "void" formulation); <u>Gucci v. Sinatra (*In re* Gucci)</u>, 197 Fed. Appx. 58, 59 (2d Cir. 2006) (unpublished) (stating that the automatic stay made issuance of a lien and arbitral award void *ab initio*); <u>Middle Tenn. News Co., Inc. v. Charnel of Cincinnati, Inc.</u>, 250 F.3d 1077, 1082 (7th Cir. 2001) ("Actions taken in violation of an automatic stay ordinarily are void."); <u>Burkart v. Coleman (*In re* Tippett)</u>, 542 F.3d 684, 691-92 (9th Cir. 2008) (citing <u>Schwartz v. United States (*In re* Schwartz)</u>, 954 F.2d 569, 571 (9th Cir.1992), restating that the purpose of the automatic stay is to provide "broad protection of debtors from creditors" and this purpose "could be vindicated only if all violations were rendered void, not merely voidable"); <u>United States v. White</u>, 466 F.3d 1241, 1244 (11th Cir. 2006) ("[A]ctions taken in violation of the automatic stay are void and without effect.").
2. Some circuits have not chosen a specific formulation. <u>See</u> <u>Bronson v. United States</u>, 46 F.3d 1573, 1579 (Fed. Cir. 1995) (declining to adopt the "void" terminology, finding that "it is inaccurate and overly broad to characterize every violation of § 362 as being absolutely void"); <u>and</u> <u>Easley v. Pettibone Mich. Corp.</u>, 990 F.2d 905, 909 (6th Cir.1993) ("We think that 'invalid' is a more appropriate adjective to use when defining an action taken against a debtor

during the duration of the automatic stay. . . . Like the word 'void,' 'invalid' describes something that is without legal force or effect. . . . However, something that is invalid is not incurable, in contrast to a void action which is incapable of being ratified."); but see Rogers v. Rogers (*In re* Rogers), 2008 WL 1740248, *4, No. 05-3368 (Bankr. E.D. Tenn., April 11, 2008) (using both "invalid" and "voidable" and citing Easley).

3. The Fifth Circuit purports to adhere to the "voidable" formulation, but has not used that term consistently. Compare Chapman v. Bituminous Ins. Co. (*In re* Coho Res., Inc.), 345 F.3d 338, 344 (5th Cir. 2003) ("We adhere to the view that violations are merely "voidable" and are subject to discretionary 'cure.' This position rests on the bankruptcy court's statutory power to annul the automatic stay, i.e., to 'lift the automatic stay retroactively and thereby validate actions which otherwise would be void.'") (citations omitted); and Bustamante v. Cueva (*In re* Cueva), 371 F.3d 232, 236 (5th Cir. 2004) (stating that actions taken in violation of the stay are "invalid"); Elbar Investments Inc. v. Pierce (*In re* Pierce), 91 Fed. Appx. 927 (5th Cir. 2004) (unpublished) (using the terms "invalid" and "void" to describe the lower court's findings, and stating that a tax sale in violation of the stay was "null and without legal effect).

VIII. Remedies for stay violations

Given the breadth of the automatic stay, courts are often confronted by stay violations and requests for money or other relief on account of these violations. The Code specifically addresses the remedy for these violations in section 362(k).[12] That section states:

> (1) 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.
> (2) If such violation is based on an action taken by an entity in the good faith belief that subsection (h) applies to the debtor, the recovery under paragraph (1) of this subsection against such entity shall be limited to actual damages.

As with most matters in bankruptcy cases, a debtor need only prove a violation of the automatic stay by a preponderance of the evidence.[13]

A. Campbell v. Countrywide Home Loans, Inc., 545 F.3d 348 (5th Cir. 2008)

1. Facts and Disposition
   a. Mortgage lender in chapter 13 case filed a proof of claim that stated that the lender had a right to increase debtor's post-petition mortgage payments to recoup certain escrow deficiencies arising from missed pre-petition payments.

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[12] Prior to 2005, this section was enacted as section 362(h). BAPCPA re-designated subsection 362(h) as subsection 362(k).

[13] Johnson v. Smith (*In re* Johnson), 501 F.3d 1163, 1169-70 & n.5 (10th Cir. 2007) (collecting cases stating the preponderance of the evidence is the appropriate standard).

b. Debtor objected to this language, arguing that this proof of claim language/allegation violated section 362(a)(6), as it was an impermissible attempt to recover a claim against the debtor that arose before the commencement of the case.
c. The bankruptcy court sustained debtor's objection to the language, but found no violation of the stay and therefore denied sanctions.

2. Rationale
   a. The automatic stay is a self-executing injunction that creates a private right of action in favor of the debtor.
   b. Section 362(k) requires that a stay violation be "willful" for the debtor to be entitled to damages.
   c. Proof that a stay violation was "willful" does not require proof of specific intent to violate the automatic stay.
   d. Three elements are required for to prove a stay violation was willful:
      i. The creditor knew of the stay;
      ii. The creditor's action was intentional; and
      iii. The creditor's actions violated the stay.
   e. Legal actions taken within the bankruptcy court do not violate the stay – even grossly overstating the amount of a debt owed on a proof of claim would not violate the stay. The bankruptcy court has other procedural tools to deal with misconduct that occurs within the bankruptcy court (such as section 105 and rule 9011).

B. <u>Radcliffe v. Int'l Painters and Allied Trades Industry Pension Fund (*In re* Radcliffe)</u>, 390 B.R. 881 (N.D. Ind. 2008)

1. Facts
   a. Radcliffe, the debtor and owner/operator of a company, gave a personal guarantee to a pension fund for contributions owed by Radcliffe's company. In addition to administering the pensions for Radcliffe's company's employees, the pension fund also administered Radcliffe's personal pension.
   b. The required contributions were not made, and the fund then sued and obtained a default judgment against Radcliffe, personally.
   c. Radcliffe then filed a chapter 7 petition. The pension fund was listed as a creditor in his petition. Subsequently, the fund sent Radcliffe a letter stating that it intended to offset pension benefits owed to Radcliffe against the amount Radcliffe owed the fund from the default judgment. The letter stated the fund was on notice of the bankruptcy petition, but that this offset was not barred by the automatic stay.
   d. Radcliffe filed an adversary complaint, alleging the fund had violated the automatic stay.
   e. The bankruptcy court determined a willful violation of the stay had occurred, and awarded both compensatory and punitive damages. The fund appealed to the district court
2. Resolution
   a. The district court affirmed, finding that section 362(a)(6) was violated, in that the offset was an act to collect, assess, or recover a claim against Radcliffe.
   b. The court found that the letter indicating the fund would offset Radcliffe's pension monies was qualitatively different that the "administrative freeze" permitted by the Supreme Court in <u>Citizens Bank of Maryland v. Strumpf</u>, 516 U.S. 16 (1995). The court highlighted the

fact that the fund failed to petition the bankruptcy court for relief from the stay, and instead forced Radcliffe to file a complaint.

c. The court found the violation was willful, noting that even if the creditor was acting on a good faith belief that its actions were not in violation of the stay, that would not affect the analysis.

d. With regard to the award for punitive damages, the district court stated that its review should be deferential. The "appropriate circumstances" referenced in section 362(h) (now 362(k)(1), post-BAPCPA), grants the bankruptcy court "significant discretion in the award of punitive damages."

3. Compare

a. Harchar v. United States (*In re* Harchar), 393 B.R. 160 (Bankr. N.D. Ohio 2008) (finding no stay violation–under either 362(a)(3) or (a)(6)–when IRS implementation of procedure that stopped all automated activity, such as the sending of default/demand notices, also stopped the transmission of the debtors' tax refund and put a "freeze" on the debtors' account).

C. Frankel v. Strayer (*In re* Frankel), 391 B.R. 266 (Bankr. M.D. Pa. 2008)

1. Facts and Issue

a. Frankel, the debtor, was an incarcerated person and disbarred lawyer, who was imprisoned following his conviction on some sixty counts of theft by unlawful disposition for stealing money from his clients' trust accounts.

b. Strayer, the defendant in the instant adversary proceeding, was a former client of Frankel's that was owed money from the settlement of a personal injury claim. The settlement proceeds were among the funds misappropriated by Frankel.

c. Approximately a year after Frankel filed bankruptcy, Stayer's counsel filed a complaint against Frankel and others to recover Strayer's settlement funds, but failed to obtain relief from stay prior to filing.

d. Frankel responded by filing an adversary proceeding, alleging a violation of the automatic stay and requesting both actual and punitive damages, pursuant to section 362.[14]

e. Issue: What factors are considered when determining whether to award punitive damages?

2. Resolution

a. The court explained that four factors are relevant to a determination of whether to award punitive damages. These factors are:

   i. The defendants' conduct;
   ii. Their motives;
   iii. Any provocation by the debtor; and
   iv. Each individual defendant's ability to pay.

b. The court explained the purpose of punitive damages is to punish a person for outrageous conduct and deter him and others form similar conduct in the future.

c. The court noted that creditors have a duty to undo actions that have violated the stay once those actions are brought to the creditor's attention. In this case, Strayer's counsel was aware of the automatic stay when the complaint was filed, and waited 17 days to amend the complaint to delete the debtor's name.

[14] Frankel's bankruptcy case was filed two days before the effective date of BAPCPA, and thus the court referred to section 362(h), rather than 362(k). The Frankel court notes that BAPCPA made no substantive changes to the damages provision of section 362.

d. The court accepted Strayer's counsel's explanation that the inclusion of Frankel's name on the complaint was an unintentional error (apparently there was more than one version of the complaint prepared). However, the stay violation still occurred, and damages were warranted.
e. The court awarded attorneys' fees and costs, but held that punitive damages were not required to deter counsel from similar conduct in the future.

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