The Automatic Stay in Bankruptcy

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# THE AUTOMATIC STAY IN BANKRUPTCY

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Editor’s Note: This is Part I of Professor Kennedy’s discussion of the automatic stay in bankruptcy. Part II, “Automatic Stays Under the Proposed Bankruptcy Legislation,” will appear in Volume 12, Issue 1, of the University of Michigan Journal of Law Reform.
THE AUTOMATIC STAY IN BANKRUPTCY

FRANK R. KENNEDY*

The filing of a petition under the Bankruptcy Act constitutes an automatic stay of all litigation against the debtor and most acts and actions against the debtor's property. The stay is one of the most notable features of the Rules of Bankruptcy Procedure promulgated by the Supreme Court.1 The constitutional and statutory basis for the automatic stay has been challenged, and the propriety and the scope of the stay have been contested and ruled on, in many reported opinions. The need and justification for an automatic stay in bankruptcy and debtor relief cases have been widely acknowledged, and an automatic stay seems certain to be included in any comprehensive bankruptcy reform legislation likely to be enacted by Congress.2 The role of this procedural device is still sufficiently new, its full implications sufficiently unexplored and unappreciated, and its day-to-day operations and effects sufficiently controversial and unsettled that an article devoted to the automatic stay seems useful at this stage of its development.3

* Professor of Law, University of Michigan. As Reporter for the Advisory Committee on Bankruptcy Rules, I was considerably involved in the drafting of the automatic stay rules and, as Executive Director of the Commission on Bankruptcy Laws of the United States, in the drafting of a section on the automatic stay in the Bankruptcy Act of 1973 proposed by the Commission. I thus come to questions addressed to the validity of the automatic stay rules and the soundness of the policy decisions implicit in the proposal for a stay section in proposed bankruptcy legislation with a predisposition in favor of affirmative answers.

I wish to acknowledge research assistance rendered in the preparation of this article by Richard Rufner, a member of the third-year class of the University of Michigan Law School.


In accordance with general practice, citations to the present Bankruptcy Act in this article will refer only to the original numbering of the Act as enacted in the Statutes at Large, not to the numbering of Title 11 of the United States Code. The proposed bankruptcy legislation pending in Congress and referred to in note 2 infra will eliminate the confusing discrepancies between the numbers in the original Act and Title 11.

2 See § 362 of H.R. 8200 and S. 2266, pending in the 95th Congress. H.R. 8200 was passed by the House on February 1, 1978. Wall St. J., Feb. 2, 1978, at 8, col. 3. S. 2266, which was introduced on October 31, 1978, has not come to a vote in the Senate. Hereinafter these bills will be cited as H.R. 8200 and S. 2266.

3 The automatic stay provisions of the rules have been discussed in Miller, The Automatic Stay in Chapter XI Cases—A Catalyst for Rehabilitation or an Abuse of Creditors’ Rights, 94 BANKR. L.J. 676 (1977); Peitzman & Smith, The Secured Creditor’s Complaint: Relief from the Automatic Stays in Bankruptcy Proceedings, 65 CAL. L. REV. 1216 (1977); Webster, Collateral Control Decisions in Chapter Cases—Clear Rules v. Judicial Discretion, 51 AM. BANKR. L.J. 197 (1977); Werth & Reed, The Chapter XI Stay Order and the Secured Creditor, 38 OHIO ST. L.J. 33 (1977); 12 W. COLLIER, BANKRUPTCY ¶¶ 401.1-401.7 (14th ed. 1975); 13 id. ¶¶ 601.01-601.10 (1975); 13A id. ¶¶ 10-601.01 et. seq. (1976); 14 id. ¶¶
Although the scope of the stay will be more fully elaborated later in this article, it will facilitate understanding to set out briefly at the threshold of the discussion the general features of the automatic stay. The filing of a petition for adjudication of a debtor as a bankrupt or for relief under one of the six debtor relief chapters of the Bankruptcy Act not only commences a case under the Act\(^4\) but also operates *ipso facto* as a stay of certain judicial proceedings and acts.\(^5\) The stay is triggered by an involuntary petition, when one is authorized,\(^6\) as well as by a voluntary petition.\(^7\) Although there are two stay rules for straight bankruptcy cases,\(^8\) the combined stays in such cases are narrower than the stays prescribed for cases under the debtor relief chapters.\(^9\) The stay provided by Bankruptcy Rule 401 operates only against certain in personam actions, including all actions that are based on dischargeable claims and claims that are not dischargeable unless excepted from discharge by section 17a(1), (5), (6), or (7) of the Act.\(^10\) Rule 601 operates against the enforcement of any lien against property in the custody of the bankruptcy court or any lien obtained by judicial proceedings within four months prior to bankruptcy. With minor qualifications,\(^11\) a stay that commences a debtor relief case under Chapter VIII, IX, X, XI, XII, or XIII operates against any kind of proceeding against the debtor or any kind of lien enforcement against its

\(^{11-44.01\text{ et seq.} (1976); 15 id. §§ 13-401.01\text{ et seq.} (1975). \text{[Hereinafter the Collier treatise on Bankruptcy will be cited as COLLIERS with a reference to the date of the publication of the material cited].}}\)


\(^5\) Subdivision (a) of each of the automatic stay rules cited in note 1 supra provides for an automatic stay. *But cf.* North Peachtree I-285 Property, Ltd. v. Hicks, 136 Ga. App. 426, 221 S.E.2d 607 (1975) (filing of Chapter XI petition held not to terminate or stay a pending state court action, absent an appropriate order by the bankruptcy court or action taken in the state court).

\(^6\) Involuntary petitions are authorized only for straight bankruptcy—*i.e.*, only for liquidation of the debtor's estate—and for reorganization under Chapter VIII or Chapter X. The relevant provisions of the Bankruptcy Act are §§ 5b, 59b, 77(a), and 126, and the governing Rules are 104, 105(b) and (c), 8-103, and 10-105. A petition filed against a partnership by one or fewer than all the partners pursuant to § 5b of the Act and Rule 105(b), or by a party in interest pursuant to § 5i of the Act and Rule 105(d), has the same effect under the automatic stay rules as an involuntary petition filed by creditors of the partnership.

\(^7\) A voluntary petition may be filed by an eligible debtor pursuant to § 5b, 59a, 77(a), 85(a), 126, 321, 421, or 621 of the Act. The corresponding Rules are 103, 105(a), 8-102, 9-3, 10-104(a), 11-3, 12-3, and 13-103.

\(^8\) See Parts III infra.

\(^9\) See Part III infra.

\(^10\) Section 17a(1) excepts from discharge certain tax claims; § 17a(5) excepts claims for earnings that are also entitled to priority under § 64a(2) of the Act; § 17a(6) excepts liabilities for refund of employees' security deposits; and § 17a(7) excepts liabilities for alimony, maintenance, support, and torts arising out of sexual misconduct. It should be noted here that the stay also applies to collection of certain educational loan obligations, which become dischargeable only after a period of delay following an original default. *See* text accompanying notes 132, 134-35, & 223-25 infra.

\(^11\) The qualifications include the following: Rule 8-501(a) excepts from the operation of the stay (1) an action to collect damages caused by the operation of any means of transportation and (2) repossession of rolling stock equipment pursuant to contract. Rule 9-4 authorizes a stay only of a proceeding to enforce a claim against the petitioner but contains broad provisions applicable to the enforcement of liens, setoffs, and counterclaims. Rule 11-44(a) excepts a case pending under Chapter X from the scope of the stay triggered by a Chapter XI petition.
property. Moreover, a stay in a case under Chapter VIII or Chapter IX operates against a setoff by a creditor of the debtor.

I. Origins

A. The Stays of the Farm-Debtor Relief Acts

The original automatic stay appears to have been provided by section 75(o) of the first farm-debtor relief legislation, enacted on the last day of the administration of President Hoover. This provision declared that six categories of proceedings and acts “shall not be instituted, or if instituted ... prior to the filing of a petition under this section, shall not be maintained, in any court or otherwise, against the farmer or his property, at any time after the filing of the petition under this section.” The purpose of section 75 was to extend to farmers the advantages of the composition or extension proceedings already provided other debtors under section 74 but with special features to protect farmers in respect to secured debt. The stay provided was similar in scope and duration to the automatic stays of the debtor relief chapter rules. As originally enacted, section 75 excluded from the scope of the stay proceedings to collect taxes, including tax penalties and interest, and proceedings affecting property not used in farming operations, including the home and household effects of the farmer and his family. A subsequent amendment removed these limita-

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12 47 Stat. 1473 (1933).
13 The provision in full is as follows:

Except upon petition made to and granted by the judge after hearing and report by the conciliation commissioner, the following proceedings shall not be instituted, or if instituted at any time prior to the filing of a petition under this section, shall not be maintained, in any court or otherwise, against the farmer or his property, at any time after the filing of the petition under this section, and prior to the confirmation or other disposition of the composition or extension proposal by the court:

(1) Proceedings for any demand, debt, or account, including any money demand;
(2) Proceedings for foreclosure of a mortgage on land, or for cancellation, rescission, or specific performance of an agreement for sale of land or for recovery of possession of land;
(3) Proceedings to acquire title to land by virtue of any tax sale;
(4) Proceedings by way of execution, attachment, or garnishment;
(5) Proceedings to sell land under or in satisfaction of any judgment or mechanic's lien; and
(6) Seizure, distress, sale, or other proceedings under an execution or under any lease, lien, chattel mortgage, conditional sale agreement, crop payment agreement, or mortgage.

Id.

15 The stay of § 75(o) was broader insofar as it operated against proceedings for the cancellation, rescission, or specific performance of an agreement for the sale of land or for the recovery of possession of land and possibly in its application to proceedings under any lease or crop payment agreement.
16 47 Stat. 1473 (1933).
tions on the stay.\textsuperscript{17}

On June 28, 1934, as its last public act, the New Deal Congress amended section 75 to add a new subdivision (s),\textsuperscript{18} which imposed a five-year stay of all proceedings by a secured creditor against a farmer-debtor's property. The stay was available to any farmer-debtor unable to obtain appropriate relief under the other provisions of section 75. During the stay the farmer-debtor could remain in possession of his property under the control of the court but subject to a duty to pay a reasonable annual rental. At or prior to the end of the five-year period the debtor was authorized to pay the appraised price of the property into court. The farmer-debtor thereupon took full possession and title to the property and he could apply for his discharge from any deficiency remaining on the theretofore secured debt as well as from his other dischargeable debts.

Subdivision (s) was the first and only congressional exercise of the bankruptcy power to be found unconstitutional by the Supreme Court under the fifth amendment. The law was said to effect a substantial impairment of a mortgagee's security and thereby to sanction a retroactive taking of his property without just compensation.\textsuperscript{19} The Court identified five property rights of the mortgagee recognized by state law that were unconstitutionally taken: (1) the right to retain the lien until the indebtedness thereby secured is paid, (2) the right to realize upon the security by a judicial public sale, (3) the right to determine when such sale shall be held, subject only to the discretion of the court, (4) the right to protect its interest in the property by bidding at such sale, whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself, and (5) the right to control the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt.\textsuperscript{20}

As Professor Countryman has recently suggested,\textsuperscript{21} the Court's rationale could have been invoked by any lienor whose security interest recognized by state law was being attacked by the trustee as voidable under section 60 or 67 of the Bankruptcy Act. The pernicious potentialities of \textit{Louisville Bank v. Radford} have been considerably blunted, however, by subsequent developments. Three months and one day after the decision in \textit{Louisville Bank v. Radford}, Congress enacted a new version of subdivision (s),\textsuperscript{22} reducing the period of the stay from five

\textsuperscript{17} "The prohibitions of subsection (o) shall apply to all judicial or official proceedings in any court or under the direction of any official, and shall apply to all creditors, public or private, and to all of the debtor's property, wherever located . . . ." § 75(p), as amended by 49 Stat. 943 (1935). Contrast this forthright provision with § 362(b) of Title 11 as set forth in H.R. 8200 and S. 2266.
\textsuperscript{18} 48 Stat. 1289 (1934).
\textsuperscript{20} Id. at 594-95.
\textsuperscript{22} 49 Stat. 943 (1935).
years to three and giving the court discretion to terminate or modify the stay earlier and to order sale of the property at public auction. The new subdivision was held constitutional in Wright v. Vinton Branch Bank.\textsuperscript{23} The Court noted that the new subdivision (s) preserved three of the property rights enumerated in Louisville Bank v. Radford. Further, the limitations on the secured creditor’s right to determine when a judicial sale should be held and to control the security during default were held to make no unreasonable modification of the mortgagee’s rights in view of the “court’s broad power to curtail the stay for the protection of the mortgagee.”\textsuperscript{24}

The congressional intention to protect the farmer-debtor from mortgage foreclosure proceedings during the pendency of his petition for relief under section 75(s) was given unqualified effect in Kalb v. Feuerstein.\textsuperscript{25} A judgment of foreclosure had been entered by a state court of general jurisdiction over a year before the farmer-debtor had filed a petition under the Bankruptcy Act, but confirmation of a sale under the judgment did not occur until after the filing of the petition under the Act.\textsuperscript{26} The debtor was thereafter ejected pursuant to a writ of assistance issued by the state court. The debtor neither sought relief from the bankruptcy court nor appealed from any of the state court judgments but filed an equitable action in the state court against the mortgagees, who had taken possession of the farm as purchasers at the judicial sale. The Wisconsin courts denied relief, taking the position that the Bankruptcy Act provision was not self-executing and that the farmer-debtor, having taken no appeal from the previous judgments, was barred from relief by res judicata.\textsuperscript{27}

\textsuperscript{23} 300 U.S. 440 (1937).
\textsuperscript{24} Id. at 464, 470. Both Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935) and Wright v. Vinton Branch Bank were unanimous decisions of the same bench, Mr. Justice Brandeis writing the opinions in both cases. Interestingly, the Court relied on the just compensation clause of the fifth amendment in striking down the first version of § 75(s), 295 U.S. at 601-02, but it referred only to the due process clause in sustaining the constitutionality of the second version. 300 U.S. at 470. The Court referred to the bankruptcy court’s acknowledged powers to sell property of a bankrupt estate free of liens and to enjoin sales of pledged property as illustrations of how “[a] court of bankruptcy may affect the interests of lien holders in many ways.” 300 U.S. at 464. The Court had said in Louisville Bank, 295 U.S. at 579, that “[n]o instance had been found, except under the Frazier-Lemke Act [the popular name for § 75(s)], of either a statute or decision compelling the mortgagee to relinquish the property to the mortgagor free of the lien unless the debt was paid in full.” The Court later acknowledged the bankruptcy court’s power to order sales free of liens but explained that “[n]o court appears ever to have authorized a sale at a price less than that which the lien creditor offered to pay for the property in cash.” 295 U.S. at 584.

\textsuperscript{25} 308 U.S. 433 (1940).
\textsuperscript{26} Two mortgagees began foreclosure proceedings against the debtor’s property in a Wisconsin county court on March 7, 1933, and the foreclosure judgment was entered on April 21, 1933. The sheriff sold the property under the judgment on July 20, 1935, and the court confirmed the sheriff’s sale on September 16, 1935. In the meantime Kalb, the debtor, filed a petition under § 75 of the Bankruptcy Act on October 2, 1934. The petition was dismissed on June 27, 1935, but reinstated on September 6, 1935. The Supreme Court opinion does not indicate what further proceedings, if any, ever occurred in the bankruptcy court.

\textsuperscript{27} Kalb v. Luce, 228 Wis. 519 and 525, 279 N.W. 685, 280 N.W. 725 (1938), appeal dismissed, 305 U.S. 566 (1938), on remand, 231 Wis. 186, 285 N.W. 431 (1939). It was noted in Durfee v. Duke, 375 U.S. 106, 114 n.12 (1963), that the jurisdictional issue in Kalb had not been litigated in the state court.
The Supreme Court held that the grant of exclusive jurisdiction of the debtor's property and the statutory stay provisions of section 75 deprived the state court of jurisdiction. It was inconsequential that the debtor had not contested the jurisdiction of the foreclosing court in view of the clarity of the congressional intention to divest the state court of jurisdiction. In finding a congressional intent to relieve the farmer-debtor of a duty to object to the county court's jurisdiction, the Court took note of the fact that Congress relied on conciliation commissioners, "who might be laymen," to assist the farmers in obtaining the protection afforded by the Act.

Kalb v. Feuerstein is admittedly a drastic ruling, but it has not been overruled and, as a recent critic of the doctrine of the voidness of judgments observed, it "cannot be viewed as aberrational." Many of the same considerations that underlay Kalb v. Feuerstein are involved when the automatic stay prescribed by one of the Rules of Bankruptcy Procedure is disobeyed, and the opinion and result of the case will have even more relevance if the automatic stay provisions of the bankruptcy law now pending in Congress are enacted.

B. The Statutory Stays of Chapter X and Chapter XII

In addition to the relatively short-lived automatic stay of the farm-debtor relief legislation, three statutory stays in Chapters X and XII anticipated the stays of the Rules of Bankruptcy Procedure by more than thirty years. Section 148, enacted in 1938, gave to an order approving a reorganization petition under Chapter X the effect of an automatic stay both of lien enforcement against the property of the debtor and of a pending bankruptcy or equity receivership proceeding. An even closer analogy to the stays currently provided by the Rules is found in section 428, which gave the effect of an automatic stay to the filing of a petition under Chapter XII as against any act or proceeding to enforce a lien.
against the debtor's real property or chattel real. 33

Another antecedent of the provisions for an automatic stay in a Chapter XII case is section 507. That section provided that a prior mortgage foreclosure, equity, or other proceeding in a federal or state court in which a trustee or receiver of the debtor's property has been appointed or applied for shall be stayed by the filing of a Chapter XII petition. The stay of section 428 was automatic, but whether section 507 was self-executing seems never to have been decided in a reported case. 34 Rule 12-43 makes the point academic.

These three statutory provisions have generated little litigation challenging their validity or scope and little controversy in the literature with respect to their need and justification. 35 At the same time forty years' experience with these provisions has not produced many answers to the questions arising in connection with the automatic stays prescribed by the Rules of Bankruptcy Procedure.

The Rules of Bankruptcy Procedure have extended the device of the automatic stay well beyond the confines of Chapters X and XII. The automatic stay now arises immediately on the filing of a petition commencing a case under any chapter of the Bankruptcy Act, whether the petition is voluntary or involuntary. 36 Moreover, its reach includes in

33 The full text of § 428 reads as follows:

Unless and until otherwise ordered by the court, upon hearing and after notice to the debtor and all other parties in interest, the filing of a petition under this chapter shall operate as a stay of any act or proceeding to enforce any lien upon the real property or chattel real of a debtor.

For a discussion of § 428, see 9 COLLIER ¶ 4.16 (1976).

34 The automatic stay of § 428 covered nearly every case to which § 507 applied. Only an equity receivership proceeding instituted for a purpose other than the enforcement of a lien would fall within the ambit of the latter section and not the former.

35 The principal cases applying § 428 are Meyer v. Rowen, 181 F.2d 715, 716 (10th Cir. 1950) and 195 F.2d 263, 266 (10th Cir. 1952); and Potts v. Potts, 142 F.2d 883, 888 (6th Cir. 1944), cert. denied, 324 U.S. 868 (1945).

In Tingle v. Atlanta Fed. Sav. & Loan Ass'n, 93 Ga. App. 393, 395, 91 S.E.2d 304 (1956), the state court held that the stay of § 428 was inoperative as against confirmation of a foreclosure sale because the debtor's Chapter XII petition was never "perfected" and because there was no notice and hearing as required by the section. As pointed out in In re Johnson, 1 Collier Bankr. Cas. 90, 100 (Ref., N.D. La. 1974), § 428 requires a notice and hearing only if the stay is to be terminated or modified. In the Johnson case, Bankruptcy Judge Thines read the Tingle case as requiring the Chapter XII petition to be accompanied by a plan in order to be "perfected" and operative as an automatic stay. Id. at 99. Whatever the correctness of such a ruling under the law as it then existed, Rule 12-36(a) now eliminates the requirement that a plan be filed with the petition.

36 The stays provided by §§ 428 and 507 could arise only in a case commenced by a voluntary petition.

The automatic stay of § 148 arose without regard to whether the case was commenced by a voluntary or an involuntary petition, but the triggering event, approval of the petition, was likely to occur earlier in a voluntary case. Section 141 authorized the judge to approve a voluntary petition under Chapter X immediately upon the filing of a petition if he was satisfied that it complied with the requirements of the chapter and was filed in good faith. Section 142 authorized the judge to approve an involuntary petition if the debtor filed no answer or if the answer filed by the debtor controverted no material allegation of the petition, but § 136 allowed the debtor ten days after the service of the petition for filing an answer. Additional time could be allowed for the filing of the answer, and, if the answer filed controverted material allegations of the petition, a trial of the issues might entail a delay of the approval for several days or weeks.
personam actions as well as those involving the debtor's property.\textsuperscript{37} The need or justification for staying in personam proceedings differs from that underlying the stay of acts and actions directed toward enforcing rights against the debtor's property. The \textit{raison d'être} for the stay of acts and actions to enforce liens or setoff against the debtor's property is the need for protection of the estate against dismemberment and disappearance at the instance of the more aggressive creditors.\textsuperscript{38} A stay of in personam actions against the debtor, including the enforcement of judgments, may also serve that purpose to some extent,\textsuperscript{39} but, particularly for debtors, the stay protects the fresh start provided by the discharge and other modes of relief under the Act.\textsuperscript{40} The comprehensive stay prescribed by the rules for debtor relief cases against proceedings of all kinds and lien enforcement implements more fully than did the statutory stay provided by sections 148 or 428 the acknowledged purpose of these sections "to maintain the status quo of the debtor... pending a reasonable opportunity to reorganize its financial structure..."\textsuperscript{41}

C. The Mandatory Stay of Section 11a

Although section 11a of the Bankruptcy Act is susceptible to a literal reading that would have imposed a limited, automatic stay, the language fell short of accomplishing that result. The stay mandated by the first main clause of the subdivision was effective only against suits founded on dischargeable claims and only until adjudication or dismissal of the petition. It is not clear whether it imposed a duty on the bankruptcy court or

\textsuperscript{37} Most of the automatic stays provided by the Rules, including those applicable in Chapter X and XII cases, operate against "any court or other proceeding against the debtor," irrespective of the nature of the cause of action asserted or the kind of relief sought. Provisions in Rules 8-501(a), 10-601(a), 11-44(a), 12-43(a), and 13-401(a) extending the stay to any court proceeding for the purpose of rehabilitating the debtor or liquidating its estate reach cases commenced under the Bankruptcy Act by voluntary as well as involuntary petitions. A case pending under Chapter X of the Act is not stayed by the filing of a Chapter XI petition.

\textsuperscript{38} "The premise of the rule [601] is that such a stay is no less needful in straight bankruptcy than in a reorganization case to protect creditors against prejudicial dismemberment and disposition of the estate before a trustee or receiver can qualify." Advisory Committee's Note to Rule 601(a).

\textsuperscript{39} As recognized in Hill v. Harding, 107 U.S. 631, 634 (1882), the automatic stay against in personam actions not only protects the debtor against harassment but gives the receiver of the bankrupt estate an opportunity to intervene and defend the estate against the assertion of a claim that may be partially secured.

\textsuperscript{40} "The stay provided by this rule [i.e., 601] is to be distinguished from that provided by Rule 401, which reinforces §§ 11a, 14f(2), and 17c(4) of the Act by protecting the bankrupt against harassment and possible frustration of his right to a discharge." Advisory Committee's Note to Rule 601(a). \textit{See also} the Advisory Committee Notes to Rules 10-601, 11-44, 12-43, and 13-401.

The distinction between the purposes of Rules 401 and 601 is analogous to that frequently drawn between the purposes of §§ 11a and 2a(15) of the Act. \textit{See, e.g.}, \textit{In re} S.W. Straus & Co., 6 F. Supp. 547, 549 (S.D.N.Y. 1934).

\textsuperscript{41} \textit{See In re} Maier Brewing Co., 38 F. Supp. 806, 816 (S.D.Cal. 1941).
on the court in which an action subject to the stay was pending. The courts have regarded the statute as not self-executing, and debtors could find themselves without relief when neither the bankruptcy court nor the court in which the action was pending took any step to implement the evident policy of the provision.

The uninitiated reader might have supposed that the first sentence of section 11a operated to protect the debtor who filed a voluntary petition as well as one against whom an involuntary petition had been filed. Since section 18f invests the filing of a voluntary petition with the effect of an adjudication, however, the limitation of the mandatory stay of section 11a to the interval before adjudication or dismissal meant that it afforded no protection at all to the vast majority of bankrupts who would be the supposed beneficiaries of the provision. The explanation is historical: when section 11a was originally enacted in 1898, adjudication was not automatic, and the first clause did serve, for its limited term, to protect voluntary as well as involuntary bankrupts.

Section 11a was also inadequate to protect the debtor against actions on dischargeable claims during the interval between filing of a petition and adjudication because it did not affect the postpetition commencement of such actions. A possible rationale was that the commencement of such an action would be attended by notice that would alert the debtor to the need for seeking relief against its continuation, whereas prejudicial steps might be taken in a pending action by a debtor preoccupied with a pending bankruptcy petition filed by or against him. In any event, bankruptcy courts have been willing to find a statutory basis for enjoining postpetition actions against a bankrupt in the general grant of power to make necessary orders in section 2a(15).

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43 Consider, for example, the bankrupt in Hill v. Harding, 107 U.S. 631 (1882), who did not obtain injunctive relief from the court in bankruptcy but pursued his remedy through the state trial courts, appellate court, and supreme court before finally getting relief from the United States Supreme Court.

44 The elimination of the interval between the filing of a voluntary petition and an adjudication occurred in 1959 when § 18f was amended to make adjudication automatic. 2 Collier ¶ 18.01[3.6] (1974).

45 Section 11a was held to authorize a stay of the enforcement by levy of execution on a judgment on a dischargeable debt entered before the filing of a petition by or against the judgment debtor. 1A Collier ¶ 11.03 (1974).

46 In re Nuttall, 201 F. 557, 559 (S.D.N.Y. 1912); see In re S. W. Straus & Co., 6 F. Supp. 547, 549 (S.D.N.Y. 1934). Section 2a(15) vests in the bankruptcy courts jurisdiction to "[m]ake such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act." This provision is further discussed in the text accompanying notes 55 - 57 infra.
A final criticism of the mandatory stay provided by the first clause of section 11a is that it left unanswered questions concerning the status of an action on a dischargeable claim after adjudication. The practical result was that competent counsel for both voluntary and involuntary bankrupts routinely sought and obtained injunctions from the bankruptcy courts against the commencement and continuation of in personam actions, particularly actions on dischargeable claims.

**D. The Dischargeability Legislation of 1970**

Beginning about 1960, Congress became increasingly concerned about the frustration of its purpose to provide an effective fresh start for individual bankrupts.47 This concern culminated in the enactment of the dischargeability legislation of 1970.48 This legislation amended several sections of the Bankruptcy Act49 with a view to protecting individual bankrupts from the risk of losing the benefits of a discharge as a result of aggressive action by their creditors. Congress sought to reduce this risk by taking the extraordinary step of transferring the bulk of litigation concerning the effect of a discharge from the state courts to the bankruptcy courts. One provision of that legislation authorized the bankruptcy court to enjoin any action on a debt of a bankrupt,50 and another provided that "[a]n order of discharge shall . . . enjoin all creditors whose debts are discharged from thereafter instituting or continuing any action or employing any process to collect such debts as personal liabilities of the bankrupt."51

The evolution of the dischargeability legislation and Bankruptcy Rule 401 were approximately contemporaneous.52 If a debtor seeking discharge in bankruptcy is entitled to protection against the risk of being thwarted by creditors' pursuit of remedies in other forums, the risk does not end with the debtor's adjudication as a bankrupt. Moreover, the protection ought not to be dependent on the debtor's alertness and ability to persuade the bankruptcy court or the court in which an action is

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47 The Act of July 12, 1960, 74 Stat. 408, amended §§ 14c(3) and 17a(2) of the Bankruptcy Act to limit the use of a false financial statement as a bar to discharge. Subdivisions b and c of § 14 were amended by the Act of Sept. 2, 1965, 79 Stat. 646, to enable the bankruptcy court to start proceedings to determine a bankrupt's right to a discharge without awaiting the full payment of filing fees by a bankrupt permitted to pay them in installments. The Act of July 5, 1966, 80 Stat. 270, amended § 17a(1) to make certain tax debts nondischargeable.


49 §§ 2a(12), 14, 15, 17, 38, and 58b.

50 § 17c(4).

51 § 14f(2). See also Rule 404(f) and ¶ 3 of Official Form No. 24.

52 The legislative history of the dischargeability legislation extends from 1956 to 1970. Countryman, The New Dischargeability Law, 45 AM. BANKR. L. J. 1, 17-23 (1971). The Bankruptcy Rules were in the process of drafting, circulation to the bench and bar, and review by the cognizant committees of the Judicial Conference of the United States, the Supreme Court, and Congress during the years 1960 to 1973. Kennedy, Overview, in BANKRUPTCY UNDER THE NEW RULES OF PROCEDURE 1-7 (Lempert ed. 1974).
pending or commenced to stay the action pending the resolution of con-
tingencies on which his right to a discharge depends. That is the rationale
for the provision of an automatic stay in Bankruptcy Rule 401.

E. The Protection of the Bankrupt Estate Against Lien Enforcement

The language and context of section 11a and the dischargeability legis-
lation of 1970 bespeak a concern for protection of the debtor's opportun-
ity for a fresh start unburdened by liability for dischargeable debts. Other
provisions of the Act reflect the need for protection of the estate of the
bankrupt against the ravages that would be inflicted on the estate if grab
law were allowed to govern. Section 2a, in a general introduction to a long
list of categories of jurisdiction given the courts of bankruptcy, declares
that these courts are invested "with such jurisdiction at law and in equity
as will enable them to exercise original jurisdiction in proceedings under
this Act." As Collier appropriately points out, 53 the power to enjoin is
undoubtedly inherent in the bankruptcy court as a court of equity. The
most important of the twenty-three grants of jurisdiction 54 made by sec-
tion 2a has already been mentioned, 55 namely that made by section
2a(15). That clause does not, in the words of its broad grant, mention
"injunction" or "stay." Rather, the clause simply authorizes the court to
"[m]ake such orders, issue such process, and enter such judgments, in
addition to those specifically provided for, as may be necessary for the
enforcement of the provisions of this Act." Whatever doubt might be
raised as to whether an injunction of another court was intended to be
included in this broad authorization is dissolved by the proviso at the end
of the clause "that an injunction to restrain a court may be issued by the
judge only." The proviso actually incorporated a limitation on the author-
ity of the referee that had previously appeared in the General Orders. 56

The principal purpose of section 2a(15) has been regarded as that of
protecting the custody of the estate and the administration of it by the
bankruptcy court. 57 Rule 601 serves the purpose by protecting the estate
against precipitate enforcement of certain liens. The stay of acts and
actions to enforce liens is less comprehensive in straight bankruptcy cases
than in debtor rehabilitation cases. The explanation lies primarily in the
differing scope of the court's jurisdiction in the two kinds of cases.

53 1 COLLIER ¶ 2.61(1), at 323 (1974).
54 The last clause of § 2a is numbered (22), but the third clause, inserted in 1966 by 80 Stat.
270, was numbered (2A) to avoid renumbering the twenty subsequent clauses.
55 See text accompanying note 46 supra.
56 The proviso was added by the Chandler Act. 1 COLLIER ¶ 2.60 (1974). General Order
XII(3), as it read before 1938, required applications for injunctions to stay proceedings of
other courts to be heard and decided by the judge. Id. It thus appears that the power to
enjoin another court was originally withheld from the referee at the instance of the Supreme
Court rather than Congress, but that Congress ratified this allocation of power in 1938. The
Rules of Bankruptcy Procedure left this distribution of injunctive authority intact. See Rule
102(a).
57 See 1 COLLIER ¶ 2.61(1) at 324 (1974).
The automatic stay provided by Rule 601(a)(1) against any act or action to enforce a lien protects only the property in the custody of the bankruptcy court. Property is deemed to be in the custody of the bankruptcy court if it is in the actual or constructive possession of the bankrupt at the date of bankruptcy.\(^{58}\) As pointed out in the Advisory Committee's Note accompanying Rule 601, the rule is a restatement, though substantially restricted, of the familiar dictum of *Mueller v. Nugent* that "the petition is a *caveat* to all the world, and in effect an attachment and injunction."\(^ {59}\) "The automatic stay is thus a logical corollary of the bankruptcy court's exclusive jurisdiction to deal with the property of the bankrupt within its custody from the date of bankruptcy."\(^ {60}\)

The automatic stay provided by Rule 601(a)(2) operates to bar any act or action to enforce a lien against the property of the bankrupt obtained within four months before bankruptcy by a judicial proceeding. To allow such a lien to be enforced by a sale and distribution of the proceeds to the lien creditor frustrates the objective of the Bankruptcy Act to provide equitable distribution of the estate to all creditors, except in the rare situation where the estate is sufficient to pay all creditors in full. Section 67a renders a judicial lien obtained during the four-month period voidable if the debtor was insolvent at the time the lien attached, and Congress has explicitly conferred summary jurisdiction on the bankruptcy court to determine the issues under section 67a.\(^ {61}\) Quite apart from this grant of summary jurisdiction, it has long been clear that the bankruptcy court can, pursuant to section 2a(15), protect the trustee's right to seek the avoidance of a judicial lien obtained within the four-month period by enjoining its enforcement pending the institution and maintenance of proceedings under section 67a.\(^ {62}\) The stay of Rule 601 is calculated to minimize the number of instances in which recovery under this section is defeated or impaired by sale of the property after bankruptcy.\(^ {63}\)

**F. The Exclusive Jurisdiction of the Debtor and its Property in Debtor Relief Cases**

The automatic stays imposed by the Rules of Bankruptcy Procedure that apply in debtor relief cases under Chapters VIII, IX, X, XI, XII, and...
XIII\textsuperscript{64} extend to all in personam actions and proceedings against the debtor, without reference to whether they are based on dischargeable claims. Likewise these stays bar enforcement of liens against the property of the debtor without regard to who has custody of the property and without regard to the age or nature of the lien. The extension of the scope of these stays beyond the scope of the stays of Rules 401 and 601 for straight bankruptcy is a recognition of the congressional policies underlying the provisions in the debtor relief chapters that (1) confer on the bankruptcy court exclusive jurisdiction of the debtor and its property\textsuperscript{65} and that (2) broadly authorize injunctions against the commencement or continuation of suits against the debtor and against enforcement of liens upon its property.\textsuperscript{66} Congress has manifestly concluded that the bankruptcy court must have control of litigation against the debtor and of attempts to enforce liens against the estate in order to be able to supervise and facilitate its rehabilitation.\textsuperscript{67}

The provisions in the debtor relief chapters conferring exclusive jurisdiction and authorizing the issuance of stays and injunctions supplement without superseding or limiting the general grants of injunctive power implicit in sections 2a and 2a(15).\textsuperscript{68} Reference should also be made here to section 1651 of the Judicial Code, which authorizes United States courts to issue all writs not specifically provided for by statute which may be necessary for the exercise of their respective jurisdictions.\textsuperscript{69} The plenitude of explicit authority in the Bankruptcy Act for staying acts and proceedings that interfere with the attainment of its objectives makes resort to the \textquotedblleft all writs statute	extquotedblright supererogatory, but occasionally courts have recurred to it to emphasize the amplitude of the power of the bankruptcy court to protect its processes.\textsuperscript{70} Each of the Rules of Bankruptcy Procedure providing for an automatic stay includes a caveat that \textquotedblleft[n]othing in this rule precludes the issuance of, or relief from, any stay, restraining order, or injunction when otherwise authorized.\textsuperscript{71}

\textsuperscript{64} Rules 8-501, 9-4, 10-601, 11-44, 12-43, and 13-401.

\textsuperscript{65} §§ 77(a), 82(a), 111, 311, 411, and 611. These sections are discussed in 5 \textsc{Collier} ¶ 77.11-.12 (1964); 6 id. ¶ 3.03-.13 (1977); 8 id. ¶ 3.01-.05 (1974); 9 id. ¶ 3.01 (1976); and 10 id. ¶ 23.01 (1974).

\textsuperscript{66} §§ 77(j) (excepting suits for damages caused by the operation of trains, etc.), 85(f), 113, 116(4), 314, 414, and 614. Some of these sections require notice and a showing of cause before enforcement of a lien may be stayed. These sections are discussed in 5 \textsc{Collier} ¶ 77.12 (1964); 6 id. ¶ 3.15, 3.28-.34, 6.12 (1977); 8 id. ¶ 3.20-.22 (1974); 9 id. ¶ 3.06 (1976); and 10 id. ¶ 23.05 (1974). Curiously, §§ 314 and 614 appear to authorize the court to stay any and all suits \textquotedblleft other than suits to enforce liens upon the property of the debtor.,	extquotedblright but this openendedness seems not to have led any court to enjoin actions against persons other than the debtor.

\textsuperscript{67} See 6 \textsc{Collier} ¶ 3.03 (1977). The bankruptcy court's need for control of litigation does not necessarily require the court to conduct all litigation against the debtor. Cf. Foust v. Munson S.S. Lines, 299 U.S. 77, 83 (1936).

\textsuperscript{68} See notes 53 - 57 and accompanying text supra.


\textsuperscript{71} This provision is the last subdivision of each of the stay rules.
II. VALIDITY OF THE STAY

A. Constitutional Considerations

After the decision in Wright v. Vinton Branch Bank\textsuperscript{72} the constitutional validity of an automatic stay imposed at the threshold of a debtor relief case seemed assured, and the Court observed in 1938 that "[s]uch a stay [as that provided by section 75(s)] under judicial discretion as to enforcement of claims does not take property without due process and is constitutional."\textsuperscript{73} The Court cited, in addition to Wright, its earlier ruling in Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Railway,\textsuperscript{74} that an injunction entered by a bankruptcy court against enforcement of a pledgee's rights constitutes no impairment of his lien: "It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action."\textsuperscript{75} The Court did not deny the pledgee's claim that injurious consequences might result to the pledgee but pointed out that the claim presented "a question addressed not to the power of the court but to its discretion."\textsuperscript{76}

It is thus not surprising that the constitutionality of the statutory stays prescribed by sections 148 and 428 was generally assumed and, until recently, not even contested.\textsuperscript{77} The automatic stay prescribed by the statute has undoubtedly been supplemented or reinforced in many cases by the issuance of an injunction by the bankruptcy court.\textsuperscript{78} There is little point in litigating the validity and scope of an automatic stay if the action or act affected by it is also barred by an injunction that cannot be effectively challenged. Recognition that such an injunction can be obtained from the bankruptcy court without undue delay or difficulty has surely contributed to the reluctance of parties affected by an automatic stay to wage a strenuous attack against it.

\textsuperscript{72} 300 U.S. 440 (1937), discussed in the text accompanying notes 23-24 supra.
\textsuperscript{74} 294 U.S. 648, 677 (1935).
\textsuperscript{75} Id. at 676-77.
\textsuperscript{76} Id. at 677.
\textsuperscript{77} The only judicial opinions found to consider the constitutionality of a statutory stay are recent rulings in First Nat'l Bank of Atlanta v. Robinson (In re B & B Properties, Ltd.), 423 F. Supp. 23, 26 (N.D. Ga. 1976), and Tharpe & Brooks of Fla., Inc. v. Pickett, Gardner, Landers & Assoc., 14 Collier Bankr. Cas. 370, 385-90 (N.D. Ga. 1977). The latter ruling rejected attacks on the constitutionality of § 428 and Rule 12-43, but the district court in B & B Properties rested its denial of relief to secured creditors on the inappropriateness of their resort to a petition for mandamus.
\textsuperscript{78} See, e.g., Young v. Kerr Industries, Inc., 540 F.2d 755, 756 (4th Cir. 1976); Amadori Constr. Co. v. Travelers Indem. Co. (In re Stanndco Developers, Inc.), 534 F.2d 1050, 1051 (2d Cir. 1976); Potts v. Potts, 142 F.2d 883, 886 (6th Cir. 1944).

It has been frequently noted that common practice developed, prior to the advent of the Rules of Bankruptcy Procedure, for a comprehensive stay of proceedings against the debtor and the estate to be ordered at the outset of a case commenced under the Bankruptcy Act, and especially of a case initiated under one of the debtor relief chapters. See D. Stanley & M. Girth, Bankruptcy: Problem, Process, Reform 84 (1971) [hereinafter cited as Stanley & Girth]; Peitzman & Smith, supra note 3, at 1224.
The very availability of a comprehensive injunction prohibiting most creditors’ actions and acts to enforce their claims against the property of a debtor in a Chapter X or Chapter XII case is, of course, a factor of significance in evaluating the constitutionality of the automatic stay. If Congress can create courts and vest them with power to enjoin litigation against debtors in cases arising under a federal bankruptcy act, it can surely provide that the commencement of such a case automatically stays such litigation. The congressional power to authorize bankruptcy courts to restrain litigation in other courts has long been established.

The Supreme Court’s views of the demands of the due process clause have, however, undergone revision during the last decade. In particular, the Court has overruled cases upholding the constitutionality of attachment and prejudgment garnishment against contentions that these writs deprived debtors of their property without notice and hearing. The implications of recent decisions of the Court are still the subject of debate and much litigation, but categorical absolutes are, in any event, inappropriate in describing the demands of due process. The Court has been engaged in a balancing process, weighing the private interest in assuring procedural safeguards in advance of any taking against the competing need for subjecting property and enjoyment of rights to particular restraints and restrictions for compelling reasons.

Thus, the Court has recognized that a person may be immediately subjected to limitations on the exercise of his property rights when a paramount public interest is served by the restraint. That the ends of the bankruptcy process do serve the public interest is inferable from the constitutional grant of power to Congress to enact bankruptcy laws and from the constitutional exercise of its power in the Bankruptcy Act.

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80 Attachment and certain modes of prejudgment levy were generally accepted creditors’ remedies prior to 1969. McKay v. McInnes, 279 U.S. 820 (1928); Coffin Bros. & Co. v. Bennett, 277 U.S. 29 (1928); Ownbey v. Morgan, 256 U.S. 94 (1921). In 1969 and since, the Supreme Court has several times held that prejudgment seizure in accordance with established procedures nevertheless violated constitutional guaranties of due process when no hearing or notice preceded the levy. Sniadach v. Family Finance Corp., 395 U.S. 337 (1969); Fuentes v. Shevin, 407 U.S. 67 (1972); North Georgia Finishing Inc. v. Di-Chem, Inc., 419 U.S. 601 (1975).


82 See, e.g., G.M. Leasing Corp. v. United States, 429 U.S. 338, 351 (1977) (seizure of automobiles to obtain partial satisfaction of tax liabilities held not to violate either the fourth or fifth amendment); Coffin Bros. & Co. v. Bennett, 277 U.S. 29 (1928) (summary execution against bank stockholder’s property to enforce liability of stockholder of a failed bank sustained).

83 In Fidelity Mtge. Investors v. Camelia Builders, Inc., 550 F.2d 47, 55 (2d Cir. 1976), cert. denied, 429 U.S. 1093 (1977), the court stated:

The policy considerations underlying Rule 11-44 are considerable. The automatic stay . . . is designed to prevent a chaotic and uncontrolled scramble for the debtor’s assets in a variety of uncoordinated proceedings in different courts. The stay insures that the debtor’s affairs will be centralized, initially, in a single forum in order to prevent conflicting judgments from different courts and in order to harmonize all of the creditors’ interests with one another.
Recent opinions of the Supreme Court do not raise any doubts about the necessity for the bankruptcy court to be able to exercise comprehensive control of the debtor and his property within the limitations prescribed by Congress in order to perform its administrative functions and to provide the relief of debtors contemplated by the Act.

Even when the public interest is less easily discerned, the Court has recognized that due process may be satisfied by notice and a hearing that follows rather than precedes the restraint imposed on the exercise of property rights.\(^{84}\) The stay rules are carefully drafted to assure immediate access to the court by parties subject to the stay and expeditious hearing of their objections to the operation of the stay.\(^{85}\) The courts have thus far uniformly rejected challenges to the validity of the stay rules.\(^{86}\)

### B. The Scope of the Rule-Making Power

An attack on the validity of the automatic stay rules may be based on the argument that these rules exceed the bounds of the grant of rule-making authority to the Supreme Court.\(^{87}\) On the positive side, that grant authorizes the Court to prescribe general rules to govern the "forms of process, writs, pleadings, and motions, and the practice and procedure under the Bankruptcy Act." Negatively, the grant proscribes rules that "abridge, enlarge, or modify any substantive right." Similar language

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\(^{84}\) Mitchell v. W. T. Grant Co., 416 U.S. 600, 611 (1974). In a concurring opinion in North Georgia Finishing, Inc. v. Di-Chem, Inc., 419 U.S. 601, 611 (1975), Mr. Justice Powell observed: "Pregamishment notice and a prior hearing have not been constitutionally mandated in the past. Despite, the ambiguity engendered by the Court's reliance on *Fuentes*, I do not interpret its opinion today as imposing these requirements for the future."

\(^{85}\) It was noted in Tharpe & Brooks of Fla., Inc. v. Pickett, Gardner, Landers & Assoc., 14 Collier Bankr. Cas. 370, 388 n.19 (Ref., N.D. Ga. 1977), that "[t]he automatic stay in rehabilitative and bankruptcy contexts is no less necessary than a temporary restraining order under Rule 65, Federal Rules of Civil Procedure, granted without a prior hearing and a showing of possible irreparable harm. The same considerations apply to each."

\(^{86}\) See the discussion accompanying note 274 infra.

\(^{87}\) 28 U.S.C. § 2075 (1970). The grant of rule-making power to the Supreme Court in respect to "procedure and practice under the Bankruptcy Act" was made in 1964. 78 Stat. 1001. Prior to 1964 the Supreme Court's rule-making authority in the area of bankruptcy was limited to § 30 of the Act and to the prescription of interstitial rules of procedure. The General Orders of Bankruptcy were promulgated pursuant to that authority. Any order in conflict with the Act was invalid. See, *e.g.*, Meek v. Centre County Banking Co., 268 U.S. 426 (1925).
appears in other enabling legislation under which the Supreme Court has exercised its rule-making functions for the federal courts. Not surprisingly, perhaps, the Court has given a hospitable reading to the congressional grants and to the products of its exercise of the rule-making authority vested in it.

The rule of procedure that appears to be most nearly analogous to the automatic stay rules discussed in this article is Rule 62(a) of the Federal Rules of Civil Procedure. That rule imposes an automatic stay for ten days against the issuance of an execution on a judgment and of any other kind of proceedings for its enforcement until ten days have elapsed after its entry. No challenge to the validity of this rule has been discovered.

The automatic stay rules come closer in spirit and purpose, however, to being a kind of codification of the practice that characterized the inauguration of a federal equity receivership. As the law of federal equity receiverships evolved, federal courts assumed functions and fashioned appropriate procedures that are comparable to those now carried out in cases under the Bankruptcy Act. To a considerable extent the bankruptcy court's functions and procedures in reorganization cases under Chapters VIII-XII are adaptations of what the federal courts developed in administering equity receiverships during the several decades preceding the enactment of reorganization legislation in the early thirties. The federal courts recognized from the beginning that successful administration of an equity receivership required a stay of actions or acts that might interfere with the receiver's discharge of his responsibilities for operating the debtor's business and preserving the estate during the pendency of the proceedings. The comprehensive stay effected by the inception of the proceedings was so characteristic that the label of "umbrella receiverships" was often applied.

Any suggestion that the imposition of a stay abridges or modifies a substantive right is contradicted by the Supreme Court's declaration in Continental Illinois National Bank & Trust Co. v. Chicago, Rhode Island & Pacific Railway that the court's injunction against a pledgee's enforcement of his security interest did not impair his rights. A realistic
appraisal of the effect of the automatic stay supports the view that it does not abridge any substantive rights. As pointed out earlier, a debtor represented by adequate counsel routinely obtains an injunction at the threshold of a case against the actions and acts that are subject to the stays prescribed by the rules. The few courts that have considered the matter have had no difficulty in recognizing the procedural character of the automatic stay rules and rejecting challenges to their validity. Nor have they been impressed by an argument that the automatic stay rules extend the jurisdiction of the bankruptcy court.

C. Conflict with Congressional Policy

There is a long and firmly entrenched congressional policy to restrict the injunctive power of federal courts to stay state court proceedings. The policy is embodied in section 2283 of Title 28 of the United States Code:

A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments.

The explicit grants of power to bankruptcy courts to enjoin suits have been recognized as falling within the exception of the first clause of this provision. This result was not ineluctable insofar as these courts relied on the original language of section 2a(15) of the Bankruptcy Act, since it contained no express reference to authority, of the bankruptcy court to

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96 Fidelity Mgt. Investors v. Camelia Builders, Inc., 550 F.2d 47, 53, 58 (2d Cir. 1976), cert. denied, 429 U.S. 1093 (1977). In view of the decision in Kalb v. Feuerstein, 308 U.S. 433 (1940), cited in note 25 supra and discussed in the accompanying text, it is arguable that the sections of the debtor relief chapters vesting exclusive jurisdiction of the debtor and his property in the bankruptcy court divest all other courts of jurisdiction of litigation affected by the stay rules applicable in the cases commenced under those chapters.


enjoin. The proviso of section 2a(15) added in 1938, however, which specifies that only the district judge has power to restrain a court, clearly implies that parties to a state or federal court action may be enjoined by a referee and that a district judge, when acting as a bankruptcy judge, may enjoin both parties and judges from proceeding in such a court action.

Section 2283 literally restricts only the power of a court of the United States to grant an injunction to stay proceedings in a state court, whereas the stay rules operate automatically without the necessity of a court injunction. If section 2283 should nevertheless be thought to be in conflict with the automatic stay rules, the rule-making grant of 28 U.S.C. § 2075 declares that all laws in conflict with the rules promulgated pursuant to the statute "shall be of no further force or effect after such rules have taken effect." The policy embodied in section 2283 is so firmly established, however, that courts can be expected to apply the stay rules so as not to run counter to its prohibition: if the stay cannot be justified as performing the same function as an injunction expressly authorized by the Bankruptcy Act or as necessary in aid of the jurisdiction of the bankruptcy court or to protect or effectuate its judgments, it will not and should not be sustained. As the Advisory Committee's Notes accompanying the stay rules indicate, these rules were intended to reinforce and supplement the provisions of the Act authorizing bankruptcy courts to enjoin actions and acts that interfere with the court's jurisdiction over the debtor and its property. In general, the courts have been conscientious in their efforts to construe and apply the stay rules in a manner consistent with the objectives of the grants of jurisdiction and injunctive power, while being sensitive to the potential harm that stays may inflict on the parties subject to the stays.

III. THE SCOPE OF THE STAY

A. The Stay of In Personam Actions Under Rule 401

Bankruptcy Rule 401 prescribes an automatic stay against all actions on dischargeable claims. The purpose of Rule 401 is the same as that underlying...
ing section 11a, namely, to prevent frustration of the Act’s objective to afford the bankrupt a fresh start. The rule goes beyond section 11a, however, in several respects: (1) it operates automatically, whereas section 11a imposed a duty on an unspecified court;\(^\text{104}\) (2) it extends to actions commenced after the filing of the petition as well as to the continuation of those pending at bankruptcy;\(^\text{105}\) (3) it extends not only to all actions on dischargeable claims but also to actions on claims not dischargeable under four clauses of section 17a of the Act;\(^\text{106}\) and (4) it extends to actions and the enforcement of judgments against bankrupts, not merely to suits.\(^\text{107}\)

That the rule is nevertheless compatible with congressional purposes is evident in the amendments of the Bankruptcy Act, previously discussed,\(^\text{108}\) enacted in 1970 to enhance the protection of the bankrupt in seeking and obtaining a discharge. The automatic stay of Rule 401 extends to actions on claims nondischargeable under section 17a(2), (4), or (8), in recognition of the need to curb the abuse that led to the enactment of section 17c(2) of the Bankruptcy Act in 1970. That abuse is the procurement of judgments by creditors with a view to collecting their claims notwithstanding the discharge of the debtors in bankruptcy. Prior to the legislative reform such judgments were often obtained by default.\(^\text{109}\) When a bankrupt contested the creditor’s action by relying on his discharge or the dischargeability of the creditor’s claim, the creditor would invoke one of the exceptions to dischargeability, typically one involving charges of fraud, misappropriation, or conversion on the part of the bankrupt.\(^\text{110}\) When the bankrupt was vigorously represented, he might prevail in this litigation or at least obtain a settlement acceptable to him, but Congress became concerned that the typical bankrupt did not get the full benefit intended by the discharge sections of the Act. Moreover, the

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\(^{104}\) See notes 42-43 and accompanying text supra.

\(^{105}\) See notes 45-46 and accompanying text supra.

\(^{106}\) Courts have given § 11a a hospitable construction by presuming dischargeability. In re Nuttall, 201 F. 557, 559 (S.D.N.Y. 1912). Section 2a(15) has been a reservoir of injunctive power not subject to the limitations of § 11a, although this difference in scope has not always been kept clear in court opinions. See 1 COLLIER \(\|$\) 2.62 (1974). See also note 46 and the accompanying text supra.

\(^{107}\) The “suit” stayed by § 11a and the “action,” including “the enforcement of any judgment,” which is subject to the stay of Rule 401 are approximate equivalents. The term “action” is used in contradistinction to “suit” in the Federal Rules of Civil Procedure and the Rules of Bankruptcy Procedure. See 1A COLLIER \(\|$\) 11.03 (1974). It is easier to construe the language of Rule 401 than § 11a to reach a criminal proceeding instituted to collect a dischargeable debt, as the court did in In re Penny, 414 F. Supp. 1113 (W.D. N.C. 1976). Neither the word “suit” nor “action” has been held to reach contempt proceedings arising out of disobedience of an order made prior to the stay. See David v. Hooker, Ltd., 14 Collier Bankr. Cas. 303, 309 (9th Cir. 1977). Compare § 362(a) of H.R. 8200 and S. 2266, which subject “proceeding” and “process” to the statutory stay.

\(^{108}\) See notes 48-52 and accompanying text supra.


\(^{110}\) See Shuchman, supra note 109, at 741-42.
mere threat to bring such an action or the commencement of the action frequently enabled a creditor to obtain a postpetition reaffirmation of the bankrupt’s obligation, perhaps reduced by a partial payment, without any judicial determination of the nondischargeability of the debt.\textsuperscript{111} Congress dealt with the resulting frustration of the objective of the discharge provisions by requiring any creditor relying on certain grounds of nondischargeability\textsuperscript{112} to obtain a favorable determination with respect to those grounds by a proceeding commenced in the bankruptcy court during the pendency of the debtor’s case.\textsuperscript{113} Providing an automatic stay of all actions on claims that are nondischargeable only if creditors obtain timely determinations in their favor in the bankruptcy court clearly fulfills the congressional design. Judicial economy is served, and both debtor and creditors are benefited, by the certainty and celerity that the Act and the Rules have made possible in the settlement of the largest portion of disputes and litigation regarding dischargeability of debts.

The automatic stay of Rule 401 extends to actions on unscheduled claims, notwithstanding their potential nondischargeability, if the claims are provable.\textsuperscript{114} The reason for this treatment is the considerable likelihood that the claim will be scheduled or filed in time to permit the allowance of the claim and meaningful participation by the creditor in the case. If neither scheduling nor filing of the claim occurs within thirty days after the first date set for the first meeting of creditors, however, the assumptions underlying the stay are no longer warranted and it is deemed annulled. Any action commenced on such a claim, and any step taken in an action on such a claim, during the thirty-day period will be given retroactive validity or effect by the annulment of the stay without any necessity for the creditor to seek relief.\textsuperscript{115} The annulment of the stay is not, however, tantamount to a ruling that the unscheduled claim is not dischargeable. The debtor may nevertheless be able to show in a subsequent proceeding to determine dischargeability or in an action brought on the claim that the creditor had knowledge of the bankruptcy and could have filed his claim in good time. The debtor may indeed be able to obtain an injunction against commencement or continuation of an action on the

\textsuperscript{111} Shuchman, supra note 109, at 757-61.

\textsuperscript{112} Namely, those listed in § 17a(2) (liabilities for use of false pretenses, representations, or financial statement or for willful and malicious conversion of property), § 17a(4) (fraud or misappropriation in a fiduciary capacity), and § 17a(8) (liabilities for willful and malicious injuries). The reasons for the selective treatment of holders of certain nondischargeable claims are explained in Countryman, The Dischargeability Law, 45 AM. BANKR. L.J. 1,10-17 (1971).

\textsuperscript{113} § 17c(2), now supplemented by Rule 409(a)(2).

\textsuperscript{114} Such a claim is not dischargeable under § 17a(3) only if it is not scheduled in time for proof and allowance and if the creditor had no notice and no actual knowledge of the pendency of the bankruptcy case. If the scheduling or knowledge of the pendency of the case comes too late to enable the creditor to participate meaningfully in the administration of the estate, his claim is not discharged although he might have been able to file a proof of claim before the lapse of the filing period. Birkett v. Columbia Bank, 195 U.S. 345, 350 (1904); United States v. Hermetic Seal Prod. Co., 198 F. Supp. 749 (D. P.R. 1961).

\textsuperscript{115} But see In re Butcher, 1 Bankr. Ct. Dec. 913, 914 (Ref., N.D. Ohio 1975) (lien obtained by judgment after bankruptcy held to have been obtained in violation of Rule 401 although creditor was not scheduled until nearly two months after the first meeting of creditors).
unscheduled claim notwithstanding the annulment of the automatic stay.\textsuperscript{116}

Although the injunctive power of the court under section 17c(4) of the Act is without explicit limitation, Rule 401 does not stay actions on nondischargeable claims for taxes,\textsuperscript{117} wages, or commissions,\textsuperscript{118} refund of security deposits made by employees,\textsuperscript{119} alimony, maintenance, or support,\textsuperscript{120} and torts involving seduction or adultery.\textsuperscript{121} Claims listed in these exceptions involve special considerations that outweigh the bankrupt's interest in a prompt determination of dischargeability. The need of the tax collector, the employee, or salesman, and the alimony, support, or maintenance claimant for prompt payment of their nondischargeable claims is recognized as more exigent than the discharged bankrupt's need for freedom from harassment by claimants seeking unwarranted recoveries in these classifications. The bankrupt's need for an automatic stay against collection efforts by a claimant holding a judgment or settlement for seduction or criminal conversation seems insubstantial.

Notwithstanding the unavailability of an automatic stay to deter actions to collect nondischargeable claims within section 17a(1), (5), (6), and (7), a debtor may obtain an injunction against such an action from the bankruptcy court.\textsuperscript{122} The injunction may be obtained independently of and before the commencement of a proceeding to determine dischargeability, but presumably the court will not issue such an injunction unless there is a

\textsuperscript{116} For example, by showing that the claim was dischargeable even though unscheduled or scheduled belatedly. Such an injunction may be issued pursuant to § 17c(4) of the Act. For an early instance of an injunction against a creditor in such a case, see In re Beerman, 112 F. 662, 663 (N.D. Ga. 1901).

\textsuperscript{117} Nondischargeable taxes under § 17a(1) must generally have become due and payable within the three years preceding the filing of the petition under the Act, but a proviso adds five qualifications that render many taxes nondischargeable even though they became due and payable within the three-year period. See 1A COLLIER ¶ 17.14 (1971). For a case declaring Rule 401 applicable to stay the collection of dischargeable federal taxes, see Verran v. United States, 13 Collier Bankr. Cas. 288, 302 (Ref., E.D. Mich. 1977), vacated and remanded, 4 Bankr. Ct. Dec. 47 (E.D. Mich. 1978), without ruling on the applicability of Rule 401 to attempts to collect discharged taxes, the district court vacated the bankruptcy court's order insofar as it barred collection of taxes out of exempt property and property subject to a valid tax lien. The court acknowledged that the bankruptcy court had jurisdiction to enjoin the IRS under 90 Stat. 2721 (1976), 5 U.S.C.A. §§ 702-03 (1977). 4 Bankr. Ct. Dec. at 48.

\textsuperscript{118} Wages and commissions that are nondischargeable under § 17a(5) are also entitled to priority under § 64a(2). They must have been earned within the three months prior to the filing of the petition and are limited to $600 per claimant. See 1A COLLIER ¶ 17.25 (1973).

\textsuperscript{119} This ground of nondischargeability is infrequently invoked. See 1A COLLIER ¶ 17.25 (1973).

\textsuperscript{120} The dischargeability of liability for alimony, maintenance, or support is a frequently litigated question arising under § 17a, in part because of the difficulty of determining whether a property settlement falls within the scope of § 17a(7). See 1A COLLIER ¶¶ 17.18-19, 17.22A (1973).

\textsuperscript{121} Liability for "seduction of an unmarried female or for breach of promise of marriage accompanied by seduction, or for criminal conversation" is seldom invoked as a ground of nondischargeability. See 1A COLLIER ¶¶ 17.20-.22 (1973).

\textsuperscript{122} Pursuant to § 17c(4). Thus, even the federal tax collector may be enjoined from proceeding against a bankrupt or debtor in a chapter case. See, e.g., Bostwick v. United States, 521 F.2d 741 (8th Cir. 1975). For further discussion see note 161 and the accompanying text infra.
legitimate question as to whether the creditor's claim is dischargeable and there is a reasonable expectation that a determination of that question will be sought without delay. Because a judgment on a discharged claim is null and void under section 14f(1) of the Act and because a determination of dischargeability entered by the bankruptcy court is binding on a creditor duly served under Rule 409, state courts have appropriately exercised caution in allowing a creditor to enforce collection of a claim during the pendency of proceedings in the bankruptcy court.\(^{123}\)

There are limitations on the scope of the stay of Rule 401 other than those referable to the four exceptions from dischargeability in section 17a(1), (5), (6), and (7). Any action founded on a nonprovable debt is not subject to the stay.\(^{124}\) Whether an action is founded on a provable debt may be in doubt in a particular case even though the the bankrupt has scheduled the debt. Under section 57d the court may conclude that a claim, though duly filed on a proof of claim pursuant to Rule 302, is not capable of liquidation or reasonable estimation within the time reasonably available to the court.\(^{125}\) Such a claim is not allowable, provable, or dischargeable, and the logical implication is that any action on the claim is not subject to the automatic stay. Pending the bankruptcy court's disallowance pursuant to § 57d's proviso, however, the stay should be operative.\(^{126}\)

When a creditor sues on a debt secured by a pledge or obtains the appointment of a receiver in a mortgage foreclosure action prior to bankruptcy, Rule 401 is susceptible to a construction that makes the stay inoperative against such an action.\(^{127}\) A more rational interpretation,

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123 The Supreme Court of Georgia has considered a series of cases in which bankrupts have sought to defend against efforts to enforce compliance with divorce settlements by invoking the provisions of the Bankruptcy Act and the Rules dealing with discharge. Recognizing the power of the bankruptcy court to make a final binding determination and to apply a federal rather than a state standard, the state supreme court has remanded three cases to the trial court (one of them twice) with instructions to defer to any relevant determination by the bankruptcy court. Graves v. Graves, 239 S.E.2d 35 (Ga. 1977) (bankrupt held in contempt for failure to make payments on a house pursuant to a divorce settlement incorporated in a state court judgment; case remanded for consideration of whether the state court's action was subject to automatic stay); Hines v. Hines, 239 Ga. 689, 238 S.E.2d 331 (Ga. 1977) (reversing state court determination that a bankrupt's obligation to pay his former wife the value of an automobile pursuant to a separation agreement incorporated in a divorce decree was nondischargeable: "[t]he superior court should have stayed the present action pending culmination of bankruptcy proceedings"); Manuel v. Manuel, 237 Ga. 828, 229 S.E.2d 644 (1976) (case remanded to await determination by the bankruptcy court of the dischargeability of the bankrupt's obligation to make periodic payments to his former wife, maintain a life insurance policy, and pay wife's attorney's fees pursuant to a property settlement); cf. Robinson v. Mountjoy, 368 F. Supp. 1087 (W.D. Mo. 1973) (upholding a bankruptcy judge's order permitting a state court action against a discharged bankrupt to continue notwithstanding the pendency in the bankruptcy court of a proceeding to determine the dischargeability of the claims sued on in the state court).


126 See notes 234-36 and accompanying text infra.

127 Cf. Worley v. Budget Credit, Inc., BANKR. L. REP. (CCH) ¶ 64,285 (6th Cir. 1971), cert. denied, 406 U.S. 907 (1972), where the court appeared to take the view that if a debt is secured at all, it is to be treated as entirely secured for the purposes of Chapter XIII. See also Wolff v. Wells Fargo Bank (In re Moralez), 400 F. Supp. 1352 (N.D. Cal. 1975).
however, would make the stay effective only insofar as the creditor seeks a deficiency judgment on a provable debt, unless it is not dischargeable under section 17a(1), (5), (6), or (7). The purpose of the stay is as much served by its application to the action on the unsecured portion of the debt as to any other unsecured debt. The question seems, however, not to have been determined in any reported cases. In any event, it is clear that the court retains the power under both sections 11a and 2a(15) to enjoin the prosecution of the action to the extent it seeks a deficiency judgment.

Actions on three kinds of provable claims that are not dischargeable although not excepted in section 17a appear to be subject to the stay. These are actions on claims that are not dischargeable (1) because of the operation of res judicata, or (2) because they are claims for penalties, or (3) because they are obligations insured or guaranteed under federal educational loan legislation. The first category would be likely

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129 A bankrupt was held not protected by the automatic stay against a claim and delivery action instituted by a secured seller in Shaffer v. Anderson, 14 Collier Bankr. Cas. 327 (Ref., W.D. Mich. 1977), but the court relied on four grounds: (1) the stay did not operate against secured creditors; (2) insofar as the seller was unsecured, its claim was not scheduled within 30 days after the first meeting of creditors and its action was therefore not subject to the stay under Rule 401(c); (3) the bankrupt was barred from relief in the bankruptcy court against the seller because the bankrupt had incurred the debt sued on in violation of an order confirming a Chapter XIII plan and had not disclosed the transaction in the schedules filed in the superseding bankruptcy; and (4) he was guilty of laches in seeking relief.

130 Section 17b, enacted as part of the dischargeability legislation in 1970, clarified the operation of a denial or loss of discharge in one case as a bar to the discharge, in a subsequent case, of the debts that were dischargeable in the first case. See Countryman, The New Dischargeability Law, 41 AM. BANKR. L.J. 1, 50-53 (1971).

131 A claim based on a penalty or forfeiture may be provable, but, if asserted by the United States, a state, or a subdivision of either, it is not allowable beyond the amount represented by actual pecuniary loss to the governmental unit owning the claim. Bankruptcy Act § 57j; 3 COLLIER ¶ 57.22 (1974). The nondischargeability of liabilities for penalties rests on an uncertain foundation, since § 17a does not mention penalties. See 1A COLLIER ¶ 17.13 (1967). Some cases rest nondischargeability on nonprovability, but that is an unsatisfactory rationale. Compare United States v. Mighell, 273 F.2d 682, 685 (10th Cir. 1959) with Custom Wood Products, Inc. v. United States, 338 F. Supp. 337, 339-40 (W.D. Mich. 1971). To the extent that penalties can be assimilated or connected to nondischargeable taxes, their nondischargeability is more easily supported. See United States v. Sotelo, 98 S.Ct. 1795, 1800 (1978); Plumb, The Tax Recommendations of the Commission on the Bankruptcy Laws—Priority and Dischargeability of Tax Claims, 59 CORN. L. REV. 991, 1058 (1974); cf. Berger, Tax or Penalty? Dischargeable in Bankruptcy?, 83 COM. L.J. 79 (1978).


Sections 316 and 326 of H.R. 8200 repeal both of the provisions cited above. As originally introduced H.R. 8200 contained no exception for educational loan obligations in the section on discharge. When H.R. 8200 was passed by the House on February 1, 1978, however, § 523(a) was amended to include as an additional category of nondischargeable debts any obligation insured or guaranteed under the Higher Education Act of 1965 (20 U.S.C. § 1701 et seq.) if the obligation first became due within five years before, or after, the filing of the
to consist of stale claims provable in a prior bankruptcy case in which a discharge was not obtained. Collection of claims in the second category arguably but not incontrovertibly should be unimpeded by the stay when the penalties are imposed for delinquent nondischargeable taxes, but the arguments supporting nondischargeability for other kinds of penalties do not rest on any exigency requiring prompt collection. The third category of nondischargeable claims is a result of legislation enacted after Rule 401 was promulgated, but the condition precipitating the filing of the petition for relief by or against a defaulting educational loan obligor is likely to render early collection proceedings fruitless. Actions founded on these three classes of claims thus do not appear to present any of the considerations that warrant exemption from operation of the automatic stay.

Courts have generally given generous scope to Rule 401. Occasionally a court construes the rule not to apply when a sounder construction would recognize its applicability but terminate or modify its operation.

Some bankruptcy judges, however, have been overenthusiastic in their construction of this automatic stay rule. Thus, it has been held that the automatic stay of Rule 401 prohibits threats by a creditor to sue a discharged bankrupt. Although the stay does operate against carrying out threats to sue a debtor on a dischargeable debt, it reads too much into the rule to see in it a prohibition on extrajudicial efforts by a creditor to

petition. The amendment makes no reference to an obligation governed by the Public Health Service Act.

Section 523(a)(8) as set out in S. 2266 excepts from discharge "any educational debt" if the first installment became due less than five years before the filing of the petition. The term "educational debt" is not defined in the bill. Section 315 of S. 2266 repeals the provision for a five-year postponement of discharge in 20 U.S.C. § 1087-3, but the bill makes no reference to the like provision in 42 U.S.C. § 294f(g).

133 See 1A COLLIER ¶ 17.13 at 1610 n.10; Plumb, supra note 131, at 1058, n.423. It is not self-evident that the overriding need of the government for prompt and unimpeded collection of the revenue extends to the penalties incurred for delinquency.

134 But see further discussion of the implications of this legislation in the text accompanying notes 218-25 & 230-31 infra.

135 In re Richie's Villa Capri, Inc., 14 Collier Bankr. Cas. 144 (Ref., S.D.N.Y. 1977), is a case apparently contra to the position taken in the text but the result is entirely explicable. A Chapter XI debtor sought an order from the bankruptcy court staying a town from enforcing its municipal code by the imposition of criminal sanctions for building violations. The debtor curiously relied on Rule 401 rather than the more comprehensive provisions of Rule 11-44, and the court mistakenly relied on cases construing § 11a of the Act in stating that an action to collect a nondischargeable debt should not be stayed. Relying on the line of authority that treats liabilities for penalties as nondischargeable, the court held the stay imposed by Rule 401 inapplicable. This construction of Rule 401 is insupportable, and the opinion is even more vulnerable to criticism as an application of Rule 11-44. The case may be viewed, however, as one in which the court refused to grant injunctive relief sought by the debtor and incidentally, but properly, granted relief from the automatic stay. The procedure did not conform to the Rules of Bankruptcy Procedure governing adversary proceedings, but the debtor who initiated the proceeding was in no position to complain of that departure.

136 See, e.g., cases cited in notes 95, 115, & 117 supra. See also In re Mott, 1 Bankr. Ct. Dec. 1146 (Ref., D. Conn. 1975), where the stay was applied to invalidate a default judgment rendered in Puerto Rico after the debtor had filed a petition in the District of Columbia.

137 See, e.g., the cases cited supra note 135 and infra note 144.

collect a dischargeable debt, as a district court has explicitly held. Another court, purporting to follow constructions of section 11a, held the stay to operate against a wage assignment. Still another court appeared to think, quite erroneously, that Rules 401 and 601 together afforded a basis for restraining a municipality from refusing water service to a debtor who was delinquent in payment of prepetition water bills. An action seeking only injunctive relief is clearly beyond the reach of the stay of Rule 401. A ruling that stayed an administrative proceeding at which a bankrupt's liquor license was cancelled also disregards the limitation of the scope of Rule 401 to actions on provable debts.

It involves no strained construction to apply the stay to the prosecution of a counterclaim against the bankrupt in a pending action, although the courts have had difficulty in applying the governing rules and principles to counterclaims.

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140 In re Tisdale, 14 Collier Bankr. Cas. 87 (Ref., S.D.N.Y. 1977). In rationalizing application of Rule 401 to the wage assignment, the court referred to New York law, which was said to treat a wage assignment as the equivalent of a garnishment. Since the debtor was a petitioner in a Chapter XIII case, an entirely adequate basis for the ruling against the assignee is § 611 of the Act, vesting in the bankruptcy court exclusive jurisdiction of the debtor and his property, in particular the debtor's earnings, during the period of consummation of the plan.

141 See Shenberg v. Village of Carpentersville, 433 F. Supp. 677 (N.D. Ill. 1977), vacating a stay of the municipality's action in cutting off the debtor's water supply and remanding the case.

142 As the courts properly held in Civil Aeronautics Board v. Tour Travel Enterprises, 440 F. Supp. 1265 (N.D. Ill. 1977) (action to enjoin violations of Federal Aviation Act); Brennan v. T & T Trucking, Inc., 396 F. Supp. 615 (N.D. Okla. 1975) (action by Secretary of Labor to enjoin violations of Fair Labor Standards Act and to restrain nonpayment of overtime due employees).


144 In DiGiovanni v. All-Pro Golf, Inc., 332 So. 2d 91 (Fla. App. 1976), the automatic stay of Rule 401 was held inoperative against a counterclaim in a prepetition state court action brought by a bankrupt corporation and its president against its shareholder. The counterclaim was filed as a derivative action by the stockholder to obtain an accounting by the president.

The court in Rubin v. Virgin Islands Refinery Corp. (In re Co-Build. Companies, Inc.), 408 F. Supp. 717 (E.D. Pa. 1976), vacated a stay of proceeding on a counterclaim of a party to a contract with a Chapter XI debtor because the bankruptcy court had not determined that it had constructive possession of the debt sued on by the debtor. Neither § 11a nor § 314 required the bankruptcy court to have constructive possession of a claim against the debtor in order to enjoin its prosecution, and the effectiveness of the stay of Rule 401 or 11-44 should not depend on constructive possession of the claim sued on. See also note 163 and accompanying text infra.

For a case refusing to regard the stay as operative against the consideration of an appeal, see Mid-Jersey Nat'l Bank v. Fidelity-Mortgage Investors, 518 F.2d 640 (3d Cir. 1975), commented on in 44 FORD L. REV. 837 (1976) and discussed at note 165 infra.
B. The Stay of Lien Enforcement Under Rule 601

Rule 601 is directed against enforcement of liens on the property of the bankrupt. It operates against nonjudicial acts as well as the commencement or continuance of any court proceeding. "Lien" as used throughout this rule includes "a consensual security interest in personal or real property, a lien obtained by judicial proceedings, a statutory lien, or any other variety of charge against property securing an obligation." To be subject to the stay, however, enforcement must (1) be sought against property in the custody of the court or (2) be a step in the enforcement of a lien obtained by judicial proceedings within four months prior to the bankruptcy.

1. Liens Against Property in the Custody of the Court—As pointed out in the Advisory Committee's Note to Rule 601, Rule 601(a)(1) is a substantially restricted restatement of the much quoted and applied dictum of Mueller v. Nugent that "the petition is a caveat to all the world, and in effect an attachment and injunction." The stay is an implementation of the exclusive jurisdiction of the bankruptcy court over the property within its custody from the date of bankruptcy. Enforcement of liens against property in the custody of the court constitutes an interference with the custody of the court. The stay protects that custody and operates whether the lienor is proceeding in a nonbankruptcy court or by a nonjudicial mode of enforcement. It does not matter that the property...

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Footnotes:
145 Advisory Committee's Note to Rule 601(a). This usage is consistent with the Bankruptcy Act and proposed Title 11. See § 101(26), (27), and (36) of H.R. 8200, and § 101(27), (28), and (37) of S. 2266.
146 184 U.S. 1, 14 (1901).
147 Isaac v. Hobbs Tie & Timber Co., 282 U.S. 734, 737 (1931), held that a lienor cannot enforce his lien against a bankrupt's property in the custody of the bankruptcy court.
148 A judgment creditor's filing of a certificate of the judgment to make it a lien on the real property of the bankrupt during the pendency of the bankruptcy was held to violate Rule 601(a)(1) as well as Rule 401(a). In re Butcher, 1 Bankr. Ct. Dec. 913, 914 (Ref., N.D. Ohio 1975), cited in note 115 supra. Since the creditor's claim was not scheduled until more than 30 days after the first meeting of creditors, the stay of Rule 401 was annulled by its subdivision (c), but the creditor apparently admitted that his claim was dischargeable. While it is debatable whether the docketing of a judgment to make it a lien of public record constitutes an act or a proceeding to enforce a lien, an injunction against the enforcement of the lien was certainly issuable under § 17c(4). The automatic stay provided by § 362(a)(4) and (5) of proposed Title 11 as set out in H.R. 8200 and S. 2266 clearly applied to the creditor's act here.

Whether the docketing or recording of a judgment to make it effective as a lien is barred by the automatic stay of Fed. R. Civ. P. 62(a) has caused difficulty for litigants. The stay generally prohibits the issuance of an execution on a judgment or the taking of any proceedings to enforce it until the expiration of ten days after its entry. In Hamilton Steel Prods., Inc. v. Yorke, 376 F.2d 463 (7th Cir. 1967), the court rejected an argument by a judgment creditor that his failure to record his judgment was excused or prevented in any way by the operation of the automatic stay of Fed. R. Civ. P. 62(a). The trustee in bankruptcy of the judgment debtor was thus enabled to sell his property free of any judgment lien asserted by the judgment creditor. 376 F.2d at 466. The judgment creditor then sued his counsel for malpractice. Without qualifying its earlier ruling, the same court denied the creditor any recovery, ruling that even if the judgment had been recorded during the period of the stay, no valid lien would have been created by virtue of the lack of executability and finality of the judgment until the expiration of the period. Anastos v. M.J.D.M. Truck Rentals, Inc., 521 F.2d 1301, 1304 (7th Cir. 1975), cert. denied, 424 U.S. 928 (1976).
is located in a district distant from the bankruptcy court or that no injunction against enforcement of the lien has been entered.

Property is in *custodia legis* when the bankrupt has actual or constructive possession of it on the date of bankruptcy. Repossession by a secured creditor after the filing of the petition, without the consent of the court, is violative of the stay irrespective of the location of the property. Even the continuation of nonjudicial foreclosure procedures commenced prior to bankruptcy by exercise of a power of sale without the taking of possession from the bankrupt is subject to the stay. Judicial foreclosure proceedings commenced prior to bankruptcy typically result in custody of the foreclosing court when a receiver is put in charge of the property. The law is unclear, however, whether the property has passed into the custody of the foreclosing court when the bankrupt remains in actual physical possession on the date of bankruptcy.

2. Judicial Liens Obtained Within Four Months of Bankruptcy—The second branch of Rule 601 extends only to a lien obtained by judicial proceedings commenced by a creditor to collect an unsecured debt. The premise of Rule 601(a)(2) is that a lien of this kind obtained within four months of bankruptcy is likely to be voidable under section 67a of the

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149 See 1 *Collier* ¶ 2.62[1], at 329 (1974); 2 id., ¶ 23.05, at 469 (1974).

150 It has been suggested that in order for Rule 601 to be operative, "the bankruptcy court's custody must be superior to other courts." *Landers, The New Bankruptcy Rules: Relics of the Past as Fixtures of the Future*, 57 MINN. L. REV. 827, 862 (1973). The bankruptcy court's custody attaches to property in the debtor's possession, actual or constructive, from the time of the filing of the petition. *J. MacLachlan, Bankruptcy* § 194 (1956). If the property is then in another court's custody or in another person's possession, the automatic stay of Rule 601(a)(1) does not operate against the enforcement of any lien against the property. *Straton v. New*, 283 U.S. 318, 326 (1931), cited by Professor Landers, 57 MINN. L. REV. at 862 n.100, for the holding that the bankruptcy court may not enjoin a sale of property being administered in a state court proceeding to enforce a valid lien, illustrates a situation to which the stay of Rule 601(a)(1) does not apply because of the custody of another court. When the custody of another court was obtained for the purpose of enforcing a judicial lien, the filing of a bankruptcy petition within four months after the lien arose stays enforcement of the lien under Rule 601(a)(2) notwithstanding prior custody of the other court. See discussion in the text accompanying notes 152-57 infra. Although another court has superior custody in the sense that the bankruptcy court cannot, or at least will not, order the turnover of the property, the automatic stay prescribed for a debtor relief case is nonetheless operative.

151 A bankruptcy court recently ruled that when the sheriff left property in the actual physical possession of the debtor during the pendency of a mortgage foreclosure proceeding in a state court, the possession, in conjunction with certain questions raised by the trustee, sufficed "to maintain the 601 stay." *In re Stroderd*, 13 Collier Bankr. Cas. 598, 603 (Ref., W.D. La. 1977). The questions raised by the trustee involved the validity of the mortgage, the relative priority of competing lienors, the applicability of the mortgage with respect to some of the property originally seized by the sheriff, and the presence of a substantial equity.

152 Rule 601(a), like § 67a of the Act, refers to a lien obtained by "attachment, judgment, levy, or other legal or equitable process or proceedings." Such a lien is denominated a "judicial lien" by § 101(26) of H.R. 8200. A lien obtained by judicial proceedings in the enforcement of a pre-existing lien is not vulnerable under § 67a, unless perhaps the pre-existing lien itself is voidable. See *Kennedy, The Inchoate Lien in Bankruptcy: Some Reflections on Rialto Publishing Co. v. Bass*, 17 STAN. L. REV. 793, 800-01 (1965).
The stay preserves the status quo as of the date of bankruptcy until the trustee or the debtor can initiate appropriate proceedings to establish the invalidity of the lien by showing that the debtor was insolvent at the time the lien was obtained. The stay operates without regard to whether the property is in the possession of the bankrupt at the date of the filing of the petition, and often it will not be. Nor does it matter whether the property subject to the lien is exempt or nonexempt.

The rule does not affect either the substantive or the procedural law applicable in the proceeding to avoid the lien under section 67a. It may be argued that the existence of the stay prevents any postpetition purchaser of the property subject to the judicial lien from asserting that he is a bona fide purchaser protected by the proviso to section 67a(3). Whether a purchaser is so protected has depended primarily on whether he has knowledge of the vulnerability of the lien enforced by the sale at which he acquired his title. The fact that a postpetition sale violated the automatic stay should strengthen the position of the trustee or debtor in proceeding against the purchaser under section 67a, but the stay cannot deprive a bona fide purchaser of the title and protection given him by the statute.

C. The Stay of Proceedings Against the Debtor in Debtor Relief Cases

Unlike Bankruptcy Rule 401, the stay rules applicable in the debtor

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153 Although the trustee or debtor must establish the elements of voidability in an adversary proceeding against the judicial lien creditor, the burden is not heavy. The proceeding may be instituted in a bankruptcy court or in the court where the proceeding out of which the lien arose is pending. No proof of a mental element is required, except where the property is in the hands of a bona fide purchaser.

154 A judicial lien obtained within four months of bankruptcy is voidable by the trustee or the debtor under § 67a if either (1) the bankrupt was insolvent at the time of the filing of the petition or (2) the lien was obtained in fraud of the provisions of the Act. The provision for this second ground of attack, however, is for all practical purposes excess baggage. 4 COLLIER ¶ 67.06 (1967).

The stay does not, as has sometimes been supposed, terminate the jurisdiction of the nonbankruptcy court in which the lien enforcement proceedings are pending or necessarily result in their supersession. Cf. Landers, The New Bankruptcy Rules: Relics of the Past as Fixtures of the Future, 57 MINN. L. REV. 827, 863 (1973) ("The result of this provision will be to move all 67a summary proceedings into the bankruptcy court"). See notes 412-14 and accompanying text infra.

155 See, e.g., In re Ducich, 1 Bankr. Ct. Dec. 243 (C.D. Cal. 1974) (garnishment of bankrupt's employer). Under § 67a(4), the bankruptcy court clearly has summary jurisdiction to hear a challenge to the stay provided by Rule 601(a)(2), even though the property affected by the lien is adversely held by an officer of another court. See 4 COLLIER ¶ 67.18 (1967). Neither the automatic stay nor the summary jurisdiction of the bankruptcy court extends to the determination of issues respecting a lien obtained by judicial proceedings more than four months before bankruptcy and accompanied by possession in or on behalf of the lienor. 4 COLLIER ¶ 67.03[3], at 78 n.37 (1975). The stay nevertheless will beoperative if the property subject to the lien remains in the possession of the bankrupt on the date of bankruptcy, as it typically does when a judgment lien is obtained on real property. See Milliken-Tomlinson Co. v. Lessard, 1 Bankr. Ct. Dec. 484 (Ref., N.D. Me. 1975).

156 The lien is voidable by the debtor if it attaches to exempt property. 4 COLLIER ¶ 67.15[2] (1975).

157 See 4 COLLIER ¶ 67.17, at 188-190.1 n.6 (1975). The bona fide purchaser in possession would nevertheless be subject to summary jurisdiction of the court to determine the issues arising under § 67a.
relief chapters\textsuperscript{158} operate to bar all proceedings against the debtor, without regard to whether they are based on dischargeable claims\textsuperscript{159} or whether they are judicial proceedings. Like Rule 401 the automatic stay for a debtor relief case is not subject to any territorial limitation.\textsuperscript{160} The automatic stay in a debtor relief case has been held to be effective against a taxing authority, including the United States, when it attempts to proceed in or out of court to establish and collect tax claims.\textsuperscript{161} Cases are

\textsuperscript{158} Rules 8-501, 9-4, 10-601, 11-44, 12-43, and 13-401.

\textsuperscript{159} The proceeding may be based on a nonprovable claim. \textit{But see} Shenberg v. Village of Carpentersville, 433 F. Supp. 677, 678 (N.D. Ill. 1977), (indicating that the court could not stay an action on a nondischargeable debt); \textit{In re} Richie's Villa Capri, Inc., 14 Collier Bankr. Cas. 144 (Ref., S.D.N.Y. 1977) (automatic stay deemed inapplicable to action to enforce criminal penalty for violation of a municipal ordinance because penalty deemed nondischargeable).

The automatic stay rules for the chapter cases are susceptible to a construction that would preclude the filing of a complaint or a claim in the very court and case commenced by the petition that triggers the stay. If such a construction has been urged under the rules, it has apparently been disposed of without any consideration by the courts in a published ruling or opinion. Rules 8-501, 10-601, 11-44, 12-43, and 13-401 do prohibit the commencement or even the continuation of any other court proceeding to effect a rehabilitation of the debtor or a liquidation of the debtor's estate, except that a pending Chapter X case is expressly permitted to continue without being affected by the filing of a Chapter XI petition by the debtor. The chapter stay rules thus create the apparent anomaly that a petition filed under one of the rehabilitation chapters stays the filing of another petition under the Bankruptcy Act, but if a petition is nevertheless filed under a rehabilitation chapter, it stays the continuation of the previously commenced case (unless the first case is a Chapter X case and the second a Chapter XI case). A logical resolution may be found in regarding the second petition as a nullity because violative of the stay set in motion by the first petition. This resolution, however, makes pointless the exception made in rule 11-44(a) that permits the continuation of a pending Chapter X case but inferably not a case pending under any other chapter. Rules 116(c) and 117, moreover, are premised on the assumption that the filing of a second petition by or against the same debtor under the Act is not a nullity, and, accordingly, these Rules prescribe an orderly procedure for determining which case or cases shall be permitted to continue and where.


The amenability of the United States to the stay when it is proceeding to enforce nontax claims is subject to considerable doubt because of its sovereign immunity. \textit{See} United States v. Shaw, 309 U.S. 495 (1940) (denying jurisdiction to probate court to render affirmative judgment against United States on cross-claim arising out of government contract); McAvoy v. United States, 178 F.2d 353, 356 (2d Cir. 1949) (court reversed injunction entered by referee against intervention by United States in litigation on a government contract, since it is "axiomatic that the sovereign cannot be sued without its consent"). The waiver of
in conflict where the stay has been invoked against a state or local government proceeding to enforce its regulatory laws against a debtor.\footnote{162}

The bankruptcy court's power to restrain the commencement or continuation of an action against a debtor in a debtor relief case does not depend upon the court's possession of the chose in action that is the subject matter of the action. The jurisdictional grants and the injunctive powers granted the court in the debtor relief chapters provide an ample statutory base for the comprehensive stays of the Rules against actions and proceedings of every kind against the debtor.\footnote{163} As pointed out earlier,\footnote{164} the courts have recognized the necessity for such comprehensive stays to preserve the status quo while the debtor works out a plan of

sovereign immunity in respect to the collection of taxes rests considerably, but not exclusively, on § 2a(2A), which confers jurisdiction on the bankruptcy court to determine the amount of legality of any unpaid tax. \textit{See} Bostwick v. United States, 521 F.2d 741 (8th Cir. 1975); \textit{In re Durenisky}, 377 F. Supp. 798 (N.D. Tex. 1974), \textit{app. dismissed}, 519 F.2d 1024 (5th Cir. 1975). \textit{But cf.} Chrome Plate, Inc. v. District Director of Int. Rev., 442 F. Supp. 1023, 1025-26 (W.D. Tex. 1977) (upholding allowance of tax claim of United States but reversing affirmative judgment for Chapter XI debtor for an income tax refund, since the judgment was in excess of bankruptcy court's jurisdiction). For a case sustaining applicability of the automatic stay of § 148 to a governmental agency, \textit{see} United States v. Hollowell (\textit{In re Delta Food Processing Corp.}), 446 F.2d 437, 438 (5th Cir. 1971) ("unless this stay is applicable to every creditor, including governmental agencies, it will be of no effect"). The defense of sovereign immunity appears to be no longer available to the Government when only injunctive relief is sought, by virtue of the enactment of Public Law 94-574, 90 Stat. 2721 (1976), 5 U.S.C.A. §§ 702-703 (1977). This legislation does not, however, dispose of the potential conflict between the stay rules and 26 U.S.C. § 7421. \textit{See} H.R. REP. No. 94-1656, 94th Cong., 2d Sess., reprinted in [1976] U.S. CODE CONG. & AD. NEWS 6121, 6133.

\footnote{162} \textit{Compare} Colonial Tavern, Inc., v. Byrne, 420 F. Supp. 44 (D. Mass. 1976) (license revocation proceeding by a municipal authority held not subject to the stay of Rule 11-44) \textit{with} Hillsdale Foundry Co. v. Michigan, 1 Bankr. Ct. Dec. 195 (Ref., W.D. Mich. 1974) (action initiated in state court by Michigan Attorney General to enforce state's anti-pollution laws held subject to stay). The stay in the \textit{Hillsdale Foundry} case was later terminated by the district court after a hearing on an application by the debtor's counsel for an injunction against the state court judge, and issues regarding the stay thereafter became moot by virtue of the adjudication of the foundry as a bankrupt. The referee's ruling in the \textit{Hillsdale Foundry} case was criticized by the court in \textit{Colonial Tavern}, 420 F. Supp. at 45, and would be overruled by § 362(b)(4) and (5) of proposed Title 11, as set forth in H.R. 8200 and S. 2266. The \textit{Colonial Tavern} case is further discussed in the text accompanying note 172 infra. Rule 401 has been stretched in a questionable interpretation to operate as a stay of a municipal license revocation proceeding against a bankrupt in Katman v. New Jersey (\textit{In re C. Angelo Priest, Inc.}), 13 Collier Bankr. Cas. 524, 529 (Ref., D. N.J. 1977), cited in note 143 supra.

\footnote{163} \textit{Cf.} Rubin v. Virgin Islands Refinery Corp. (\textit{In re Co-Build Companies, Inc.}), 408 F. Supp. 717, 721 (E.D. Pa. 1976), where the court appeared to view the effectiveness of the stay prescribed by Rule 11-44 as dependent on constructive possession by the bankruptcy court of the adversary claim against the debtor. \textit{See also} note 144 supra.

It is asserted in Peitzman & Smith, supra note 3, at 1220 that "difficult jurisdictional questions arise which are important in determining ... the scope of the court's injunctive power." The article then reviews the conflict between the \textit{Collier} and \textit{Remington} treatises regarding the scope of summary jurisdiction in Chapter XI cases and concludes that "The Remington view—that actual or constructive possession is a prerequisite to summary jurisdiction in chapter cases, as well as in straight bankruptcies—seems the sounder position." \textit{Id.} at 1221. The conclusion as well as the statement quoted in the first sentence of this paragraph is gratuitous because the article ultimately acknowledges that "a bankruptcy court, as a court of equity, may enjoin the enforcement of remedies by a secured creditor whose substantive rights it could not reach by summary adjudication"—in Chapter XI cases as well as others. \textit{Id.} at 1222-23.

\footnote{164} \textit{See} note 41 and accompanying text supra.
reorganization or rehabilitation.

The stay in the rules for debtor relief cases appears broad enough to embrace counterclaims and the prosecution of appeals against the debtor, though the courts have encountered some difficulty in accepting so hospitable a construction of the rules.\textsuperscript{165} The chapter stay rules apply to actions against the debtor even though no money judgment is sought.\textsuperscript{166} Thus the stay operates against an action for a declaratory judgment on the liability of an insurer of the debtor.\textsuperscript{167} One of the most noteworthy applications of Rule 11-44 involved an action commenced, not by a creditor of the debtor, but by a rival lienor of property in which the debtor claimed a security interest.\textsuperscript{168} The purpose of the action was to establish the priority of the plaintiff's lien over the lien of the debtor.

The stay in most debtor relief cases operates against the commencement or continuation of "any court or other proceeding" against the debtor.\textsuperscript{169} The Advisory Committee's Note accompanying several of the Rules applicable in such cases explains that the reference to "other proceedings" "is to signify the inclusion of a pending arbitration proceeding within the scope of the automatic stay."\textsuperscript{170} Insofar as this sentence suggests that only arbitration proceedings and only those pending at the date of the filing of the petition are subject to the stay, it is unfortunate


In \textit{Mid-Jersey Nat'l Bank v. Fidelity-Mortgage Investors}, 518 F.2d 640 (3d Cir. 1975), favorably commented on in 44 \textit{Ford. L. Rev.} 837 (1976), the court held the automatic stay inapplicable to the prosecution of a cross-appeal from a money judgment entered against the debtor in a Chapter XI case. The court of appeals relied on the proposition that a deposit made by the debtor in lieu of a supersedeas bond was no longer property of the debtor. The conclusion regarding the interest of the debtor was not only questionable but an unsatisfactory basis for denying applicability of the stay to the prosecution of the cross-appeal.


A general stay of proceedings against a debtor entered pursuant to \textsection 314 of the Bankruptcy Act was held not to forbid compulsory production of documents by the officers of the debtor in an action against the debtor, its officers, and directors to recover damages for misrepresentation, breach of fiduciary duty, and conversion. Teledyne Industries, Inc. v. Eon Corp., 373 F. Supp. 191, 203 (S.D.N.Y. 1974). The court inappropriately regarded the purpose of the stay as restricted to the protection of the debtor's property. This limitation on the scope of the stay would probably be overruled by \textsection 362(a)(1) of proposed Title 11, as set forth in H.R. 8200 and S. 2266.

\textsuperscript{167} Power-Pak Products, Inc. v. Royal Globe Ins. Co., 433 F. Supp. 684 (W.D.N.Y. 1977). The court terminated the automatic stay, however, because it did not serve the "statutory purpose" to conserve the debtor's assets and aid in the estate's administration by the bankruptcy court. \textit{Id.} at 687.


\textsuperscript{169} The only stay rule applicable in debtor relief cases that does not extend to nonjudicial proceedings against the debtor is Rule 13-401.

\textsuperscript{170} The explanation appears in the Advisory Committee's Notes to Rules 10-601(a) and 12-43(a).
and reduces the scope indicated by the rule's literal language.\textsuperscript{171} One court has seized upon the Note statement in ruling that the stay does not affect pending proceedings before a municipal agency to revoke the license of a debtor.\textsuperscript{172} A number of rulings, however, support, the applicability of the automatic stay to administrative proceedings—federal, state, and local.\textsuperscript{173}

Rule 8-501 excepts from the scope of the automatic stay in Chapter VIII cases "the commencement or prosecution to judgment of any claim or action for damages caused by the operation of trains, buses, or other means of transportation." This carries into the rule the exception imposed by section 77(j) of the Act on the grant of authority to the bankruptcy court to enjoin suits.\textsuperscript{174} No comparable exception appears in any of the other automatic stay rules or in the grants of power to enjoin suits.

The impingement on these stay rules of section 959(a) of Title 28 of the United States Code should also be considered:

Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property.\textsuperscript{175}

Does the automatic stay operate in a debtor relief case against a proceeding brought to enforce a cause of action arising out of the operation of the debtor's business? The language of the automatic stay rules for the chapter cases may suggest an affirmative answer when an action or proceeding is commenced against the debtor, as distinguished from a trustee or receiver. Arguably, however, the stay does not operate with respect to a proceeding against a debtor in possession, who, like a trustee or receiver, is an entity separate from the debtor.\textsuperscript{176} Such a construction avoids conflict between the stay rules and the Judicial Code provision quoted above.\textsuperscript{177} While the result under the present stay rules of the

\textsuperscript{171} For a case applying a stay rule to arbitration proceedings, see Taylor v. Brodt, 396 N.Y.S. 2d 143 (Sup. Ct. 1977) (confirmation of arbitration award denied when Chapter XII petition was filed before arbitration hearing had been completed).


\textsuperscript{173} In re Zeitzer Food Corp., 9 Collier Bankr. Cas. 614 (Ref., E.D.N.Y. 1976) (administrative proceeding to revoke debtor's license to resell farm products); In re Airport Iron & Metal, Inc., 1 Bankr. Ct. Dec. 281 (Ref., S.D.N.Y. 1974) (proceeding before NLRB to determine whether debtor was successor entity). In sharp contrast to the court's ruling in the Colonial Tavern case, cited in note 172 supra, is Kalman v. New Jersey (In re C. Angelo Priest, Inc.), 13 Collier Bankr. Cas. 524, 529 (Ref., D.N.J. 1977), where a municipal board's proceeding resulting in cancellation of a bankrupt's liquor license was held to violate the stay of Rule 401.

\textsuperscript{174} For a discussion of this provision see 5 Collier \S 77.12 at 515-18 (1964).

\textsuperscript{175} For a discussion of this section see 7B J. Moore, Federal Practice JC-308 et seq. (2d ed., 1966).

\textsuperscript{176} 8 Collier \S\S 6.30-.32 (1974). Cf. J. MacLachlan, Bankruptcy \S 313, at 377 (1956) ("A debtor in possession is theoretically a trustee of his estate for his creditors").

\textsuperscript{177} This provision was unsuccessfully invoked against application of the automatic stay in Fidelity Mtge. Investors v. Camelia Builders, Inc., 550 F.2d 47, 56-57 (2d Cir. 1976), cert. denied, 429 U.S. 1093 (1977). The court held that the action against the Chapter XI debtor which was subject to the stay was brought to enhance a creditor's position in the reorganization of the debtor and did not arise out of the conduct of routine business operations after the Chapter XI petition was filed.
debtor relief chapters is debatable,\textsuperscript{178} the question would be settled under the proposed bankruptcy law pending in Congress: a proceeding to recover a claim against the debtor that arose before the filing of the petition is not subject to the automatic stay of the statute.\textsuperscript{179}

\textbf{D. The Stay of Acts and Proceedings to Enforce Liens Against the Property of the Debtor in Debtor Relief Cases}

The automatic stay rules applicable in chapter cases\textsuperscript{180} prohibit any act or the commencement or continuation of any court proceeding to enforce any lien against the debtor's property. Neither possession by the lienor nor custody in another court insulates the creditor against the stay. The property and the rights of lienors in the debtor's property that may be dealt with in the plan vary among the chapters.\textsuperscript{181} The language of the several chapter stay rules suggests, however, that the reach of the stay is not limited by the extent to which the lienor's rights in the property may be dealt with in the plan. The courts have accordingly sustained the stay against lienors whose rights cannot be altered by the plan without their consent.\textsuperscript{182} This construction of the chapter stay rules follows the course charted by many cases sustaining the entry and continuation of stays entered against lien foreclosures pursuant to the express grants of injunctive power in the debtor relief chapters.\textsuperscript{183}

The scope of the chapter stay rules has been influenced by the fact that the court is vested with exclusive jurisdiction of the debtor's property in

\textsuperscript{178} A proceeding ought not ordinarily be brought against a debtor in possession, or indeed a trustee or receiver, except in the bankruptcy court where the case is pending or with the permission of that court. The bankruptcy court may for cause, however, permit such litigation to be commenced or continued in another court. Cf. Thompson v. Magnolia Petroleum Co., 309 U.S. 478 (1940).

\textsuperscript{179} § 362(a)(1) & (b) of Title 11, as set out in H.R. 8200 and S. 2266.

\textsuperscript{180} Rules 8-501, 9-4, 10-601, 11-44, 12-43, and 13-401.


\textsuperscript{182} See, e.g., Akron Nat'l Bank & Trust Co. v. Freed & Co., 534 F. 2d 1235 (6th Cir. 1976) (automatic stay in Chapter XI case operative against foreclosure commenced in state court over four months before the filing of the petition); Beneficial Corp. v. Barker, 445 F. Supp. 101 (W.D. Mo. 1977).

\textsuperscript{183} See e.g., Chatman v. Daugherty, 527 F.2d 691 (6th Cir. 1975), (construing § 614); Hallenbeck v. Penn Mutual Life Ins. Co., 323 F.2d 566 (4th Cir. 1963) (construing § 614); Mongiello Bros. Coal Corp. v. Haughtaling Properties Inc., 390 F.2d 925, 928 (5th Cir. 1962) (construing §§ 113 and 148); Countryman, \textit{Real Estate Liens in Business Rehabilitation Cases}, 50 AM. BANKR. L.J. 303, 305-12 (1976). In the landmark case of Continental Ill. Nat'l Bank v. Chicago, Rock Island & Pac. Ry., 294 U.S. 648, 675-76 (1935), the Supreme Court relied on §§ 2 and 2a(15) of the Bankruptcy Act and 28 U.S.C. § 1651, the "all writs" statute, to empower the bankruptcy court to enjoin the sale of pledged collateral. The fact that § 77(j) of the Bankruptcy Act authorizes a stay only of the commencement or continuation of judicial proceedings to enforce a lien did not affect the Court's view of the injunctive powers of the bankruptcy court in railroad reorganization cases. The provisions relied on by the Court in \textit{Continental} are also available to the bankruptcy court in any case arising under the Bankruptcy Act.
each of the debtor relief chapters.\textsuperscript{184} Judicial construction of these jurisdictional grants has tended to minimize, if not to ignore, possible implications of statutory limitations on the scope of a permissible plan when the issue before the court is the permissible scope of an injunction against a lienor. The extent to which these jurisdictional grants and other provisions of the Act enable the bankruptcy court to enter orders and judgments affecting the debtor's property other than as incidental to the exercise of its power to enjoin is beyond the purview of this article.\textsuperscript{185}

The acts precluded by the stay of lien enforcement include the taking of possession of collateral and the notification of obligors on assigned accounts or rentals to remit payments to the secured creditor.\textsuperscript{186} Whether the stay forbids notice-filing or recordation is debatable, since arguably the principal purpose of such a step is not enforcement but perfection by giving effective notice to persons dealing with the debtor.\textsuperscript{187} Proposed Title 11 clarifies the application of the statutory stay to such acts.\textsuperscript{188} It does not, however, settle the troublesome question of the effect of the

\textsuperscript{184} See, e.g., Fidelity Mtge. Investors v. Camelia Builders, Inc., 550 F.2d 47, 53 (2d Cir. 1976), cert. denied, 429 U.S. 1093 (1977), where the interest of a Chapter XI debtor as the holder of a deed of trust on a condominium project and the underlying land was held to be property subject to the exclusive jurisdiction of the reorganization court under § 311 of the Act. The court said emphatically that "[e]xclusive jurisdiction means exclusive jurisdiction." \textit{id.} 550 F.2d at 53. The test of the court's sweeping statement would be posed by the filing of contemporaneous petitions by or against a mortgagor and a mortgagee of the same assets.

\textsuperscript{185} See, e.g., Sada Yoshinuma v. Oberdorfer Ins. Agency, 136 F.2d 460 (5th Cir. 1943), refusing to order turnover by a state court receiver in a Chapter XI case. See note 248 and accompanying text \textit{infra}.

In Caribbean Food Products, Inc. v. Banco Credito y Ahorro Ponceno, 575 F.2d 961 (1st Cir. 1978), the court ordered the turnover of proceeds of assigned accounts receivable collected by the secured creditor pursuant to instructions given to the debtor's customers after the filing of the petition. The bankruptcy court's power to require restoration of property improperly taken from the debtor, receiver, or trustee in bankruptcy after it has come into the custody of the court is well accepted. J. \textsc{MacLachlan}, \textsc{Bankruptcy} § 194, at 205-06 (1956). The court's turnover order may be viewed as an application of this principle.

\textsuperscript{186} Caribbean Food Prod., Inc. v. Banco Credito y Ahorro Ponceno, 575 F.2d 961 (1st Cir. 1978), abstracted in note 185 \textit{supra}.

\textsuperscript{187} Cf. \textit{In re} J.R. Nieves \& Co., 446 F.2d 188 (1st Cir. 1971). The proviso of § 67c(1)(B) allows a statutory lienor to perfect his lien against the trustee after bankruptcy if applicable lien law requires perfection of a statutory lien valid against a judicial lien creditor in order to make it valid against a subsequent bona fide purchaser. The court in the \textit{Nieves} case held that while sequestration of goods subject to a vendor's privilege under Puerto Rican law would be effective against a subsequent bona fide purchaser, such a sequestration would be an act of enforcement, not perfection, and thus the vendor's privilege could not be perfected after bankruptcy against the trustee.

\textsuperscript{188} Security Nat'l Bank v. Cotton (\textit{In re} Atlanta International Raceway, Inc.), 513 F.2d 546, 549 (5th Cir. 1975), presented the question whether transmission of a letter to a Chapter X debtor demanding payment of a note within ten days entitled the holder of the note to payment of attorney's fees when payment was not made within the ten-day period. Such notification of the debtor was a condition to the enforceability of a lien for attorney's fees under a Georgia statute, \textsc{Ga. Code Ann.}, § 20-506 (1977), but the court held that the notice was ineffective because it constituted an "act or proceeding to enforce a lien upon the property of the debtor" prohibited by § 148 of the \textsc{Bankruptcy Act}. \textit{id.} at 549. The rationale of the case is equally applicable to Rule 10-601.
automatic stay on prepetition arrangements between the debtor, secured creditors, and third-party obligors of the debtor by which payments are transmitted directly to the creditor or to an escrow holder. While the stay presumably does not revoke the arrangement or require the creditor to work out new arrangements with the obligors, the rights and duties of the secured creditor with respect to postpetition receipts are left at large. The situation calls for circumspection on the part of the secured creditor pending a determination by the court as to the proper application of these moneys.

In a quite unsatisfactory opinion the Court of Appeals for the Third Circuit declined to stay an appeal and cross-appeal from a judgment rendered against a Chapter XI debtor, on the ground that a deposit made by the debtor in lieu of a supersedeas bond was, "in the context of this case," not the property of the debtor. The court did acknowledge that the deposit was held by the court in trust and that the debtor had "a contingent reversionary interest as a potential beneficiary of the trust." The interest of the debtor in the deposit was not substantially different from that of any debtor in property pledged to a secured creditor. The fact that the Chapter XI petition was filed on the eve of the argument of the appeals and that there was some question as to whether the deposit was sufficient to protect the cross-appellant may have contributed to what appears to have been an unduly strict reading of the rule.

Troublesome questions are presented by cases involving partners and partnerships. It has been held that the filing of a petition by or against a partner does not authorize the bankruptcy court to stay proceedings against the partnership or to enforce liens against partnership property. Although that ruling is consistent with traditional legal principles, the Court of Appeals for the Third Circuit has more recently sustained an injunction issued by a court in which a Chapter X petition was pending to enjoin the continuation of a bankruptcy case commenced by two of the general members of a partnership of which the Chapter X debtor was a member. Although the court of appeals acknowledged that the Chapter X debtor arguably did not have title to the partnership assets, the debtor's interest in the partnership business was property within the exclusive jurisdiction of the reorganization court under section 111 of the Bankruptcy Act. That section, together with section 5d, long considered only a venue provision of the partnership section, enabled the court to order the transfer of the partnership bankruptcy case to the court in which the reorganization was pending. The decision antedated the promulgation

191 Id. at 644.
192 Benitez v. Bank of Nova Scotia, 110 F.2d 169, 173 (1st Cir. 1940) (involving petition filed by a member of a Puerto Rican Comunidad).
193 In re Imperial "400" National, Inc., 429 F.2d 671 (3d. Cir. 1970).
194 Id. at 678.
of the automatic stay rules, but it is doubtful that most courts regard the automatic stay triggered by a petition by or against a partner to be operative against proceedings by partnership creditors against the partnership. On the other hand, if a creditor of the partner seeks enforcement of a judgment or lien against the partner's interest in the partnership, there is no reason why the automatic stay should not apply.

Still more problematic is the question whether the filing of a petition by or against a partnership operates as a stay against acts and proceedings to enforce liens against the property of the partners. It is an oversimplification to say that the Bankruptcy Act adopts an "entity theory" of partnerships and therefore regards only the property owned, legally or beneficially, for partnership purposes as belonging to the estate of a partnership debtor. The surplus of each general partner's property remaining after payment of his individual debts must be added to the partnership assets. There is substantial case authority for requiring partners of a bankrupt partnership to file schedules of their assets and liabilities and to turn over an amount of their separate property equivalent to the surplus that belongs to the partnership trustee. Bankruptcy Judge Norton recently found the automatic stay in a Chapter XII case inoperative as to the separate property of the general members of the partnership debtor but issued an injunction to restrain a secured creditor of the partnership from proceeding to collect its claim from individual assets of a general partner. It is submitted that the automatic stay resulting from the filing of a petition by or against a partnership should operate to stay the enforcement of any judgment or lien against separate property of the general partners, pending a determination by the bankruptcy court that the enforcement does not affect the surplus belonging to the partnership estate.

Another troublesome question is whether the automatic stay rules for cases under Chapters X, XI, XII, and XIII preclude a setoff by a creditor.
against an obligation owing by the creditor to the debtor.\textsuperscript{203} Although a bank’s right of setoff is sometimes described as a lien or type of security interest,\textsuperscript{204} the better view is generally opposed to this categorization of the right of setoff.\textsuperscript{205} The fact that the automatic stay rules applicable in Chapter VIII and IX cases\textsuperscript{206} explicitly operate against setoff is persuasive evidence that the other stay rules are not intended to affect the right. The automatic stay provided by section 362 of proposed Title 11 applies explicitly to setoff.\textsuperscript{207}

Provisions in Chapters X and XII that specially protect particular classes of secured creditors raise questions concerning the applicability of Rules 10-601 and 12-43 to acts and proceedings to foreclose these protected security interests. Sections 263 and 517 provide that nothing in Chapters X and XII shall affect or apply to creditors secured by mortgages insured under the National Housing Act.\textsuperscript{208} The courts have regarded these sections as meaning exactly what they say.\textsuperscript{209} If either Rule 10-601 or 12-43 should be deemed to apply because of the absence of any exception for such a creditor, the court should grant prompt relief on request by the creditor. On the other hand, a provision in section 517 that precludes an application of Chapter XII “to allow extension or impair-

\textsuperscript{203} Rule 11-44 has been held to apply to a setoff. Preferred Surfacing, Inc. v. Gwinnett Bank & Trust Co., 400 F. Supp. 280 (N.D. Ga. 1975); Ben Hyman & Co. v. Fulton Nat’l Bank, 8 Collier Bankr. Cas. 145, 156-57 (Ref., N.D. Ga. 1976), rev’d, 423 F. Supp. 1006 (N.D. Ga. 1976). Without determining the correctness of the ruling on the applicability of Rule 11-44 to setoff, the court based its reversal in the latter case on three considerations: (1) the bankruptcy judge had exceeded his power in ordering turnover of balances in the debtor’s bank account without providing any protection of the creditor’s security; (2) the Chapter XI case had in the meantime been converted into a straight bankruptcy case where the right to setoff is generally available; and (3) the court’s order punishing the bank creditor for contempt was imposed without fair warning to the bank in view of the uncertainty in the law concerning setoff in Chapter XI cases. 423 F. Supp. at 1010-11.

The applicability of the automatic stay of Rule 13-401 to setoff by a bank in a Chapter XIII case was denied in In re Williams, 422 F. Supp. 342 (N.D. Ga. 1976), but a court order postponing setoff was nevertheless held to be valid and an adjudication of contempt based on disregard of the order was sustained.

\textsuperscript{204} See cases cited in note 203 supra; Batson v. Alexander City Bank, 179 Ala. 490, 497, 60 So. 313, 315 (1912); McStay Supply Co. v. Stoddard, 35 Nev. 284, 297, 132 P. 545, 548 (1913); cf. United States v. Munsey Trust Co., 332 U.S. 234, 240 (1947) (referring to the United States as “the best secured of creditors” because of its right of setoff against a government contractor).


\textsuperscript{206} See Rules 8-501(a) and 9-4(a). The Advisory Committee’s Note to Rule 8-501 explains that setoff is made subject to the stay of the rule “[i]n light of the holding in Baker v. Gold Seal Liquors, Inc., 417 U.S. 467 (1974), that ‘as a general rule of administration for § 77 Reorganization Courts, the setoff should not be allowed.’ 417 U.S. at 474.” The trustee’s ultimate right to payment of the outstanding obligation to the debtor is, of course, a matter of substantive law not governed or affected by the rule.

\textsuperscript{207} § 362(a)(7) of proposed Title 11, as set forth in H.R. 8200 and S. 2266. Section 362(b)(6) of S. 2266, however, excludes from the stay a setoff in connection with certain commodity futures transactions.

\textsuperscript{208} These provisions are discussed in 6A COLLIER ¶ 15.04 (1977) and 9 id. ¶ 14.02 (1976).

ment of any secured obligation" held by the Home Owners Loan Corporation or a Federal Home Loan Bank has been held not to prohibit a temporary stay at the commencement of a Chapter XII case against foreclosure by a member of the Federal Home Loan Bank.\textsuperscript{210} Such a court-ordered stay was held to be neither an extension nor an impairment of a secured obligation within the prohibition of section 517,\textsuperscript{211} and the rationale fully sustains the applicability of the automatic stay to such a foreclosure.

Section 77(j) and section 116(5) and (6), using language similar to the first clause of sections 263 and 517, protect the interests of financers of rolling stock equipment sold or leased to a debtor in a section 77 case, aircraft and aircraft parts sold or leased to air carriers certified by the Civil Aeronautics Board, and vessels acquired by water carriers certified by the Interstate Commerce Commission.\textsuperscript{212} These provisions specify that the "title of any owner, whether as trustee or otherwise," to the categories of property referred to, and the right to take possession pursuant to a security agreement or lease, cannot be affected by the provisions of section 77 and Chapter X. Rule 8-501(a) explicitly excepts from the automatic stay in Chapter VIII cases the taking of possession of rolling stock equipment by an "owner, as trustee, lessor, or otherwise." No comparable exception is provided in Rule 10-601(a). While the rule apparently applies notwithstanding the categorical prohibitions of the protective provisions of the Act, appropriate deference to the congressional policy decisions involved requires expeditious and forthright grant of relief to any protected beneficiaries.

IV. THE DURATION OF THE STAY

Although there is considerable parallelism in the provisions of the several rules governing the duration of a stay, there are some noteworthy differences.

A. General Limitations

Subdivision (c) of each of the stay rules, except Rules 601 and 10-601, annuls the stay as against any unscheduled creditor who has not filed a claim within thirty days after the first date set for the first meeting of creditors.\textsuperscript{213} Every rule recognizes that the court may terminate the stay in proceedings seeking relief pursuant to one of the subdivisions of the


\textsuperscript{211} In re Hall Associates, supra note 210, at 292.

\textsuperscript{212} For a discussion of § 77(j) see 5 COLLIER § 77.12, at 518-19 (1964). For a discussion of § 116(5) and (6), see 6 COLLIER ¶¶ 3.34A-34B (1977).

\textsuperscript{213} See discussion in text accompanying notes 114-116 supra.
rule, and every rule terminates the stay on dismissal of the case.\textsuperscript{214} Only Rule 401 does not likewise terminate the stay when the case is closed, thereby causing an unanticipated problem.\textsuperscript{215} When a chapter case is converted to bankruptcy, the broad stay prescribed by the chapter rule is terminated, and the question whether the automatic stays prescribed by Rules 401 and 601 then take effect must also be considered.\textsuperscript{216} All the rules that operate against enforcement of liens on property—that is, all but Rule 401—terminate the stay when the property subject to the lien is abandoned or transferred with the approval of the court, and Rule 601 also terminates a stay against lien enforcement when the property subject to the lien is set apart as exempt.\textsuperscript{217} Finally, the automatic stay provided by Rule 401 terminates automatically if the bankrupt is denied his discharge or otherwise loses his right to a discharge.

\textbf{B. Effect on Collection of Educational Loans}

Since September 30, 1977, an individual indebted on an educational loan insured or guaranteed under federal legislation is subject to a limitation when he seeks a discharge of the obligation under the Bankruptcy Act.\textsuperscript{218} The obligation is not dischargeable until at least five years have intervened between the date repayment of the first installment is due and the grant of the discharge.\textsuperscript{219} The dual purpose evident here is to give the

\begin{footnotesize}
\begin{enumerate}
\item The closing of a Chapter XI case effected by a final decree was held to terminate an injunction entered pursuant to § 314 of the Act against holders of nondischargeable claims. In re Lieb Bros., Inc., 198 F. Supp. 229, 232 (D. N.J. 1961).
\item See Part IV B infra.
\item See Part IV C infra.
\item Since exemptions are not ordinarily set apart in chapter cases, a provision for termination of the stay in such cases was not deemed necessary. Moreover, the need of the debtor for continuing use of exempt property during the pendency of the case—\textit{i.e.}, the continuing occupancy of his homestead during the term of a Chapter XIII plan—seems a sufficient warrant for extending the stay to exempt property until one of the other terminating events occurs.
\item See statutes cited in note 132 supra.
\item This provision is similar to one originally proposed by the Commission on Bankruptcy Laws. H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. § 4-506(a)(8) (1973). Under the Commission proposal, five years must intervene between the due date of the first installment and the filing of the petition in the case, whereas the legislation enacted in 1976 indicates that the discharge can be granted whenever the five-year period has elapsed. Query, whether a bankruptcy case in which the debtor could not obtain a discharge from the educational loan obligation because of the five-year bar can be reopened after the lapse of the five-year period to obtain a determination that the debt is now dischargeable? Rule 409(a)(1) and section 17c(6) authorize the reopening of a case for the purpose of obtaining a determination of dischargeability and excuse the applicant from the payment of any filing fee. The Commission's proposal authorized the granting of a discharge within the five-year period if payment would impose an undue hardship on the debtor and his dependents. The hardship provision is incorporated in 90 Stat. 2141 (1976), supra note 132, but not in 90 Stat. 2262 (1976), supra note 132.
Somewhat differing versions of section 523(a)(8) of Title 11, as set out in H.R. 8200 and S. 2266, both postpone dischargeability of an educational loan obligation unless at least five years have intervened between the maturing of the first installment and the filing of the petition commencing the debtor's case, and both contain provisions, again diverging in form and content, to permit dischargeability of such an obligation if hardship would otherwise result.
\end{enumerate}
\end{footnotesize}
debtor a five-year interval within which to pay, or to work out a plan to pay, the matured obligation, and the creditor a like interval within which to resort to collection procedures if necessary to stimulate or enforce payment.\footnote{220}{See H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. 140 (1973) (§ 4-506(a)(8) n.16 of the Bankruptcy Act of 1973 proposed by the Commission on Bankruptcy Laws of the United States).} Unless perhaps the claim is being sued on by the federal government,\footnote{221}{See note 161 and accompanying text supra.} the automatic stay of Rule 401 and any applicable chapter stay rule operate against the commencement or continuation of any action to collect the nondischargeable obligation.\footnote{222}{The automatic stay of Rule 401 operates against the commencement or continuation of any action, or the enforcement of any judgment, founded on an unsecured provable debt unless it is excepted from discharge under § 17a(1), (5), (6), or (7).}

Subdivision (b) of Rule 401, prescribing the duration of the stay, does not provide for its termination on the closing of the case because at the time of its promulgation there was no need for such a provision.\footnote{223}{When Rule 401(a) was promulgated in 1973, every contingency was provided for. With respect to dischargeable debts, the stay does not continue under subdivision (b) after the bankrupt is denied a discharge, waives it, or otherwise loses it. If the discharge is granted, the order of discharge is a statutory injunction against any action or use of process to collect dischargeable debts; the statutory stay thus overlaps and may be deemed to supersede the stay of Rule 401 with respect to such debts. With respect to nonprovable debts, secured debts, and debts not dischargeable under § 17a(1), (5), (6), or (7), the stay of Rule 401 never becomes operative. With respect to debts not dischargeable under § 17a(4), the stay becomes inoperative after the lapse of 30 days after the first date set for the first meeting of creditors except with respect to claims scheduled or filed before the end of the 30 day period. The automatic stay terminates with respect to such scheduled or filed claims as if they had been promptly scheduled. With respect to a debt not dischargeable under § 17a(2), (3), or (8), a creditor must obtain a determination of dischargeability and an appropriate order necessary for the enforcement of the debt pursuant to Rule 408. An exception to the foregoing statement applies to a creditor who relies on § 17a(8) and who has demanded or intends to demand a jury trial of the action on his claim in a nonbankruptcy court, but such a creditor must obtain relief from the automatic stay to continue his action in a nonbankruptcy court. If a bankruptcy case is dismissed without any grant or denial, waiver, or loss of the right to discharge, the automatic stay does not continue as to any creditor under Rule 401(b).} It would be a stultifying construction of the Act and the Rules, however, that would stay automatically any action or enforcement of a judgment on an educational loan excepted from discharge after the close of the bankruptcy case. The purpose of the stay to protect the opportunity of the debtor to assert his rights during the pendency of the bankruptcy case would have been served, and the creditor should be unimpeded by any stay in seeking the collection of the debt excepted from discharge. Since extension of the automatic stay of Rule 401 beyond the closing is incompatible with the congressional policy embodied in the 1976 legislation regarding the dischargeability of certain loan obligations, the courts should treat the stay as terminated with respect to such loan obligations as are not discharged when the case is closed. The suggested approach makes it unnecessary to construe the word "discharged" in Rule 401(b) to mean "closed" in order to reach a sensible result. Although dismissal under the Act frequently includes the closing of a case after complete administration,\footnote{224}{See, e.g., §§ 261, 367(4), 391, 516, and 676. See note 242 infra.} the term as used in the Rules refers only to termination
prior to complete administration. Circumspect counsel for the collector should seek relief from the stay before suing the discharged obligor, although it is inconceivable that in any clear case of nondischargeability the collector would be subject to any sanction for proceeding after the case is closed. Disregard of the stay after the closing of the case should at least be excusable if the collector faced imminent lapse of the period of limitations and obtaining relief from the stay was either not thought to be required or would have resulted in prejudicial delay or other difficulties.

C. Effect of Conversion of a Case from One Chapter to Another

All the chapter stay rules terminate the stay when a chapter case is converted to bankruptcy, and the assumption is commonly made that the stays provided by Rules 401 and 601 become automatically and immediately effective. The result is ordinarily a restriction on the reach of the automatic stays theretofore in effect with respect to both in personam actions and lien enforcement, but it is assumed that there is no interlude between the operation of the stays against most in personam actions and against enforcement of liens on property in the custody of the court or liens vulnerable under section 67a of the Act. The conclusion that the automatic stays do become effective on the conversion of a chapter case to bankruptcy is, however, far from clear.

The automatic stays provided by Rules 401 and 601 arise only upon the filing of a petition, and conversion of a chapter case to bankruptcy is not conditional upon the filing of a petition. Statutory provisions like sections

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See Rules 120 (Dismissal Without Determination of the Merits), 514 (Closing Cases), 10-117 (Conversion to Chapter XI), 10-308 (Dismissal or Conversion to Bankruptcy or Chapter XI After Approval of the Petition), 11-42 (Dismissal or Conversion to Bankruptcy Prior to or After Confirmation of Plan), 12-41 (Dismissal or Conversion to Bankruptcy Prior to or After Confirmation of Plan), 13-112 (Dismissal or Conversion to Bankruptcy Without Confirmation of Plan), and 13-215 (Dismissal or Conversion to Bankruptcy After Confirmation of Plan).

See, e.g., In re Stroderd, 13 Collier Bankr. Cas. 598, 602 (Ref., W.D. La. 1977); cf. Shaffer v. Anderson, 14 Collier Bankr. Cas. 327, 333 (Ref., W.D. Mich. 1977), where the stay of Rule 401, assumed to be operative in a bankruptcy superseding a Chapter XIII case, did not affect a claim and delivery action against the bankrupt because the plaintiff creditor was secured and its claim was not scheduled until almost three months after the first meeting of creditors.

Whereas the stay prescribed for a debtor relief case extends to actions and enforcement of judgments on nondischargeable as well as dischargeable claims and, except under Rule 13-401, to nonjudicial as well as judicial proceedings, Rule 401 limits the operation of the automatic stay in straight bankruptcy cases to actions and enforcement of judgments on unsecured provable debts and further excepts from the stay actions on debts that are not dischargeable under § 17a(1), (5), (6), or (7) of the Act. Other differences in the scope of the stay for different kinds of cases are summarized in the text accompanying notes 8-11 supra. They are further elaborated in Part III of this article.

Whereas the automatic stay prescribed for a debtor relief case extends to the enforcement of a lien against the property of the debtor, without regard to who has possession or custody of the property and without regard to the nature of the lien, Rule 601 limits the operation of the automatic stay to (1) property in the custody of the bankruptcy court or (2) property subject to judicial liens obtained within four months of bankruptcy. These differences are further elaborated in Part III of this article.
378, 483, and 667, which require a converted case to be conducted as if a petition for adjudication had been filed, do not compel the conclusion that rules making the filing of a petition operative as an automatic stay have such an effect in a converted case. Rule 122, which governs the procedure in bankruptcy cases converted from chapter cases, does not appear to require automatic applicability of Rules 401 and 601 on conversion. A construction making these rules immediately effective on conversion raises questions about the effect in the converted case of a ruling that had terminated, modified, or conditioned the automatic stay during the pendency of the chapter case.\(^{229}\) Ordinarily, of course, if relief was granted against a stay in a chapter case, the considerations that led to the court's order would be even more cogent in the subsequent bankruptcy. When an order of adjudication of bankruptcy is entered in a converted case, however, it behooves the court to particularize the scope of the stays intended thereafter to be in effect, particularly when any order granting relief has been entered in the superseded case.

A similar problem arises and a similar approach seems appropriate when a case commenced under one chapter is converted to a case under another chapter without the filing of a petition under the second chapter. On the other hand, when a second petition is filed under a different chapter, as expressly authorized by Rules 11-3, 12-3, and 13-104, there is ordinarily no reason why the usual effect should not be given to the filing of each petition. Where relief from the stay has been granted in the first case, however, the court should be alert to prevent the abuse of its processes through the filing of successive petitions with the purpose of frustrating the relief previously granted.

**D. Effect of the Stay on Statutes of Limitation**

A critical question likely to arise in connection with an action on an insured or guaranteed educational loan obligation and, to a lesser extent, with any nondischargeable debt, is what effect the stay has on the running of the statute of limitations. Section 11f of the Act suspends the statute of limitations affecting the provable debts of a bankrupt from the date of the filing of the petition until thirty days after denial or loss of his right to discharge or after the dismissal of the case. Unless dismissal as used in section 11f is construed to include the closing of a case,\(^{230}\) the statute of limitations arguably is suspended indefinitely when a discharge is granted and the case is closed after full administration. A counter argument, avoiding such an incongruous result, is that since the Act does not bar the enforcement of a nondischargeable debt, the statute of limitations is not suspended at all during the pendency of a bankruptcy case with respect to

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\(^{229}\) Robert Greenfield, Esq., of the Los Angeles bar has reported to me a ruling by a bankruptcy judge that the conversion of a chapter case to a bankruptcy case resulted in the imposition of full-fledged stays under Rules 401 and 601, although relief had been granted against a stay of a mortgage foreclosure in the superseded chapter case. Letter from Robert Greenfield (Nov. 22, 1977).

\(^{230}\) See notes 224 *supra* and 242 *infra*. 
such a debt. That argument would at least have been persuasive prior to the promulgation of Rule 401. Since that rule went into effect, actions on four categories of debts—i.e., those excepted from discharge by subsections 17a(2), (3), (4), and (8)—are apparently stayed indefinitely when the debtor gets a discharge and the case is closed rather than dismissed.

The problems respecting creditors with claims falling within these four clauses turn out, however, to be of a quite limited character. A creditor with a claim nondischargeable under section 17a(2), (4), or (8) must ordinarily commence a proceeding in the bankruptcy court to obtain a determination of nondischargeability and a judgment on his claim within a limited time fixed by the court, which cannot be more than ninety days after the first date set for the first meeting of creditors. Although the allowability in bankruptcy of provable claims is not affected by the interposition of the bar of the statute of limitations after the filing of the petition, that proposition does not necessarily entitle the creditor to file a complaint seeking a judgment on a claim that is nondischargeable. If the petition by or against the bankrupt is filed on the eve of the expiration of the statute of limitations for bringing an action on the creditor's nondischargeable claim, the time may run out before the creditor files a complaint. Since the stay should not be construed as a bar to the filing of a complaint in the bankruptcy court, however, it does not create any problem for creditors required to file timely complaints to preserve their rights under section 17a(2), (4), and (8). Ordinarily there is thus no sound reason for suspending the statute of limitations for bringing an action on the creditor's nondischargeable claim, the time may run out before the creditor files a complaint. Since the stay should not be construed as a bar to the filing of a complaint in the bankruptcy court, however, it does not create any problem for creditors required to file timely complaints to preserve their rights under section 17a(2), (4), and (8). Ordinarily there is thus no sound reason for suspending the statute of limitations on the filing of a complaint or the enforcement of a judgment on a claim nondischargeable under section 17a(2), (4), or (8). The same conclusion applies a fortiori to action on a claim not dischargeable under section 17a(1), (5), (6), or (7), since the automatic stay of Rule 401 does not operate against such an action.

When the claim of the plaintiff is for willful and malicious injuries to the person or property of the bankrupt other than conversion, the stay does not operate against the commencement of any postpetition action, since the claim is not provable. For the same reason, the pendency of a bankruptcy petition by or against the tortfeasor does not suspend the statute of limitations. The same observation pertains to any other non-

231 See 59 Harv. L. Rev. 1157 (1946); 31 Minn. L. Rev. 91 (1946). Cf. J. MacLachlan, Bankruptcy 90 (1956): "Where claims are not subject to stay, it would seem that there should be no effect upon statutes of limitation, but there is no such express restriction upon the suspension provision."

In Maier v. Meyers, 314 Mich. 471, 22 N.W. 2d 869 (1946), however, the court held the suspension of limitations to have been suspended during bankruptcy in respect to a claim excepted from discharge by § 17a(2). The case was criticized in the two law review comments cited supra. "A necessary corollary of the court's construction of § 11(1) of the suspensions acts was reading into that section a fourth provision for terminating the period of suspension, i.e., the grant of a discharge." 59 Harv. L. Rev. at 1158.

232 As pointed out in the discussion accompanying notes 219-22 supra, the 1976 legislation postponing dischargeability of certain educational loan obligations added another category of debts to which the automatic stay of Rule 401 applies, but a construction of the rule to make the stay operative indefinitely against actions and judgments on such obligations should be rejected. See text accompanying notes 223-25 supra.

provable claim, except perhaps one that becomes nonprovable because the court determines pursuant to section 57d that the claim cannot be liquidated or reasonably estimated within the time available for expeditious administration of the estate.\footnote{See 3 Collier, ¶ 57.15 (1974).} When a creditor has a contingent or unliquidated claim, he is nonetheless subject to the automatic stay unless the claim is of a kind not dischargeable under section 17a(1), (5), (6), or (7). A creditor should not be permitted to determine, with or without his debtor's concurrence, that his claim is too difficult to liquidate to be allowable under section 57d and provable under section 63d and that he is therefore free to sue the bankrupt without regard to the stay. If, after the creditor has filed a proof of claim not excepted from discharge under section 17a, the court determines pursuant to sections 57d and 63d that it is nonallowable and nonprovable, such a determination ought to be tantamount to an annulment of the stay, whether or not its ruling on the claim makes reference to the stay. It is arguable that the statute of limitations ought to be tolled during the interim between the filing of a petition in bankruptcy and a disallowance of the claim under the proviso to section 57d.\footnote{Cf. Maier v. Meyers, 314 Mich. 471, 22 N.W.2d 869 (1946), cited in note 231 \textsuperscript{supra}, where court held the statute of limitations suspended during bankruptcy in respect to an action on a nondischargeable claim.} The instances of potential prejudice to creditors resulting from the interrelation of sections 11f, 57d, and 63d of the Act with Rule 401 are likely to be rare, however, and would disappear under the proposed bankruptcy legislation, which eliminates difficulty of liquidation as a ground for disallowance and dispenses with the concept of provability altogether.\footnote{See \textit{House Comm. on the Judiciary, Bankruptcy Law Revision, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 180 (1977), discussing proposed 11 U.S.C. § 502(c), as set out in H.R. 8200 and S. 2266.}

Action on a claim that is neither scheduled nor filed before the lapse of thirty days after the first date set for the first meeting of creditors is not subject to the automatic stay.\footnote{Rule 401(c).} The temporary effectiveness of the stay, if the claim is otherwise dischargeable, is annulled by Rule 401(c) and can therefore be disregarded. There is thus no reason for suspension of the statute of limitations applicable to action on such a claim. A special problem may arise with respect to a claim scheduled or filed within the thirty-day period. Notwithstanding the scheduling or filing, the court may determine that the claim is nondischargeable because the creditor did not have a meaningful opportunity to participate in the creditors' meeting.\footnote{If scheduling of his claim and knowledge of a pending bankruptcy of his debtor come to a creditor too late for him to participate meaningfully in the bankruptcy case, the creditor's claim may be excepted from the debtor's discharge. Birkett v. Columbia Bank, 195 U.S. 345, 350 (1904).}

A creditor relying on section 17a(3) is not required to seek a determination of nondischargeability during the pendency of the bankruptcy case or prior to any particular date. If the bankrupt is discharged, the automatic stay continues with respect to an action by the creditor who filed during
the thirty-day period, unless the court modifies its operation. There may thus be an extended interval during which the creditor remains subject to the stay, and in such a situation the creditor may contend that the statute of limitations applicable to an action on his claim was tolled during the interval. In view of the availability to the creditor, during the pendency of the case and thereafter, of a determination by the bankruptcy court of the dischargeability of his claim and of a judgment against the debtor on his nondischargeable claim, there appears to be no reason for suspending the statute of limitations in such a situation.

The argument against suspension of the statute of limitations to actions on nondischargeable claims is subject to the criticism that it ignores, or at least discounts, the fact that section 11f suspends the statute of limitations affecting the debts of a bankrupt provable under this Act whether dischargeable or not. The apparent irrelevance of nondischargeability under this subdivision is belied, however, by the fact that denial, waiver, or loss of discharge by a bankrupt triggers termination of the suspension under section 11f(1) thirty days after the discharge issue is settled against the bankrupt. As earlier suggested, it attributes irrationality to Congress to construe section 11f to suspend all statutes of limitation indefinitely when a discharge is granted. Such a construction would mean that while a bankrupt denied a discharge could at least invoke statutes of limitation when sued on nondischargeable as well as dischargeable claims, a discharged bankrupt would never be able to invoke the statute of limitations when sued on a debt excepted from discharge. It does not make the scheme of section 11f intelligible to read clause (3) to terminate the suspension with respect to nondischargeable claims thirty days after the case is closed when a discharge has been granted. That reading inexplicably gives creditors holding nondischargeable claims against a discharged bankrupt the benefit of a suspension of the limitations during the entire period of the pendency of the bankruptcy case plus thirty days, whereas creditors holding such claims against a bankrupt denied discharge get the benefit of a suspension for a period lapsing thirty days after the denial, waiver, or loss of discharge. The argument made in this section of the article for not suspending the statute of limitations as to actions on nondischargeable claims in straight bankruptcy gives effect to the policies implicit in section 11f and avoids anomalous results when Rule 401 is applied to creditors holding nondischargeable claims.239

What of the effect of the automatic stay on the statute of limitations that applies to actions to enforce liens? There are more ways in which a stay may be terminated under Rule 601 than under Rule 401,240 and there is thus less likelihood of prejudice to the creditor resulting from operation of

239 The argument has been supported elsewhere. See note 231 supra.
240 Both Rule 401 and Rule 601 recognize that the court may terminate or otherwise modify the automatic stay by appropriate action on a request. Rule 401 continues the automatic stay, if not so modified, until dismissal or denial or loss of the right to discharge. Rule 601, however, provides for termination of the stay of lien enforcement on dismissal or closing of the case or on disposition of the property subject to the lien by transfer, abandonment, or setting apart as exempt.
a statute of limitations. The stay of Rule 601 is an effective bar for its
duration to the enforcement of liens against property in the custody of the
court and of judicial liens against property obtained within four months of
bankruptcy. The effect of the automatic stay against the enforcement of
liens on the statute of limitations is of course entirely analogous to the
effect of an injunction issued by the court against such enforcement.
Although the issuance of such injunctions has traditionally been routine
and the applicability of statutes of limitations to nonjudicial enforcement
of liens is unclear, problems involving application of the statute of limita­
tions to lien enforcement after bankruptcy of the debtor have seldom
arisen.
Since the stay does not prevent the debtor from bringing any action, it
cannot have any effect on the statutes of limitations that apply to his
causes of action. If, however, the stay leads to the dismissal of an action
against a debtor, including a pending counterclaim filed by the debtor, the
debtor may be left remediless because of the intervention of the statute of
limitations.241
The breadth of the automatic stay in chapter cases has not generated
difficulties with the statute of limitations because the suspension of the
statute of limitations in chapter cases is correspondingly broad.242 The
proposed bankruptcy legislation pending in Congress provides for a com­
prehensive stay in straight bankruptcy as well as debtor relief cases, but
there is no suspension of any statute of limitations applicable to an action
on a claim subject to the stay. The creditor or other person subject to the
stay is nevertheless allowed at least thirty days after notice of the termina­
tion or expiration of the stay for commencing an action that becomes
barred by the statute of limitation during the operation of the stay.

V. RELIEF FROM THE STAY

A. Procedure

1. Pleadings—Relief from an automatic stay may be sought by filing a
complaint with the bankruptcy court,243 which commences an adversary

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241 See First Wisconsin Nat'l Bank of Milwaukee v. Grandlich Dev. Corp., 565 F.2d 879,
880 (5th Cir. 1978).
242 Sections 261, 391, 516, and 676 of the Act suspend all statutes of limitation affecting
claims provable under Chapters X, XI, XII, and XIII. The suspension is effective during the
pendency of a case under each chapter and until it is finally dismissed. Dismissal in this
context includes closing by a final decree after confirmation and consummation of a plan.
There are no comparable provisions in Chapters VIII and IX. Sections 261, 391, 516, and 676
are discussed in 6A COLLIER ¶ 15.02 (1977); 9 id. ¶ 12.01 (1975); 9 id. ¶ 14.01 (1976); and 10
id. ¶ 32.01 (1974).
While the court acknowledged the proposition stated in the text in Willis v. Gladding
Corp., 567 F2d 630, 632 (5th Cir. 1978), it referred to possible "statute of limitations
questions" that might arise if it did not vacate a dismissal of an action pending against a
Chapter XI debtor.
Adversary proceedings are governed by the rules in Part VII of the Bankruptcy Rules, which are adaptations of the Federal Rules of Civil Procedure. The principal differences are found in Rules 704 and 712. Rule 704 requires the bankruptcy judge to set a date for trial or for a pretrial conference upon the commencement of an adversary proceeding. The rule then directs that a summons and notice of the trial or pretrial conference be issued without delay. The court is required, however, to set the trial of the issues on a complaint seeking relief from a stay for the earliest possible time, and “it shall take precedence over all matters except older matters of the same character.” Rule 712 allows

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244 Bankr. Rule 703. It has been suggested that the practice previous to the promulgation of the Rules was for the hearing on continuation of a stay to be brought on by a motion. C.I. Mortgage Group v. Groundhog Mtn. Corp., 4 Collier Bankr. Cas. 387, 389-90 (Ref., S.D.N.Y. 1975) (suggesting that a complaint seeking relief for a stay is “a fit aspect of ordinary motion practice and not of a plenary suit”); Peitzman & Smith, supra note 3, at 1242-43. The practice prior to the promulgation of the Rules was not comparable because, except in Chapter XII cases, when an automatic stay became operative on the filing of the petition, the debtor or other party in interest had to take the initiative to obtain a stay.


Rules 8, 9, and 10 of the Federal Rules of Civil Procedure generally apply to the pleadings filed in an adversary proceeding by virtue of the incorporation of those rules by reference in Bankruptcy Rules 708, 709, and 710. It has been suggested that a secured creditor should “include the same detail in a complaint to vacate a stay in a typical foreclosure complaint.” Werth & Reed, The Chapter XI Stay Order and the Secured Creditor, 38 OHIO ST. L.J. 33, 36 (1977).

247 While the court may set a date for a pretrial conference, the party seeking relief under the stay rules should not ordinarily be subjected to the delay incident to a pretrial conference. Cf. Reliance Standard Life Ins. Co. v. Pembroke Manor Apts., 547 F.2d 805 (4th Cir. 1977), where the bankruptcy judge, promptly after the filing of a Chapter XII petition, determined that a first mortgage was partially unsecured for classification purposes under Rule 12-31(b); the district court of appeal terminated the automatic stay of Rule 12-43, and the court of appeals on review reversed, in part because the bankruptcy judge’s determination was made in a pretrial hearing and in part because the finding of no equity rested on a “liquidation” rather than “going concern” value.

In Associated Midwest, Inc. v. White Birch Park, Inc., 443 F. Supp. 1342 (E.D. Mich. 1978), the bankruptcy judge permitted a Chapter XI debtor unlimited discovery and adjourned hearings on pretrial motions and pretrial conferences. As a result no date for a hearing on the secured creditor’s complaint seeking relief from the automatic stay of its pending mortgage foreclosure had been set, although seven and one-half months had intervened since the filing of the complaint. The district court, on appeal by the mortgagee from rulings on several motions, reversed the bankruptcy court for its failure to conduct a hearing at the earliest possible date on the complaint of relief from the stay. The district court directed the bankruptcy court to allow the mortgagee to introduce “relevant evidence on the sole issue of whether the property in question is essential to the rehabilitation of the debtor or to the liquidation of the debtor’s estate.” Id. at 1346. After giving instructions to the bankruptcy judge as to the factual and legal issues to be determined, the evidence to be allowed, and possible dispositions of the proceeding, the district court refrained from dictating the remedy to be formulated by the bankruptcy judge. Id. Other aspects of the case are discussed at notes 269, 271, 276, 334, and 387 infra.

It has been suggested that the requirement that precedence be given the trial of the issues in a proceeding to obtain relief from a stay may be unrealistic and more honored in the breach than in the performance. Miller, The Automatic Stay in Chapter XI Cases—A Catalyst for Rehabilitation or an Abuse of Creditors’ Rights?, 94 BANKING L.J. 676, 704-05 (1977). Section 362(e) of proposed Title 11 attempts to deal with this problem by putting a
the defendant thirty days for serving his answer after the issuance of the summons, but Rule 906 authorizes the court to reduce that time for cause shown.

2. Standing of a Secured Creditor in a Chapter XIII Case—There is a restriction on the standing of a party to seek relief from a stay in a Chapter XIII case that does not apply in a case under any other chapter. The clear implication of the chapter stay rules other than Rule 13-401 is that any party aggrieved by the stay may have standing to challenge it. Under Rule 13-401, however, only "a creditor who has timely filed his claim or who is secured by an estate in real property or chattels real" is recognized as an appropriate plaintiff entitled to seek relief from the stay. Thus, a creditor secured by personal property of a Chapter XIII debtor must file a claim in order to proceed to enforce his security interest. Moreover, according to Rule 13-302(e), the secured creditor must file his secured claim before the conclusion of the first meeting of creditors if he wishes to preserve his status as a secured creditor, although the court may grant an extension or allow a later filing. An unsecured creditor must likewise timely file his claim—that is, within six months after the first date set for the first meeting of creditors—in order to be qualified to file a complaint seeking relief from a stay under Rule 13-401.

Arguably, a person who is neither a secured nor an unsecured creditor has no standing to file a complaint seeking relief from a stay, but so drastic a reading of Rule 13-401 is neither compelled nor persuasive. Consider, for example, a partition suit in which the Chapter XIII debtor is one of many holders of undivided interests and which has progressed nearly to a successful conclusion in state court when the Chapter XIII petition is filed. The automatic stay clearly bars the continuance of the action against the debtor, but it would be stultifying to deny the other parties to the partition action standing to seek relief from the stay in the bankruptcy court.

If the secured creditor is a pledgee, the stay is nevertheless operative and the claim-filing requirement of Rule 13-401(d) applies. The bankruptcy court has exclusive jurisdiction of the property notwithstanding the possession of the secured creditor. Like Chapter XI, Chapter XIII contains no statutory authority for the issuance of a turnover order to a lienor in possession, and the court's power to issue such an order under Chapter XIII is even more questionable than under Chapter XI. An argument can be made under either chapter, however, that if the debtor's possession of the collateral is necessary to the performance of a plan of rehabilitation and if the secured creditor's interest in the collateral can be adequately protected, the court may issue an appropriate order to obtain such possession.248 This argument, however, is not implied from the stay

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248 See Countryman, Treatment of Secured Claims in Chapter Cases, 82 COM. L.J. 349, 351-54 (1977). See also note 185 supra.
rule in either a Chapter XI or a Chapter XIII case.\textsuperscript{249}

3. \textit{Ex Parte Relief}—The rules governing stays of action and acts to enforce liens recognize that immediate relief may be warranted without notice to the adverse party. Such relief may be granted \textit{ex parte} under most of the Rules on a showing by sworn allegations that “immediate and irreparable injury, loss, or damage will result to the plaintiff” before a hearing can be held.\textsuperscript{250} The plaintiff must, however, disclose the efforts made to give notice and the reason it should not be required. If \textit{ex parte} relief is obtained, the plaintiff is obliged to give prompt notice to the trustee or receiver or, if neither of these officers has qualified, to the petitioners. Reinstatement of a stay terminated or modified without notice may be sought by motion made on two days’ notice or, if the court so orders, on shorter notice. The court is required to proceed to hear and determine the motion for reinstatement “as expeditiously as the ends of justice require.” The procedure applicable in proceedings to obtain \textit{ex parte} relief from a stay is patterned on that governing the issuance of a temporary restraining order under the Federal Rules of Civil Procedure. There is no ten-day limit on the effectiveness of an order granting relief from the stay, however, as there is for a temporary restraining order.

4. \textit{Burden of Pleading and Proof}—All the stay rules authorize the court “for cause shown” to terminate, annul, modify, or condition the stay. The rules require a party seeking continuation of any stay against lien enforcement, however, to show that he is entitled to the protection.\textsuperscript{251} It is not easy to reconcile the requirement of a showing of cause for modification of the stay with the requirement of a showing of entitlement for its continuation. It has been suggested that the burden of proof rests on the party seeking continuation of the stay, whether or not lien enforcement is involved.\textsuperscript{252} The legislative developments reflected in the amendments of the Bankruptcy Act from 1960 to 1970, however, provide


\textsuperscript{250} Rules 601(d)(1), 8-501(d)(1), 10-601(d)(1), 11-44(e)(1), 12-43(e)(1), and 13-401(e)(1). The provisions of the debtor relief stay rules authorize \textit{ex parte} relief not only against the commencement or continuation of rehabilitation or liquidation proceedings.

\textsuperscript{251} The following provision appears as the last sentence of Rules 601(c), 8-501(c), 10-601(c), 11-44(d), 12-43(d), and 13-401(d): “A party seeking continuation of a stay against lien enforcement shall show that he is entitled thereto.” Rule 9-4(c) requires a party seeking continuation of a stay against any proceeding or act in a Chapter IX case to show his entitlement.

\textsuperscript{252} See Miller, supra note 247, at 706 n.88. The suggestion was made in the context of the stay in Chapter XI cases, but if silence in Rule 11-44 means, contrary to the usual canons of statutory construction, that the burden is similarly placed in both in personam and lien enforcement cases under Chapter XI, the same construction arguably should be given to the other stay rules. In re Zeckendorf, 326 F. Supp. 182 (S.D.N.Y. 1971), was cited for the proposition that, in a case antedating the Rules, the burden was on the debtor to justify continuation of relief from a stay of an in personam action, and the Rules, it was argued, were not intended to enlarge or modify substantive rights. The answer to the latter suggestion is that allocation of the burden of proof is generally procedural, not substantive. See, e.g., \textit{Restatement (Second) of Conflict of Laws} § 133 (1971). The \textit{Zeckendorf} case is abstracted and further discussed in note 255 infra.

\textsuperscript{253} See notes 47-52 and accompanying text supra.
support the view that the burden of proof as well as the initiative should rest on the party seeking relief from the stay against in personam actions of the kinds mentioned in Rule 401(a). As pointed out in the Advisory Committee's Note to Rule 401, "facts providing a justification for modifying the stay will ordinarily be more easily provable by the creditor than disprovable by the bankrupt." In any event, the Bankruptcy Rules leave to the courts, except in Chapter IX cases,\textsuperscript{254} the allocation of the burden of proof as well as the burden of going forward with the evidence in a proceeding to obtain relief from a stay of in personam actions.\textsuperscript{255}

The provision requiring the lienor to show cause may be given effect if the party seeking relief is first required to allege and prove, or offer to prove, a prima facie case. The burden of proof, then, by virtue of the last sentence of the subdivision authorizing relief,\textsuperscript{256} falls on the debtor or other party seeking continuation of the stay to overcome the prima facie case.\textsuperscript{257} The ultimate burden of persuasion is apparently placed on the defendant, the provision requiring a showing of cause serving only to fix the lienor's initial burden of pleading and going forward with the evidence.\textsuperscript{258} The Federal Rules of Evidence apply in the adversary proceeding initiated by the complaint,\textsuperscript{259} and the Federal Rules of Civil Procedure govern discovery, subject to minor adaptations.\textsuperscript{260}

5. \textit{Counterclaims}—Whether a creditor who files a complaint seeking relief from an automatic stay should be required to respond to a counterclaim filed by the trustee, receiver, or debtor is governed by Rule 713. Rule 713, an adaptation of Rule 13 of the Federal Rules of Civil Procedure, protects a party sued by a trustee or receiver in an adversary proceeding from being required to state a compulsory counterclaim—that

\textsuperscript{254} Rule 9-4(c). See note 251 supra.

\textsuperscript{255} Cf. \textit{In re Zeckendorf}, 326 F. Supp. 182 (S.D.N.Y. 1971). The court in the Zeckendorf case, District Judge Frankel, criticized Referee Herzog for placing the burden of demonstration and persuasion on the creditors to obtain modifications of a stay of an action. The action, brought nearly four months before the debtor filed a Chapter XI petition, charged violations of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), and S.E.C. Rule 10b-5, 17 C.F.R. § 240. 10b-5. There were numerous plaintiffs and defendants, and the action had been pending in the district court for nearly three years when District Judge Frankel delivered his ruling vacating an injunction entered by the referee pursuant to § 314. In the meantime, many motions and notices had been filed, a hearing had been held, and discovery procedures had been pursued in the litigation. The facts presented an appropriate case for the grant of relief ordered by the court, with directions to the referee to modify the restraining order to protect the debtor against the entry of a judgment until the issues of dischargeability had been resolved. 326 F. Supp. at 185. The opinion and rulings are entirely consistent with Rule 11-44.

\textsuperscript{256} See note 251 supra.


\textsuperscript{259} See Rule 917.

\textsuperscript{260} See Rules 726-737.
is, one arising out of the transaction or occurrence that is the subject matter of the trustee's or receiver's claim. Since Rule 13 of the Federal Rules of Civil Procedure is otherwise generally applicable in adversary proceedings, the trustee, receiver, or debtor appears to be subject to the compulsory counterclaim rule when a creditor or other party in interest seeks relief from an automatic stay.\(^{261}\) This result is consistent with that reached by the courts prior to the promulgation of the Bankruptcy Rules.\(^{262}\) As the Advisory Committee's Note accompanying Rule 713 points out, however, a rigid application of the compulsory counterclaim rule against the trustee, receiver, or debtor may defeat the objective of the rules to facilitate a just, speedy, and inexpensive determination of litigation. Thus, if the filing of a complaint seeking relief from a stay against lien enforcement required the answer to include all claims the trustee, receiver, or debtor may have against the lienor under the avoidance sections, he would typically be obliged to ask for an extension of the time for filing a responsive pleading. Indeed, in most bankruptcy cases, the trustee would not have been appointed or elected when the court would be called upon to continue or to grant relief against the stay. Moreover, the trial of the issues presented by a counterclaim would be likely to require a pretrial conference, discovery, and an extended trial of issues on the merits.

If the trustee, receiver, or debtor does file a counterclaim, has the party seeking relief from the stay submitted to the jurisdiction of the court to determine the counterclaim? Neither the stay rules nor the rules governing counterclaims extend the scope of the summary jurisdiction of the bankruptcy court to determine the controversy raised by a counterclaim,\(^{263}\) but, according to conventional principles of federal jurisdiction, the court would have jurisdiction unless the counterclaim is permissive only.\(^{264}\) There are, however, at least three issues that complicate the application of these conventional principles. First, do the complaint seeking only relief from an automatic stay against lien enforcement and the counterclaim seeking avoidance of the lien present claims arising out of the same transaction or occurrence? Second, should a party required to come into the bankruptcy court in order to get relief from an automatic stay prescribed by a Rule of Bankruptcy Procedure be subjected to the further obligation of defending himself against a counterclaim filed in a forum that was not his choice? Third, should the determination of the issues raised by a complaint seeking relief from an automatic stay be

\(^{261}\) Rule 713(3) protects the trustee, receiver, or debtor against imposition of the usual bar when he fails to file a compulsory counterclaim in his answer as a result of oversight, inadvertence, or excusable neglect. The omitted counterclaim may be set up later by amendment, by commencing a new adversary proceeding, or by the filing of a plenary action in a nonbankruptcy court.

\(^{262}\) The relevant case law with citations is set out in the Advisory Committee's Note to Rule 713.

\(^{263}\) See Kennedy, Overview in Bankruptcy Under the New Rules of Procedure 11 (Lempert ed. 1974).

complicated and delayed by consideration and resolution of issues concerning the validity of the plaintiff's underlying claim?

(a). Compulsoriness of the Counterclaim—It has been held that a complaint seeking relief from a stay does not even state a claim, as that term is used in the rules governing counterclaims, and thus cannot provide a basis for the assertion of a counterclaim.\(^{265}\) The view of the courts rejecting the standing of the defendant to plead a counterclaim is predicated on the defensive character of the plaintiff's complaint requesting relief from the stay. Every complaint filed under the Rules of Bankruptcy Procedure, as under the Federal Rules of Civil Procedure, must, however, state a claim for relief or be subject to dismissal.\(^{266}\)

If a party stayed from enforcing a claim seeks relief from the stay, it might appear that the party defending the stay should be able to challenge the validity of the claim and that his attack has a sufficiently close relationship to the plaintiff's claim to warrant categorization as a compulsory counterclaim.\(^{267}\) When a plaintiff seeks relief from a stay of the prosecution or enforcement of his claim, however, there are at least two related but different claims to be considered, namely, the claim the plaintiff is being stayed from pursuing and the claim for relief from the stay imposed by the rules. When the defendant opposes the complaint seeking relief from the stay by attacking the validity of the underlying claim being pursued by the plaintiff, the counterclaim does not arise out of the same subject matter as the plaintiff's claim.\(^{268}\) The transaction or occurrence that is the subject matter of the plaintiff's claim for relief is the stay of the action, proceeding, or nonjudicial act, not the underlying claim he is seeking to enforce.\(^{268}\) It may be appropriate for the defendant to


\(^{267}\) Several tests have been employed by the courts in determining whether a counterclaim should be categorized as compulsory: (1) whether the issues of law and fact raised by the claim and counterclaim are largely the same; (2) whether judgment on the plaintiff's claim will be res judicata of the defendant's counterclaim; (3) whether trial of the plaintiff's and defendant's claims will require substantially the same evidence; and (4) whether the plaintiff's and defendant's claims have a logical relationship to each other. 6 C. Wright & A. Miller, Federal Practice and Procedure § 1410 (1971).


\(^{269}\) The claim of the creditor is the right to sue or act outside the bankruptcy court, whereas the trustee's, receiver's, or debtor's claim is the right to postpone the creditor's action or act. Cf. Associated Midwest, Inc. v. White Birch Park, Inc., 443 F. Supp. 1342, 1346 (E.D. Mich. 1978), where the court, in directing the exclusion of evidence relating to a counterclaim, unduly narrowed the issue raised by a complaint filed under Rule 11-44 to the essentiality of the property in question. See also notes 271 and 276 infra.
present a counterclaim that goes to the merits of the claim the plaintiff is precluded by the stay from enforcing, but such a counterclaim often will be permissive and presents different jurisdictional considerations.\textsuperscript{269a}

(b). Inappropriateness of Hinging Jurisdiction and Venue on the Stay Rules—Notwithstanding the relationship between the creditor’s claim for relief from an injunction issued by a bankruptcy court or from an automatic stay imposed by the Bankruptcy Rules and the defendant’s counterclaim challenging the merits of the stayed claim, there is good reason not to regard them as so related as to compel the defendant to present such a counterclaim. Otherwise, the grant of injunctive powers to the bankruptcy court and the automatic stay rules could become means for enlarging the jurisdiction of the court to embrace all the issues in the litigation subject to injunction or stay. The purposes underlying the injunctive provisions of the Act and the automatic stay rules do not require that all litigation against the debtor be forced into the bankruptcy court.

Thus, where the stay operates against a secured creditor in possession of the collateral or against an unsecured creditor who is or may be liable to the trustee, receiver, or debtor, the creditor may generally remain aloof from the proceedings in the bankruptcy court if he does not wish to contest the stay or to seek relief from the bankruptcy court. Prior to the Bankruptcy Rules, except where the Bankruptcy Act imposed an automatic stay in a Chapter X or a Chapter XII case,\textsuperscript{270} the trustee, receiver, or debtor had to take the initiative to obtain a stay or an injunction against the commencement or continuation of an action by a creditor or other adversary in another court. The grant of jurisdiction to the bankruptcy court to enjoin an action pending in another court does not carry with it ancillary jurisdiction to determine the validity of the claim sued on in the action stayed.\textsuperscript{271} Unless there is an independent ground for summary


\textsuperscript{270} By § 148 in a Chapter X case and §§ 428 and 507 in a Chapter XII case. See notes 32-33 and accompanying text supra.


In the \textit{White Birch Park} case, a Chapter XI debtor had counterclaimed on grounds of fraud and usury against a secured creditor who had sought relief from the stay of its pending mortgage foreclosure action. The district court, in reviewing several rulings of the bankruptcy judge, held that the bankruptcy court was without power to grant relief to the debtor on its counterclaim. Unfortunately, the district court rested its ruling on the lack of power of a Chapter XI court to affect the claims of secured creditors. If the court in which the foreclosure was pending had not acquired prior custody, it is clear that the bankruptcy court could have avoided the mortgagee’s security interest for fraud and usury. 2 \textit{COLLIER} ¶ 23.04[2] (1974); 8 \textit{id.} ¶ 6.32 [7]-[7.5] (1974); J. \textit{MACLACHLAN, BANKRUPTCY} §§ 339-40 (1956). The fact that the court in which the foreclosure was pending may have acquired prior custody raises a question as to the summary jurisdiction of the bankruptcy court to determine controversies respecting the property, but in view of the exclusive jurisdiction of the debtor’s property conferred on the bankruptcy court by § 311, that court had jurisdiction to determine the validity of the mortgages notwithstanding the pendency of the foreclosure action in another court. See 8 \textit{COLLIER} ¶ 3.02 (1974). It is another question whether the
jurisdiction of a claim against the adversary, the trustee, receiver, or debtor cannot join such a claim in a complaint seeking an injunction. Accordingly, when a party subject to an injunction seeks relief from it, the trustee, receiver, or debtor cannot, by challenging the merits of the adversary's underlying claim, force litigation of these issues in the bankruptcy court instead of the court where the enjoined action is pending or may be brought. If the imposition of the automatic stay by the Rules should be construed to enable the bankruptcy court to exercise jurisdiction over a counterclaim filed against a party seeking relief from the stay, the rule would have the result of extending the summary jurisdiction of the bankruptcy court.

Whether or not the Bankruptcy Rules could have extended the scope of the summary jurisdiction, they were not drafted with that end in view. To decline jurisdiction of a counterclaim against one who is seeking relief from a stay avoids not only an objectionable use of the Rules to expand the court's jurisdiction but also the criticism that the Rules have taken the choice of forum for the counterclaim from the creditor or other adversary party and given it to the trustee, receiver, or debtor. A similar result did not seem to bother the Supreme Court in Katchen v. Landy, where the trustee was allowed to prosecute in the bankruptcy court a counterclaim for surrender of voidable preferences against a creditor who had

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272 See the Advisory Committee's Introductory Note to the Preliminary Draft of the Rules of Bankruptcy Procedure and the Advisory Committee's Notes to Rules 701 and 928; cf. Krause v. Essex Properties, Ltd., 430 F. Supp. 1112, 1115-116 (N.D. Cal. 1977) (quoting and emphasizing Rule 928, which declares that the rules "shall not be construed to extend or limit the jurisdiction of courts of bankruptcy over subject matter"). Frequent comments are nevertheless encountered suggesting that the Rules have broadened or strengthened the jurisdiction of the bankruptcy court. See, e.g., In re Caribbean Food Prod., Inc., v. Banco Credito Y Ahorro Ponceno, 14 Collier Bankr. Cas. 358, 360 (D. P.R. 1977), aff'd, 575 F.2d 961 (1st Cir. 1978); White Birch Park, Inc. v. Consumers Power Co., 14 Collier Bankr. Cas. 412, 416 (Ref., E.D. Mich. 1977) ("it is well-settled that the recent Bankruptcy Rules have influenced the courts broadening jurisdiction").

273 See Krause v. Essex Properties, Ltd., 430 F. Supp. 1112, 1115-16 (N.D. Cal. 1977), where the debtor had raised usury as an affirmative defense in a mortgage foreclosure action pending in state court and thereafter, in a subsequently filed Chapter XII case, stated a counterclaim alleging usury and a number of other causes of action in opposition to the mortgagee's complaint seeking relief from the automatic stay; cf. Henkin v. United States, 229 F.2d 895, 897 (2d Cir. 1956), where the United States was held not to have consented to jurisdiction of the bankruptcy court to determine the validity if its lien by seeking vacation of a stay against its foreclosure; In re Oceana Internati'l, Inc., 376 F. Supp. 956, 960 (S.D.N.Y. 1974), where the court rejected a claim that a mortgagee had submitted to summary jurisdiction by seeking dissolution of an injunction against its foreclosure. The courts in the last two cited cases emphasized the defensive character of the secured creditor's requests for relief. See also note 265 supra.

In In re The All American Burger, Inc., 9 Colliier Bankr. Cas. 748 (Ref., C.D. Cal. 1976), the court rejected an argument of the debtor that the filing of a complaint for relief from a stay constituted a general consent to the jurisdiction of the bankruptcy court to determine an unrelated controversy between the parties.

filed a claim there and who had no alternative forum. The Court found a specific congressional intention to make the allowance of a creditor's claim conditional upon summary determination and avoidance of any voidable transfer to the creditor, but it is not clear that the considerations underlying *Katchen v. Landy* support jurisdiction of a counterclaim against a party seeking relief from a stay prescribed by the Bankruptcy Rules.

(c). Need for Expeditious Determination of Need for Relief from Stay—The stay rules contain several safeguards against the risk of undue delay in the consideration and disposition of a complaint seeking relief from the stay. They include the requirement that the trial of the issues presented by such a complaint and its answer be set for the earliest possible date. If "immediate and irreparable injury, loss, or damage will result to the plaintiff before the adverse party or his attorney can be heard in opposition," ex parte relief may be granted under most of the rules without notice to the adverse party. The injection of a counterclaim may frustrate the hope of an early determination of whether an automatic stay should be terminated or modified. If the court has jurisdiction of the counterclaim on an independent ground—that is, independent of the submission by the creditor or other adversary to the jurisdiction of the bankruptcy court—the court may, of course, proceed to determine it, but it will often be wise to dispose first of the plaintiff's request for relief

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275 See Part V A 3 supra.

276 See, e.g., Associated Midwest, Inc. v. White Birch Park, Inc., 443 F. Supp. 1342 (E.D. Mich. 1978), where a Chapter XI debtor filed a counterclaim against a secured creditor, who had sought relief from a stay of its pending mortgage foreclosure action. The debtor alleged fraud and usury in its counterclaim and filed 220 written interrogatories concerning the financial status of the secured creditor during the preceding six years. A date for a hearing on the complaint seeking relief not having been set, although more than seven months had elapsed after the complaint was filed, the district court directed an expedited hearing to be held on remand of the proceeding to the bankruptcy judge. 443 F. Supp. at 1346. The district court concluded that the bankruptcy court had no jurisdiction of the counterclaim. This aspect of the case is discussed in notes 269 & 271 supra.

The requirement of the stay rules that a party seeking relief file a complaint has been criticized as an invitation to the debtor or other adversary to assert counterclaims and affirmative defenses and to argue that the filing of the complaint constitutes submission to summary jurisdiction. Peitzman & Smith, supra note 3, at 1247. The cases cited in notes 268 and 273 suggest that the courts are generally making correct disposition of the issues raised by these responsive pleadings and arguments. The *White Birch Park* case illustrates the delays possible under the present Rules. Proposed § 362(e) of Title II U.S.C. as set forth in H.R. 8200 and S. 2266 addresses the problem of delay in action by the bankruptcy judge on a request for relief from an automatic stay. Unfortunately the Rules are also susceptible to abuse by secured creditors when they "inundate the debtor and the...court with early repetitive motions, complaints, hearings and trials" and thus "require diversion of the attention of the debtor and his counsel from the consideration of the formulation of a viable plan,... contrary to the expected orderly rehabilitative process." *In re Carousel Ltd.* Partnership, 14 Collier Bankr. Cas. 760, 765 n.11 (Ref., N.D. Ga. 1977).

277 See Pratt & Whitney Aircraft Club, Inc. v. Fairway Wholesale, Inc., 2 Bankr. Ct. Dec. 1302, 1303 (Ref., D. Conn. 1976) (acknowledging that the court would not have jurisdiction over a permissive counterclaim for return of a preference by a landlord who sought relief from an automatic stay in a Chapter XI case but for the fact that the plaintiff filed a reply to the counterclaim before making a jurisdictional objection).

In a Chapter X case, § 23 poses no jurisdictional obstacle to the entertainment by the court of a counterclaim presented by the debtor or trustee. 6 COLLIER ¶ 3.18 (1977).
from the stay. Alternatively, the stay may be continued pending a determination of the counterclaim.278 Even though the counterclaim falls within the summary jurisdiction of the bankruptcy court, wise judicial administration may dictate deference to a nonbankruptcy court, particularly when an action on the counterclaim is already at an advanced stage.

B. Considerations Favoring and Opposing Continuation of the Stay

1. In Personam Actions Against a Bankrupt—Neither Rule 401 nor any of the other stay rules undertakes to indicate what factors a court should take into account in determining whether to continue or modify a stay. Section 11a authorizes the court to prolong a stay of actions grounded on dischargeable claims beyond the date of adjudication until the determination of the bankrupt’s right to a discharge. The considerations formerly weighed by the courts in extending, modifying, or terminating the stay of such actions are now appropriately assessed by bankruptcy courts in passing on the issues raised by a complaint seeking relief from the automatic stay of in personam actions prescribed by Rule 401. The Advisory Committee’s Note to Rule 401 recognizes that appropriate justification for relief from the stay may exist when the amount of an unliquidated claim can be more expeditiously and conveniently determined in a pending action279 or when the creditor seeks a judgment against the debtor to satisfy a condition precedent to the liability of a surety or other third party.280 Relief is also appropriate when the litigation threatens no im-

278 See, e.g., In re Stroderd, 13 Collier Bankr. Cas. 598, 603 (Ref., W.D. La. 1977). In First Wis. Nat'l Bank v. Sal Amato, Inc., 1 Bankr. Ct. Dec. 954 (Ref., D. Conn. 1975), the debtor in a Chapter XI case opposed a complaint seeking relief from a stay by alleging that he held a substantial equity in the property and that the secured debt was usurious. When the creditor thereupon moved for dismissal of the debtor's claim, the court, treating the motion as one for a summary judgment, continued the stay pending the trial of the issues raised by the defenses. The court in Krause v. Essex Properties, Ltd., 430 F. Supp. 1112, 1116 (N.D. Cal. 1977), noted that the plaintiff in Sal Amato did not raise any jurisdictional objection and that the debtor had asserted usury only defensively in support of his claim that there was a substantial equity, not for the purpose of setoff or affirmative recovery.

279 Citing In re Gerstenzang, 52 F.2d 863, 864 (S.D.N.Y. 1931). For illustrative cases granting relief under Rule 401, see Wood v. Fiedler, 548 F.2d 216 (8th Cir. 1977) (determination of dischargeability of the claim was deferred while malpractice action pending in state court was permitted to proceed against bankrupt); In re DeCordier, Bankr. L. Rep. (CCH) ¶ 66,774 (Ref., E.D.N.Y. 1978) (same); but cf. J. Thad Heinlein Co. v. National Aluminum Co., 14 Collier Bankr. Cas. 678, 682 (Ref., W.D. Pa. 1977) (relief denied where bankrupt already discharged from potential liability to parties to pending negligence action and vacation of stay would result in confusion).

pairment of the estate or the fresh start policy of the Act. In such situations the relief may be conditioned to prohibit enforcement of the judgment against property of the estate or exempt property of the debtor.

2. Acts and Actions to Enforce Liens Against Property of the Bankrupt in the Custody of the Bankruptcy Court—The issues to be resolved by the bankruptcy court when a lienor seeks relief from a stay under Rule 601 against property in the custody of the court are fairly simple and straightforward. The key question is whether extension of the stay is necessary or at least justified as a protection against loss of or injury to the interest of the estate in the property. This was the question faced by the courts prior to the promulgation of the Bankruptcy Rules when the trustee resisted reclamation proceedings and other efforts of lienors to enforce their liens against such property in the custody of the court. Prior to the Rules, such a lienor was uniformly required to bear the burden of proof when he sought reclamation or permission to foreclosure outside the bankruptcy court. In imposing the burden on the party seeking continuation of the stay, Rule 601(c) is probably more generous than prior law to the lienor without possession.

The existence of an equity or a dispute concerning the validity of the creditor's lien ordinarily constitutes good cause for continuing the stay in straight bankruptcy proceedings. The trustee who is able to establish either of these facts is in a good position not only to resist the lienor's effort to terminate the stay but also to obtain authority to sell the property free of the lien. If the validity of the lien is not vulnerable to attack and


282 See In re Zeckendorf, 326 F. Supp. 182, 185 (S.D.N.Y. 1971), abstracted in note 255 supra and in notes 298 & 300 and accompanying text infra. See also notes 384, 386-87 and accompanying text infra.

283 See 4A COLLIER ¶¶ 70.06, at 79 n.5; id. 70.16(7) at 164 n.37; id. 70.39(3) (1967).

284 See, e.g., In re Valley Gold Ranch, Inc., 13 Collier Bankr. Cas. 710, 713 (Ref., N.D. Cal. 1977). The Valley Gold Ranch case presented the unusual spectacle of what the court referred to as a "straw man" bankruptcy. The bankrupt had been created by incorporation four days before bankruptcy for the acknowledged purpose of filing a bankruptcy petition. The sole stockholder transferred to the corporation encumbered real property scheduled to be sold under a deed of trust three days after bankruptcy. The corporation assumed secured and unsecured debts related to the property transferred to it. The stockholder retained other property and, of course, remained obligated on the debts assumed by the corporation. Secured creditors sought relief from the automatic stay imposed by Rule 601 on enforcement of their liens by sale and argued that since the transfer to the corporation was a fraud on creditors of the transferor, the court should not facilitate the consummation of the fraudulent purpose. The court declined to lift the stay for the reason that the purpose of the transfer was to preserve an equity for unsecured creditors that would otherwise be lost as a result of the scheduled foreclosure. Since the secured creditors were amply secured, the court could not discern how they could be injured. The court was nevertheless troubled by countenancing of the "straw man" bankruptcy.

285 See 4A COLLIER ¶¶ 70.97(2), 70.98(11), 70.99(1) (1967); Rule 606(b)(3) requires a proceeding to sell property free of liens to conform to the rules governing an adversary proceeding. Kennedy, An Adversary Proceeding Under the New Bankruptcy Rules, with Special Reference to a Sale Free of Liens, 79 COM. L.J. 425 (1974).
there is insufficient value in the property to yield anything for the unsecured creditors, the trustee should abandon the property and allow the lienor to pursue his remedy outside the bankruptcy court.

3. Enforcement of Liens Obtained by Judicial Proceedings Within Four Months of Bankruptcy—Relief from the stay imposed by Rule 601(a)(2) against enforcement of a lien obtained by judicial proceedings within four months of bankruptcy ought to be available whenever it appears that the debtor was not insolvent when the lien was obtained.\(^{286}\) If the lien was not obtained by judicial proceedings or was obtained more than four months before bankruptcy, the stay was never operative against its enforcement and relief need not be sought under Rule 601(c) or (d).\(^{287}\) The burden of proof is on the trustee, receiver, or debtor to establish the elements of voidability under section 67a of a lien obtained by judicial proceedings,\(^{288}\) and it comports with that allocation of the burden as well as with the last sentence of section 601(c)\(^{289}\) to require the party relying on the stay to establish the character of the lien and the date it was obtained. Since the lienor is in a better position to establish both those elements, however, the trustee, receiver, or debtor should not be obliged to furnish official records of the attachment of the judicial lien. If a lien creditor alleges in a complaint seeking relief from a stay of proceedings imposed by Rule 601(a)(2) that the debtor was not insolvent at the time the lien was obtained, the stay should be terminated unless the trustee, receiver, or debtor contests the allegation and carries the burden of proof on the issue of insolvency.\(^{290}\)

4. Proceedings and Enforcement of Judgments Against the Debtor in Debtor Relief Cases—The language of the stay rules for cases under Chapters VIII, IX, XI, XII, and XIII is practically identical. Unlike the stay rules applicable in straight bankruptcy, the stay rules for the chapter cases operate against any kind of proceeding and the enforcement of any kind of judgment against the debtor. The comprehensive scope of the stay may reach proceedings and judgments even though they do not interfere significantly with the attainment of the objectives of the debtor relief chapter under which the case is pending.\(^{291}\) Thus, unless and until mod-

\(^{286}\) As pointed out in notes 63 and 154-57 and accompanying text supra, the stay imposed by Rule 601(a)(2) is intended to prevent frustration of the purpose of § 67a by a transfer of the property subject to the voidable lien to a bona fide purchaser. See Advisory Committee’s Note to Rule 601(a). The stay should accordingly be terminated by the court when it appears that the lien is not voidable.


\(^{288}\) See 4 COLLIER ¶ 67.18, at 200 nn.13, 15 (1975).

\(^{289}\) “A party seeking continuation of a stay against lien enforcement shall show that he is entitled thereto.”

\(^{290}\) See 4 COLLIER ¶ 67.05, at 100-02 n.5 (1975).

\(^{291}\) Without questioning the scope of the injunctive power of the bankruptcy court, the appellate courts sometimes vacated injunctions issued in debtor relief cases before the advent of the Rules because they found continuation of the litigation restrained to be compatible with conduct of the reorganization case. See, e.g., Foust v. Munson S.S. Lines, 299 U.S. 77, 87 (1936) (conduct of a jury trial on a seaman’s claim under the Merchant Marine Act commenced before the filing of a § 77B petition by the debtor-employer was held...
ified, the stay prevents the commencement or continuation of a proceeding or the enforcement of a judgment by one who is not a creditor and whose rights cannot be affected by any plan that the court could confirm under the Act.

As previously noted, the party seeking relief must show cause for relief, and, with a single exception, the party seeking continuation of the stay has no obligation to show that he is entitled to a stay unless it operates against lien enforcement. Nevertheless, if the creditor alleges in his complaint that the proceeding or judgment is unrelated to the debtor relief case and that its continuation or enforcement will not interfere with the conduct of the debtor relief case, that should constitute a sufficient statement of cause. If the trustee, receiver, or debtor contests this allegation, resolution of the issue should not require any elaborate presentation of evidence by the party seeking relief. Not only would it be inappropriate to require the plaintiff to supply extensive proof of a negative, but the party seeking continuation of the stay is ordinarily in a better position to provide the information needed by the court to determine the issue presented. The trustee, receiver, or debtor typically will assert that any litigation and the enforcement of any judgment will, at a minimum, distract those engaged in the effort to keep the business going or the family group intact and, at worst, destroy any hope of successful rehabilitation.

The purpose of the stay rules is to protect the rehabilitation process against litigation that would compromise the ability to formulate and obtain confirmation of a plan.

In resolving the often difficult but important question of the effect of nonbankruptcy litigation on a chapter case, the courts may consider the

not to "hinder, burden, delay, or be inconsistent with the pending reorganization"); Amadori Constr. Co. v. Hoffenberg (In re Stanndco Developers, Inc.), 534 F.2d 1050, 1055 (2d Cir. 1976) (suit seeking determination of validity of lien for the purpose of fastening liability on a surety was said not to "interfere with the execution of any plan of reorganization"); cf. Callaway v. Benton, 336 U.S. 132, 142 (1949) ("Congress did not give the bankruptcy court exclusive jurisdiction over all controversies that in some way affect the debtor's estate").

292 See Part V A 4 supra.

293 Rule 9-4(c) requires a party seeking continuation of a stay against any proceeding or act in a Chapter IX case to show that he is entitled to the stay.

294 While the bankruptcy court prior to the Rules could enjoin such a plaintiff, the courts were understandably reluctant to grant or, if granted, to continue such an injunction. See, e.g., In re Laufer, 230 F.2d 866 (2d Cir. 1956) (fair trader's injunction against price cutting by Chapter XI debtor held improperly restrained by referee); Herman v. Herman, 12 Collier Bankr. Cas. 274 (W.D. Mich. 1977) (denying injunction of action against Chapter XIII debtor to compel payment of child support, an obligation not included in plan); cf. Bauer v. American Training Serv., Inc., 12 Collier Bankr. Cas. 40 (Ref., D. N.J. 1977) (stockholder's derivative action permitted to continue in the interest of the estate of a Chapter XI debtor, a trustee being designated to represent the debtor's estate in the litigation).

295 See Foust v. Munson S.S. Lines, 229 U.S. 77, 86 (1936); In re Laufer, 230 F.2d 866, 868 (2d Cir. 1956).

same factors in acting on complaints seeking relief from the automatic stay as they did prior to the promulgation of the Bankruptcy Rules in granting injunctions and relief from injunctions against suits not seeking the enforcement of liens.297 Thus, both before and since the Rules, the courts have granted relief from a stay when the principal purpose of the litigation was to establish the liability of a third person.298 If the transfer of litigation pending in another court to the bankruptcy court will disrupt the calendar of the bankruptcy court and the discharge of its duties in connection with other cases, the court can be fairly easily persuaded to modify the stay to permit the proceeding to continue in the other court.299 Another factor likely to influence the court in granting relief is the length of time the proceeding has been pending in the other court.300 In acting on

298 Foust v. Munson S.S. Lines, 299 U.S. 77, 84, 87 (1936) (suit by a seaman against a § 77B debtor expected to be defended by the debtor's insurer); Amadori Constr. Co. v. Hoffenberg (In re Stanndco Developers, Inc.), 534 F.2d 1050 (2d Cir. 1976) (action to establish liability of surety on bond releasing mechanic's lien against Chapter X debtor's property); Power-Pak Prod., Inc. v. Royal-Globe Ins. Co., 433 F. Supp. 684 (W.D.N.Y. 1977) (action by insurer against debtor for declaratory judgment on insurer's liability). The fact that the ultimate result of the litigation in the nonbankruptcy court may be adverse to the debtor's interest has not deterred the courts from granting relief in some cases. Thus in Foust, it was acknowledged that the insurance coverage of the liability asserted was not complete. The argument that juries often give larger verdicts "than reason justifies" was not persuasive to the court. In Stanndco, it was acknowledged that if the plaintiff prevailed against the surety, the surety would be entitled to enforce a security interest taken in the debtor's property. These potential impingements on the debtor's estate were not deemed of sufficient significance to warrant further postponement of the litigation. The Foust and Stanndco rulings involved stays entered by the courts before the effective dates of the Bankruptcy Rules. A case reaching the same result as Stanndco under the Rules is Sandberg v. Marty's Bum Steer, 2 Bankr. Ct. Dec. 1009 (Ref., S.D.N.Y. 1976). In In re Zeckendorf, 326 F. Supp. 182 (S.D.N.Y. 1971), abstracted and discussed in notes 252 & 255 supra and note 300 infra, the circumstances were thought to dictate relief from the stay, although the role of the debtor in the litigated events was "central." 326 F. Supp. at 185.
299 See, e.g., Austin v. Wendell-West Co., 9 Collier Bankr. Cas. 319 (9th Cir. 1976) (stay of action brought by 23 plaintiffs against Chapter XII debtors held to have been properly lifted; dischargeability of plaintiff's claims reserved for bankruptcy court). Judge Trask, dissenting, read § 17c of the Act to require the court to enjoin the proceedings in the nonbankruptcy courts. 9 Collier Bankr. Cas. at 326. He did not take note of the fact that the applicability of § 17c in debtor relief cases has been a matter of debate. See Countryman, The New Dischargeability Law, 45 AM. BANKR. L.J. 1, 54-55 (1971); cf. Forman, Application of the New Dischargeability Law of 1970 to Corporations and Chapter XI, 46 AM. BANKR. L.J. 105 (1972); Weintraub, The Dischargeability Amendments: Are They Applicable to Corporate Bankrupts and to Chapter XI?, 46 AM. BANKR. L.J. 115 (1972).

There was a reference in the district judge's ruling in Austin v. Wendell-West Co., to the prohibitive expense to the individual plaintiffs if they were required to travel from California, where they resided and the land in dispute was located, to Seattle, where the Chapter XII case was pending. The proceedings, if conducted in the bankruptcy court, could, of course, be transferred by the court to any other district "in the interest of justice and for the convenience of the parties." Bankr. Rule 782.

In the Zeckendorf case litigation had been pending only about four months when a Chapter XI petition was filed against the debtor and many other persons, but it had been pending for over two years when the debtor's counsel sought enforcement of the stay.
requests for relief the court is often influenced by the argument that relief can be granted without disadvantaging the rehabilitation process by the entry of an order against the enforcement of any judgment against the debtor's estate.301

5. Acts and Proceedings to Enforce Liens Against the Property of the Debtor in Debtor Relief Cases—Notwithstanding the identity of the language in the stay rules for debtor relief cases, the courts do take into account different considerations that depend on the chapter involved when passing on requests for relief from automatic stays. As a result, care must be exercised in applying a construction or interpretation of a stay rule in one case to another case under a different chapter, even though the relevant language of the stay rules in the two chapters is identical. Thus, the significance of the presence or absence of an equity in property subject to a lien varies from chapter to chapter.302 While it has been stated that a stronger ground should be required to sustain a stay of lien enforcement in a Chapter XI case than in a Chapter X case, because of the difference in the power of the court under the two chapters to affect the rights of a lienor,303 this difference has not perceptibly influenced the approach of the courts in construing the automatic stay rules for the debtor relief chapters. A special rule of construction has developed, however, for Chapter XIII cases: subject to the satisfaction of what may be referred to as the Hallenbeck conditions,304 the courts have frequently followed a general and guiding proposition that in rehabilitation proceedings such as contemplated under Chapter XIII, "injunctive relief should be granted more liberally than would be the case in other proceedings."305

The case law construing the sections of Chapters VIII-XIII that vest exclusive jurisdiction of the debtor's property in the bankruptcy court and authorize injunctions against suits to enforce liens provides persuasive authority for the courts to follow in evaluating complaints seeking relief from the automatic stay rules prescribed for cases under those chapters.306 In deciding whether an injunction should be entered or continued against the enforcement of a lien in a Chapter X, XI, or XII case, the courts have typically inquired into: the likelihood of a successful reor-

Nearly three years had elapsed when the district judge delivered his opinion requiring a modification of the stay. Meanwhile, as indicated in note 255 supra, the litigation had been moving forward "sedately" notwithstanding the stay. 326 F. Supp. at 183.

302 See notes 340-61 and accompanying text infra.
303 See, e.g., Lance, Inc. v. Dewco Serv., Inc., 422 F.2d 778, 782 (9th Cir. 1970), citing a passage in the COLLIER treatise now found in 8 COLLIER ¶ 3.22, at 256 (1974).
304 These conditions, specified in Hallenbeck v. Penn Mutual Life Ins. Co., 323 F.2d 566, 572 (4th Cir. 1963), are discussed in the text accompanying notes 394-95 infra.
306 See, e.g., Murphy v. Bankers Commercial Corp., 203 F.2d 645, 646 (2d Cir. 1953) (injunction against foreclosure proceedings pending in Honduras held properly denied in bankruptcy case in the absence of proof of irreparable injury); In re Murel Holding Corp., 75 F.2d 941, 942-43 (2d Cir. 1935) (debtor required to make a "clear showing" to obtain stay of foreclosure of mortgage on apartment house in § 77B case).
ganization; the likely need of the property subject to the lien for a successful reorganization; and the likelihood of injury to the security of the lienor caused by the stay.\textsuperscript{307}

A commentator has recently propounded the view supported by impressive documentation, that a number of courts, in particular the Court of Appeals for the Third Circuit, have tended to require the party seeking continuation of the stay to carry the burden on all three of these issues.\textsuperscript{308} As he suggests, the courts of the other circuits adopt a more flexible approach.\textsuperscript{309} While they give some weight to the proofs and arguments adduced in regard to these three issues, other considerations are also taken into account, and particular factors may be given varying degrees of significance in different cases.

\textit{(a). Likelihood of Successful Rehabilitation—}\ The issue of whether there is a likelihood of a successful reorganization may arise at different stages in a Chapter X case. First, in order to be approved, every petition filed under Chapter X must be found by the court to have been filed in good faith,\textsuperscript{310} and a petition is not filed in good faith if "it is unreasonable to expect that a plan of reorganization can be effected."\textsuperscript{311} Second, before a plan of reorganization can be confirmed under Chapter X, the court must find that the plan is feasible,\textsuperscript{312} and the standard of feasibility under Chapter X has generally been viewed by the courts as equivalent to likelihood of successful reorganization.\textsuperscript{313} In addition, the court must be satisfied at the time of confirmation that "the proposal of the plan and its acceptance are in good faith."\textsuperscript{314} A plan put forward without any realistic hope for its success would not be proposed in good faith.\textsuperscript{315}

If the court is satisfied that a Chapter X petition is filed in good faith, it can approve the petition without delay.\textsuperscript{316} If the court wishes to hold a

\textsuperscript{307} See Murphy, Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings, 30 BUS. LAW. 15, 31 (1974).

\textsuperscript{308} Webster, Collateral Control Decisions in Chapter Cases, Clear Rules v. Judicial Discretion, 51 AM. BANKR. L.J. 197, 206-21 (1977). Mr. Webster notes that Bankruptcy Judge Paskay has imposed a four-part test by requiring Chapter XI debtors seeking prolongation of the automatic stay against lien enforcement to show: (1) an equity in the property subject to the security interest; (2) that the stay does not jeopardize the security interest; (3) a realistic possibility of confirmation of a plan; and (4) the essentiality of the encumbered property to the operation of the debtor's business and the consummation of a plan. Northwestern Financial Investors v. O.K. Motels, 1 Collier Bankr. Cas. 416, 419 (M.D. Fla. 1974); Continental Mortgage Co. v. Bric of America, Inc., 4 Collier Bankr. Cas. 34, 39 (M.D. Fla. 1975). In both cases the stay was lifted because the debtor failed to pass the test. The test is approved in Seidman, The Plight of the Secured Creditors in Chapter XI, 80 COM. L.J. 343, 346 (1975). The requirements that the debtor have an equity and that it not be jeopardized by the stay are discussed as aspects of a single consideration in the text accompanying notes 340-61 infra.

\textsuperscript{309} 51 AM. BANKR. L.J. at 222-40.

\textsuperscript{310} Bankruptcy Act §§ 141 (voluntary petition), 142 (involuntary petition); Bankr. Rule 10-113(a) & (b).

\textsuperscript{311} Bankruptcy Act § 146(3); In re Hunterbrook Bldg. Corp., 276 F.2d 190 (2d Cir. 1960).

\textsuperscript{312} Bankruptcy Act § 221(2).

\textsuperscript{313} 6 COLLIER ¶ 11.07 (1977); King, Feasibility in Chapter X Proceedings, 49 AM. BANKR. L.J. 323, 325-26 (1975).

\textsuperscript{314} Bankruptcy Act § 221(3).

\textsuperscript{315} 6A COLLIER ¶ 11.08, at 243 nn.8-10 (1977).

\textsuperscript{316} The procedure described in this paragraph is governed by Bankr. Rule 10-113.
hearing before approving the petition, however, it may do so on such notice as it may direct. If an answer challenges the good faith of the petition or raises issues requiring an inquiry into that matter, the court is required to hold a hearing "at the earliest practicable time on such notice as it may direct."\footnote{Bankr. Rule 10-113(c)(2).} Although Rule 10-601(c) also requires the trial of issues raised on a complaint seeking relief from the automatic stay to be held at the earliest possible date and to be given precedence over all matters except older matters of the same character, it is likely that such a trial will be held after the Chapter X petition has already been approved. If the lienor filed an answer contesting the good faith of the petition, he may have already been heard on the issue of the likelihood of a successful reorganization. Insofar as he renews the attack on the likelihood of a successful reorganization at the trial on the issues raised by the request for relief from the stay, the lienor will face a defense of collateral estoppel. Even if collateral estoppel is not operative because the lienor did not contest the good faith of the petition, he will be confronted ordinarily with the argument that approval of the petition necessarily rested on a finding that effectuation of a plan of reorganization was not an unreasonable expectation.\footnote{But cf. Mongiello Bros. Coal Corp. v. Houghtaling Properties, Inc., 309 F.2d 925, 927-30 (5th Cir. 1962), abstracted in note 319 infra.} The significance of prior approval of the Chapter X petition is, of course, augmented if there has been a vigorous contest and inquiry into the good faith issue, involving particularly the prospects for a successful reorganization. On the other hand, the approval is far from conclusive of the request for relief from the stay, since other considerations may well support the termination, modification, or conditioning of the stay.\footnote{Cf. Mongiello Bros. Coal Corp. v. Houghtaling Properties, Inc., 309 F.2d 925 (5th Cir. 1962), where the court apparently regarded the finding of good faith in the order of approval of the petition vulnerable to attack because of a lack of supportive findings of fact. There had been no contest of the Chapter X petition, and the matter on appeal was the stay of a sale pursuant to a state foreclosure decree.}

Although Chapters XI and XII do not require the court to approve a petition as one filed in good faith, there is case law declaring that the court may dismiss a petition filed under Chapter XI if rehabilitation is hopeless,\footnote{Ira Haupt & Co. v. Klebanow, 348 F.2d 907 (2d Cir. 1965) (dismissal grounded on "no prospect of rehabilitation"); see Ford Motor Credit Corp. v. Philadelphia Import Center, Inc. (In re Carlton Indus., Inc.), 2 Bankr. Ct. Dec. 1312, 1313 (Ref., E.D. Va. 1976) (emphasizing "vast and significant" difference between "no prospect" and the absence of a "reasonable prospect" that constitutes lack of the good faith required by § 146 for approval of a Chapter X petition).} and the reasoning is equally applicable to a petition filed under Chapter XII.\footnote{Charlestown Sav. Bank v. Martin (In re Colonial Realty Investment Co.), 516 F.2d 154, 160-61 (1st Cir. 1975); In re Bolton Hall Nursing Home, 3 Bankr. Ct. Dec. 441 (D. Mass 1977); Trustees of Builders Inv. Group v. Samoset Assoc., 3 Bankr. Ct. Dec. 393, 395-96 (Ref., D. Me. 1977). In In re Carousel Ltd. Partnership, 14 Collier Bankr. Cas. 760 (Ref., N.D. Ga. 1977), when a secured creditor sought dismissal of a Chapter XII petition by an "application" filed within two weeks of the filing of the petition, the court denied the application as unauthorized by the Act or the Chapter XII Rules. The court acknowledged that the cases cited
require a plan, in order to be confirmed, to be feasible and proposed in good faith. Since the requirements applicable to plans filed under Chapters X, XI, and XII differ in important respects, the indicia of lack of good faith are not the same. In passing on requests for relief from stays in all chapter cases, however, the courts eschew conducting elaborate hearings on the prospects for successful reorganization.

The degree of likelihood of a successful rehabilitation required to justify continuation of a stay in a chapter case is variously stated. The typical formulation in a case denying relief is that reorganization appears to be a "reasonable possibility." In a recent Chapter XII case Judge Babitt was satisfied by evidence that "it is as reasonably likely that the debtor will successfully rehabilitate as not." The typical rationale when relief is granted is that reorganization is not a "realistic expectation." Where above discuss "good faith" of a Chapter XII petitioner but explained them as concerned with the good faith required of a plan proposed for confirmation or good faith in the sense required in a hearing on whether a stay should be continued. In the absence of objection the court may, in a Chapter XI, XII, or XIII case, find that a plan has been proposed and accepted in good faith without the taking of proof. In the absence of objection the court may, in a Chapter XI, XII, or XIII case, find that a plan has been proposed and accepted in good faith without the taking of proof. Bankr. Rules 11-38(d), 12-38(d), and 13-213(a). The requirement of feasibility does not apply if all creditors have accepted the plan, as provided in §§ 361, 457, and 651, but the plan and its acceptance must be in good faith to be confirmed under any of these sections. But see C.I. Mortgage Group v. Nevada Towers Assoc., 14 Collier Bankr. Cas. 146, 152 n.7 (Ref., S.D.N.Y. 1977) ("the degree of proof required to establish the possibility of rehabilitation and thereby the good faith of the petition matches the degree of proof necessary to establish the possibility of rehabilitation in deciding whether or not to vacate or modify the stay of Rule 12-43(a)").


See C.I. Mortgage Group v. Nevada Towers Assoc., 14 Collier Bankr. Cas. 146, 151 (Ref., S.D.N.Y. 1977) ("the degree of proof required to establish the possibility of rehabilitation and thereby the good faith of the petition matches the degree of proof necessary to establish the possibility of rehabilitation in deciding whether or not to vacate or modify the stay of Rule 12-43(a)").

the prospects for successful rehabilitation in a Chapter XII case were "dim," the court continued the stay for three months.327

Whether the issue of the likelihood of a successful reorganization is raised in a contest of the petitioner's good faith or in a request for relief from the stay, its determination requires the court to speculate on the probable outcome of a complicated and uncertain process. A cold-blooded appraisal of relevant experience probably warrants adoption by the courts of a strong presumption against the likelihood of success of any reorganization.328 Notwithstanding the burden of justification imposed on the party seeking continuation of the stay, the bankruptcy courts have understandably been reluctant to terminate a stay at an early stage of the reorganization process solely on a finding that reorganization is hopeless or unlikely.329

A decision by the bankruptcy judge that a successful reorganization is not reasonably probable is not likely to be reversed, since such a determination is almost certain to be a self-fulfilling prophecy. The effort required to establish the error by appeal would indeed aggravate the burden of overcoming the financial difficulties that led to the filing of the reorganization petition. A decision predicated on an erroneous finding that a successful reorganization is reasonably likely is more apt to be overruled by events than by a court on appeal. These observations help to explain the reluctance of courts to find no reasonable expectation of a successful reorganization, but they afford little consolation to a lienor whose security suffers continuing deterioration during the pendency of the stay. There are cases where courts can confidently determine at an early stage that reorganization cannot reasonably be expected, and in such a case this determination justifies termination of the stay. In most cases, however, disposition of a complaint seeking relief from the stay will require a consideration of other issues.

Dicta are frequently encountered to the effect that a Chapter XIII debtor must show good faith in submitting a plan and an ability to perform in order to be entitled to a stay.330 The proportion of dismissals and "repeaters" under Chapter XIII is high,331 but even partial success of a Chapter XIII plan is generally viewed as a benefit, at least to creditors.332 To terminate the automatic stay would assuredly reduce the number of confirmed plans and accelerate and augment plan failures; but modifica-

332 See D. Stanley & M. Girth, supra note 328, at 102 and 105-06.
tion of a Chapter XIII plan to fit the debtor's financial capabilities is ordinarily preferable, for both the debtor and his creditors, to liquidation and foreclosure. Only a few cases illustrate the possibility that the courts will terminate a stay in a Chapter XIII case because of the debtor's inability to perform.\footnote{See Colonial Mortgage Serv. Co. v. Johnson, 1 Bankr. Ct. Dec. 982 (Ref., D.D.C. 1975) (plan to pay arrearage of $2,064.59 on $22,100 secured debt held not realistic, and continuation of stay would be in derogation of rights of secured creditor); cf. In re Cassidy, 1 Bankr. Ct. Dec. 1455 (E.D.N.Y. 1974) (case remanded for findings on debtor's good faith, feasibility of plan, existence of debtor's equity, and reasonableness of delay of mortgagee).}

(b). Essentiality of the Encumbered Property—In a few cases, the court has resolved the question whether enforcement of a lien against a debtor undergoing reorganization should be enjoined by focusing on whether the property subject to the lien was essential to a successful reorganization.\footnote{National Bank v. Goodwin, 12 Collier Bankr. Cas. 493 (Ref., D. Md. 1977) (debtor's stock not essential to Chapter XI plan); Pledger v. Red Carpet Corp., 11 Collier Bankr. Cas. 487, 489 (Ref., N.D. Fla. 1976) (mortgaged cottage used by debtor and family not necessary to operation of Chapter XI debtor's restaurant, lounge, and motel business); cf. Continental Mortgage Co. v. Bric of America, Inc., 4 Collier Bankr. Cas. 34, 40 (Ref., M.D. Fla. 1975) (mortgaged, unimproved realty not essential to debtor's business because debtor no longer had a going business and had never developed property).} Essentiality may be found not only when the property is indispensable to the reorganized enterprise\footnote{In remanding a proceeding on a complaint filed under Rule 11-44 to the bankruptcy judge for an expedited hearing, a district court instructed the bankruptcy judge to "permit the debtor to introduce relevant evidence on the sole issue of whether the property in question is essential to the rehabilitation of the debtor or to the liquidation of the debtor's estate." Associated Midwest, Inc., v. White Birch Park, Inc., 443 F. Supp. 1342, 1346 (E.D. Mich. 1978). It did not appear in the opinion why the debtor's evidence should bear only on this issue, but the court was concerned to preclude further inquiry on remand into issues raised by the debtor's counterclaim based on allegations of fraud. The issues raised by the counterclaim are discussed in notes 269, 271, and 276 and the accompanying text supra. The reference to essentiality of the property to the liquidation of the debtor's estate is inexplicable. In In re Tracy, 194 F. Supp. 293, 295 (N.D. Cal. 1961), it was suggested that if the debtor had ample accounts receivable to pay all his unsecured creditors, it would be an abuse of discretion to restrain the enforcement of a lien against fixed assets. Since there was uncertainty, however, as to the collectibility of the accounts and there appeared ample equity in the fixed assets, a stay entered by the referee pursuant to § 314 was continued. The court nevertheless directed the referee on remand to reconsider, inter alia, whether the debtor's residence, which constituted security for two mortgages, "was of such essential necessity to the transaction of business" of the debtor and its sale "a sufficient disadvantage to the consummation of the arrangement" as to justify the continuation of the stay. In re Atlantic Steel Prod. Corp., 31 F. Supp. 408, 410 (E.D.N.Y. 1939) (foreclosure of mortgage on debtor's plant and equipment enjoined pursuant to § 314 since foreclosure would have rendered impossible the carrying out of the plan); BVA Credit Corp. v. Consolidated Motor Inns, 6 Collier Bankr. Cas. 18, 32 (Ref., N.D. Ga. 1975) (relief from stay and reclamation deemed, for lessor of equipment, "absolutely . . . essential to reorganization or the prospect thereof"). Any significant interruption of business during the effort to evolve a reorganization is almost certain to be fatal to the effort. Thus, repossession of a substantial portion of the inventory of a merchant or manufacturer by a lienor could destroy any prospect of rehabilitation under the Bankruptcy Act, even though the particular inventory is not expected to be part of the property of the reorganized enterprise. In re Creed Bros., Inc., 14 Collier Bankr. Cas. 426, 429, 431 (Ref., S.D.N.Y. 1977) (pledged inventory of lumber and building mate-} but also when it is required to enable the debtor to operate its business during the pendency of the case in the bankruptcy court. In Chapter XIII cases, the courts typically
require that the stay be necessary to preserve the debtor's estate or to enable the debtor to carry out the plan. In the absence of a demonstrated need of the property for the purposes of the reorganization or rehabilitation, the proponent of the injunction or stay cannot sustain the burden of justifying interference with the lienor's right to enforce his lien. Indispensability of the property to the debtor's survival and hope of rehabilitation is not enough, of course, to justify continuation of the stay when rehabilitation is hopeless or the stay threatens injury to the lienor's security.

(c). Presence of Equity and Potential Injury to the Creditor's Security—Most litigation regarding injunctions and stays of lien enforcement has focused on whether the injunction or stay will injure the secured position of the creditor. Determination of that issue practically entails a preliminary determination of the value of the collateral. If a substantial

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A number of cases have emphasized, as a justification for staying foreclosure of a mortgage of real estate during the pendency of a Chapter XIII case, the need to preserve the debtor's equity of redemption for the benefit of other creditors if bankruptcy should eventuate. See Hallenbeck, 323 F.2d at 572; In re Garrett, 203 F. Supp. 459, 460-61 (N.D. Ala. 1962).

338 See, e.g., Thompson v. Ford Motor Credit Co., 475 F.2d 1217, 1219 (5th Cir. 1973) (loss of car, debtor's only means for getting to work, would endanger debtor's continued employment and ability to make payments under the plan); In re Mickens, BANKR. L. REP. (CCH) ¶ 66,752 (W.D. Tenn. 1977) (injunction against reclamation of car dissolved, bus transportation being available); General Motors Acceptance Corp. v. Garcia, 396 F. Supp. 519, 522, 524 (C.D. Cal. 1974) (vehicles protected from reclamation by injunction necessary for husband and wife to carry out plan); In re Rutledge, 277 F. Supp. 933, 936 (E.D. Ark. 1967) (automobile "necessary for the success of the plan" of a disabled war veteran); Leavenworth Nat'l Bank v. Visoscky, 13 Collier Bankr. Cas. 688, 691-92 (Ref., D. Kan. 1977) ("the vehicles, furniture and other personal property herein are essential to the rehabilitation of this Plan because while living outside the city limits, both husband and wife need transportation to get to and from their respective jobs; and obviously, the seven children need a bed in which to lay their heads, a stove for their food to be cooked, and refrigerator to preserve the food, and a table on which to eat"); In re Pilson, 9 Collier Bankr. Cas. 424, 428 (Ref., W.D. Va. 1976) (stay against foreclosure of mortgage on family dwelling deemed "absolutely necessary to preserve debtors' estate in the real property and to carry out the plan"); Bank of Virginia Tidewater v. Porter, 8 Collier Bankr. Cas. 18, 20, 22 (Ref., S.D. Cal. 1976) (vehicle "for general transportation and general use" deemed "necessary to preserve these debtors' estate and carry out their plan"); cf. First Nat'l Bank v. Freeman, 1 Bankr. Ct. Dec. 576 (Ref., M.D. Ga. 1975) (automobile needed to take debtor's blind daughter to and from academy).

If, on the other hand, there is no surplus value in the property beyond what is required to pay the debt secured, the debtor, receiver, or trustee will find it exceedingly difficult to convince the court that a stay of enforcement will not injure the secured creditor. The property, unless it is land, is almost certain to depreciate during the pendency of the stay, and if the property is used by the debtor during the term of the stay, the rate of depreciation may be so high as practically to destroy the value of the collateral.

If the equity is nonexistent or thin and the debtor is unable to make payments of accruing installments of principal and interest of secured debt, the debtor's burden of justifying continuation of the stay is heavy indeed.\textsuperscript{341}

The standard of valuation presents a subsidiary issue that may assume critical importance in a determination of the presence or absence of an equity and the adequacy of the protection for the lienor subject to a stay. In seeking relief from the stay, a secured creditor is likely to support his argument by attempting to show the inadequacy of the collateral to cover his debt and the prejudice likely to accrue from a postponement of foreclosure of the security interest. The argument may well be predicated on a valuation of the property on liquidation rather than on a going concern value. If the court nevertheless stays the enforcement of the security interest and valuation of the collateral becomes necessary later in the determination of whether a proposed plan should be confirmed, the secured creditor is then likely to insist on a valuation by reference to the going concern standard.\textsuperscript{342}


\textsuperscript{341} But cf. \textit{C.I. Mortgage Group v. Nevada Towers Assoc.}, 14 Collier Bankr. Cas. 146, 155 (Ref., S.D.N.Y. 1977), where the secured creditor argued that the stay threatened to add $780,000 to its deficiency claim, but the court anticipated that the property could be improved sufficiently during the stay to permit full payment of the secured debt, whereas termination of the stay would force the secured creditor to take the property with no prospect for return on its investment; \textit{In re Lax Enterprises}, 11 Collier Bankr. Cas. 628, 632 (Ref., N.D. Ohio 1976), where accrual of interest and penalty interest could shortly deplete the debtor's equity and the court allowed foreclosure proceedings to continue up to execution.

\textsuperscript{342} See \textit{Webster}, supra note 308, at 232. Bankruptcy Judge Cyr observed in \textit{Chemical Bank v. American Kitchen Foods, Inc.}, 2 Bankr. Ct. Dec. 715, 719-20 (Ref., D. Me. 1976) that "it sometimes serves the interests of secured creditors to attempt to whipsaw the debtor by insisting upon a going-concern of fair-market valuation at the commencement of the proceedings, but a forced-sale valuation later on, in order to demonstrate more extensive collateral depletion or diminution following the petition. A secured creditor is then better positioned to assert that retention and use of the collateral by the debtor has rendered the secured creditor an involuntary lender entitled to priority payment from the estate for the impairment of its lien." In the scenario envisioned by Judge Cyr, the secured creditor apparently has not engaged in a closely contested hearing at an early stage of the case on whether there was an equity sufficient to justify continuation of the automatic stay. Judge
The usual assumption is that the court should receive evidence as to the "fair market value" when the issue is whether property sought to be reclaimed or subjected to foreclosure has any equity. Since the secured creditor may be relegated to collection by forced sale if the rehabilitation effort under the Bankruptcy Act aborts, there is logic in an argument that the liquidation value of the property ought to be the focus of the court's inquiry at the hearing on a complaint seeking relief from the stay. If there is a substantial difference between the forced sale value and the going concern value of property subject to a lien, however, and if the question of value must be determined at the threshold of the case or if a successful reorganization appears to be a reasonable prospect, the court is likely to avoid making and relying on a stark determination of the liquidation value. If the property subject to the lien is inventory reasonably salable in the ordinary course of business, it is sensible for the court to try to determine what the property will bring when disposed of in a commercially reasonable manner. It is generally conceded that the value of property subject to a lien may change during the course of a case, and thus a finding of a particular value at one stage or for one purpose ought not to preclude a re-examination of the question when circumstances may have changed.


Going concern value was preferred to liquidation value in Reliance Standard Life v. Pembroke Manor Apts., 547 F.2d 805 (4th Cir. 1977) (Chapter XII case); In re Creed Bros., Inc., 14 Collier Bankr. Cas. 426, 431 (Ref., S.D.N.Y. 1977) (Chapter XI case); cf. In re Lax Enterprises, 11 Collier Bankr. Cas. 628 (Ref., N.D. Ohio 1976) (considering both an "income approach" and a "cost approach" to valuation of properties of a motor inn). Reliance on the "going concern value" is criticized by Webster, supra note 308, at 235-37, on the ground that it gives the secured creditor the benefit of a bonus to the extent it recognizes a value above what he would receive if he enforced his security in accord with his contract.

In Chemical Bank v. American Kitchen Foods, Inc., 2 Bankr. Ct. Dec. 715, 722 (Ref., D. Me. 1976), Bankruptcy Judge Cyr, in a careful opinion, argued for consistent application throughout reorganization proceedings of "the most economically realistic collateral standard," that is, the value recoverable from a sale or other disposition conducted in a commercially reasonable manner in accordance with §§ 9-504(3) and 9-507(2) of the Uniform Commercial Code.

The absence of an equity has usually been viewed as critically significant in a Chapter XI case. The assumption that an equity is necessary to the continuation of a stay has often been predicated on the bankruptcy court's lack of power to affect the rights of secured creditors, without their consent, in a plan confirmed under Chapter XI. The existence of an equity is not, however, and should not be, indispensable to the continuation of a stay. Congress explicitly authorized the bankruptcy court to enjoin lien enforcement when appropriate in the pursuit of the objective of rehabilitation under Chapter XI. If the secured creditor is adequately protected from injury resulting from the stay, the collateral is essential to the reorganization, and a reorganization in the interest of unsecured creditors is a realistic possibility, the absence of an equity should be immaterial. The possibilities for discharging the burden of proof required to sustain the stay should not be overwhelming when the debtor has a positive cash flow and the enterprise is in the hands of capable management.

The presence or absence of an equity does not have comparable importance in a Chapter X or a Chapter XII case, because it is at least

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348 See Silver Gate Sav. & Loan Ass'n v. Carlson (In re Victor Builders, Inc.), 418 F.2d 880, 882 (9th Cir. 1969) (upholding remand of case to referee to determine whether there was equity in property; presence of equity said to warrant permanent injunction of mortgage foreclosure until final decree; absence of equity said to require termination of temporary restraining order under § 314).

349 The validity of a Chapter XI plan affecting secured creditors with their consent was recognized in RIDC Industrial Dev. Fund v. Snyder, 539 F.2d 487, 494 (5th Cir. 1976), cert. denied, 429 U.S. 1095 (1977).


351 See Festerson, Equitable Powers in Bankruptcy Rehabilitation: Protection of the Debtor and the Doomsday Principle, 40 AM. BANKR. L.J. 311, 333 (1972); Webster, supra note 308, at 231-32. The court observed in In re Bolton Hall Nursing Home, 14 Collier Bankr. Cas. 90, 92 (D. Mass. 1977), that Chapters XI and XII were intended for the use of debtors without equity in their property.


354 See, e.g., C.I. Mortgage Group v. Nevada Towers Assoc., 14 Collier Bankr. Cas. 146, 156 (Ref., S.D.N.Y. 1977) (court continued the stay and rejected the secured creditor's request for a determination of the value of its security); C.I. Mortgage Group v. Castle Village Co., 13 Collier Bankr. Cas. 452, 462 (Ref., S.D.N.Y. 1977) (existence of an equity was not required as a condition to the continuation of a stay against a second mortgagee in a Chapter XII case); In re Triangle Inn Assoc., BANKR. L. REP. (CCH) ¶ 66,335 (Ref., E.D.
theoretically possible for a plan confirmed under either of these chapters to reduce or otherwise alter the rights of secured creditors in the property subject to their liens.\textsuperscript{356} Secured creditors seeking termination of stays in Chapter X and XII cases frequently contend, however, that since they will not accept any proposal affecting their rights, there is no reasonable possibility of a successful reorganization when the debtor has no equity. This argument has been viewed by some courts as well nigh conclusive of the right to a termination of the automatic stay, and even dismissal of the case, when the debtor's petition has been filed under either Chapter X or XII.\textsuperscript{357}

\textsuperscript{356} Va. 1976) (stay continued at instance of junior mortgagees and the debtor, notwithstanding the first mortgagee's "biased" appraisal showing no equity and the court's acknowledgement that prospects for a successful rehabilitation were dim). Cf. \textit{In re} Hartsdale Assoc., 11 Collier Bankr. Cas. 87, 93 (Ref., S.D.N.Y. 1976) (second mortgagee stayed for eight months where property alleged to be worth more than two mortgages but not more than third and fourth mortgages; "eroding position of secured creditors" held to warrant lifting stay to permit foreclosure to proceed to point of sale). The court in \textit{Nevada Towers Assoc.} nevertheless suggested that "there is greater tension between the needs of a Chapter XII debtor and the mortgagee than in the typical Chapter XI case," because the security is more likely to be "at the heart of the case" in Chapter XII than in Chapter XI.

A Chapter XII case often cited for requiring an equity is \textit{Hamburger v. Dyer}, 117 F.2d 932 (6th Cir.), \textit{cert. denied}, 313 U.S. 572 (1941). This construction of the chapter has been regarded as a necessary result of the absolute priority rule, which has subsequently been eliminated from the chapter. See C.I. Mortgage Group v. Castle Village Co., 13 Collier Bankr. Cas. at 462.

\textsuperscript{357} Where, however, a Chapter XII debtor's secured debts were nearly double the fair market value of his property, the property was deteriorating, and there was no evidence that a plan could be worked out which would offer secured creditors adequate protection, termination of the stay was required. \textit{In re} Hosmer, BANKR. L. REP. (CCH) \textsuperscript{r} 66,778 (Ref., N.D. Ga. 1977).

In a recent opinion District Judge Carter declared that "there is virtual unanimity in the decided case law that rejection of a plan in a Chapter XII proceeding by all the secured creditors bars its confirmation." \textit{In re} Schwab Adams Co., No. 77-B-225 (S.D.N.Y. 1978). Judge Carter cited the following cases to support this proposition: \textit{Taylor v. Wood}, 458 F.2d 15 (9th Cir. 1972); \textit{Meyer v. Rowan}, 195 F.2d 263, 266 (10th Cir. 1952); \textit{Kyser v. MacAdam}, 117 F.2d 232, 238 (2d Cir. 1941) (secured creditors held improperly denied right to vote on plan notwithstanding delivery to them, pursuant to plan, of mortgages equal in worth to the value of their security in the debtor's estate).

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In a number of recent opinions, bankruptcy courts have not allowed adamant opposition or even vehement attack by secured creditors to prevent efforts to obtain debtor relief under Chapter X or XII. Some of these opinions point out that the court retains the power to confirm a plan, notwithstanding creditors' objections, when the plan provides adequate protection for the realization of the value of their claims. This position has been taken even when all the debtor's property is subject to the lien of a single creditor who insists that he will not consent to a plan altering his rights and that the court cannot confirm a plan against the opposition of the only creditor entitled to vote on a plan. In sustaining the stay in such a case, the courts are likely to emphasize the possibility that creditor opposition may dissolve in the light of subsequent developments and a consideration of the opportunities and benefits presented by a specific plan.

The preservation of an equity has been recognized as a justification for continuing a stay in a number of Chapter XIII cases. The courts sometimes stress the protection of the unsecured creditors' interest in this source of payment of their claims in the event of a superseding bankruptcy, but more often the court's concern is with the contribution the property may make to the debtor's rehabilitation. A usual requirement for continuing the stay is that the security of the creditor not be impaired during its pendency.

The existence of an equity should not, of course, in and of itself, sustain the burden of proof resting on the party seeking continuation of the

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The court in In re Schwab Adams, No. 77-B-225 (S.D.N.Y. 1978), cited and quoted in note 357 supra, acknowledged that a single secured creditor was not allowed to veto a plan where adequate protection was provided in In re Pine Gate Assoc., Ltd., 10 Collier Bankr. Cas. 581 (Ref., N.D. Ga. 1976), and Massachusetts Mut. Life Ins. Co. v. Marietta Cobb Apt. Co., 3 Bankr. Ct. Dec. 720 (Ref., S.D.N.Y. 1977), but in each case only one secured creditor was involved. Bankruptcy Judge Norton had emphasized that fact as a limiting consideration in his opinion in Pine Gate Assoc., but Judge Babitt had not regarded it as one of controlling significance in Marietta Cobb. The court of appeals in Taylor v. Wood, 458 F.2d 15 (9th Cir. 1972), held a Chapter XII plan incapable of confirmation where the only creditor affected refused to accept, 458 F.2d at 16. See also Meyer v. Rowen, 195 F.2d 263, 266 (10th Cir. 1952), where the only secured creditors affected by the plan were related and had the same interest, and a proposal to provide them adequate protection was said not to authorize confirmation over their opposition.

361 Cf. In re Bermec Corp., 445 F.2d 367, 369 (2d Cir. 1971) ("creditors have been known to change their minds when a plan is actually put on the table").

362 See note 337 supra.

363 See note 338 supra.

stay.\textsuperscript{365} Since an equity existing at the threshold of the case may quickly disappear, the secured creditor should not be delayed in enforcing his rights if the debtor is in default, unless the secured creditor is protected against injurious diminution of his collateral, the collateral is necessary to the reorganization, and the success of the reorganization in the interest of unsecured creditors is a reasonable possibility.\textsuperscript{366}

(d). Progress Toward Formulation and Implementation of a Plan—A factor surfacing in an increasing number of cases where relief from a stay has been granted is the lack of progress toward the "formulation and implementation" of a viable plan of reorganization.\textsuperscript{367} This is a factor, of course, that becomes more influential in the disposition of a request for relief the longer the stay has run. Assessing this factor involves nothing less than a determination of what is a reasonable period of time for the debtor, receiver, or trustee to develop a plan and obtain the approvals requisite to confirmation. No rule of thumb has developed to guide the courts in making this determination. Before the court can conclude that the stay has run long enough, all the circumstances bearing on the debtor's situation and the reorganization process must enter into the calculus—including the causes of the debtor's financial distress, the nature and size of the enterprise, the causes for delay, the prospects for early resolution of the difficulties producing the delay, the consequences of further prolongation compared to termination of the stay, and the vigor of the efforts being made to accomplish the legitimate objectives of the proceedings.


\textsuperscript{366} Trust Co. v. Weems (\textit{In re} Hamilton Mortgage Corp.), 13 Collier Bankr. Cas. 77, 99 (Ref., E.D. Tenn. 1977) (stay limited where little equity existed and unpaid interest was accruing); \textit{In re} Advanced Lighting Prod. Co., BANKR. L. REP. (CCH) ¶ 66,466 (Ref., M.D. Fla. 1977) (inventory subject to floating lien being depleted); First Nat'l Bank v. The Overmyer Co., Inc., 10 Collier Bankr. Cas. 389 (Ref., S.D.N.Y. 1976) (rapid accrual of interest causing erosion of collateral); National Life Ins. Co. v. Jenifer Mall Corp., 2 Collier Bankr. Cas. 657, 663 (Ref., D.D.C. 1974) (equity expected to be consumed in five months by interest accruing during stay); \textit{In re} Hartsdale Assoc., 1 Collier Bankr. Cas. 87, 93 (Ref., S.D.N.Y. 1976) (relief granted where mortgagee's position was deteriorating because of accrual of unpaid interest during stay); Northwestern Financial Investors v. O.K. Motels, 1 Collier Bankr. Cas. 416, 420 (Ref., M.D. Fla. 1974) (collateral diminished by constantly accruing interest).

\textsuperscript{367} See, e.g., Lincoln-Alliance Bank & Trust Co. v. Dye, 115 F.2d 234 (2d Cir. 1940) (foreclosure permitted after stay of 14 months, during which debtor acquired equity but proposed no plan); Trust Co. v. Weems (\textit{In re} Hamilton Mortgage Corp.), 13 Collier Bankr. Cas. 77, 109 (Ref., E.D. Tenn. 1977) (stay of first mortgage limited to 90 more days in Chapter XI case filed by second mortgagee where no payment of interest had been made during year of pendency of Chapter XI case and there was no equity in the property); \textit{In re} Hartsdale Assoc. 11 Collier Bankr. Cas. 87, 93 (Ref., S.D.N.Y. 1976) (stay modified after eight months); Otab Land Co. v. DLB Dev. Corp., 6 Collier Bankr. Cas. 192, 205 (Ref., S.D. Cal. 1975) (stay terminated after ten months where there was no prospect of financing a plan); Bateman Financial Corp. v. Glanville Mortgage Co., 5 Collier Bankr. Cas. 488, 492-93 (Ref., M.D. Fla. 1975) (14 months' stay could not equitably be extended to permit formulation of plan to pay creditors following upturn in economy); C.I. Mortgage Group v. Groundhog Mtn. Corp., 4 Collier Bankr. Cas. 387, 393 (Ref., S.D.N.Y. 1975) (stay terminated when debtor made no movement toward plan during nine months of stay and made no payment on secured debt).
The courts have not hesitated to recognize a duty of diligence on the party seeking continuation of a stay against lien enforcement. Failure to develop a plan and the conditions conducive to its confirmation may be viewed as lack of good faith. Prolongation of the stay may indeed be characterized as unconscionable in light of the debtor's conduct.\textsuperscript{368} It is clear, however, that the burden imposed on the party seeking continuation of the stay requires more than showing an absence of bad faith or of unconscionability.

If the court perceives or is persuaded that the debtor's real purpose in filing a petition is to stall the secured creditor in his effort to enforce his lien against the debtor's property, termination of the automatic stay is practically automatic.\textsuperscript{369} Since this decision is appealable, however, the termination is not necessarily immediate. The secured creditor is, of course, often inclined to argue that the debtor's purpose is to delay lien enforcement, when the court suspects but cannot be certain of the debtor's motives. Except in a clear case, the court is unlikely to terminate the stay solely on the basis of a finding of an ulterior purpose on the part of the debtor.\textsuperscript{370}

Closely related to the consideration that court processes should not be perverted for the prime purpose of delaying a secured creditor in the pursuit of his remedies is the notion that Chapter XI should not be a means of effecting a protracted liquidation. The leading case for this proposition, \textit{In re Pure Penn Petroleum Co.},\textsuperscript{371} is currently of uncertain vitality,\textsuperscript{372} but a number of cases have referred to a debtor's purpose to obtain court supervision of an orderly liquidation as a factor adverse to the continuation of the stay.\textsuperscript{373}

\textsuperscript{368} See, e.g., First & Merchants Nat'l Bank v. County Green Ltd. Partnership, 438 F. Supp. 699, 700 (W.D. Va. 1977); Bateman Financial Corp. v. Granville Mortgage Corp., 5 Collier Bankr. Cas. 488, 492-93 (Ref., M.D. Fla. 1975). In the \textit{County Green} case, the debtor, a limited partnership, filed a Chapter XI petition within two weeks after commencement of foreclosure procedures to enforce a security agreement covering the debtor's property, but no plan was submitted until more than a year later. The first plan submitted was found not to have been filed in good faith, and a second plan required large payments to the two general partners, subordination of the lien of the construction lender, and forgiveness of interest accrued during the 15 months that had elapsed during the pendency of the stay.

\textsuperscript{369} See, e.g., Chaffee County Fluorspar Corp. v. Athen, 169 F.2d 448, 450 (10th Cir. 1948); \textit{cf.} C.I. Mortgage Group v. Groundhog Mtn. Corp., 4 Collier Bankr. Cas. 387, 393 (Ref., S.D.N.Y. 1975).

\textsuperscript{370} See, e.g., Mongiello Bros. Coal Corp. v. Houghtaling Properties Inc., 309 F.2d 925, 930 (5th Cir. 1962) (case remanded for findings of fact on the petitioners' good faith where individual mortgagors had transferred their property to a corporation in contemplation of the filing of a Chapter X petition).

For a case upholding a stay against foreclosure notwithstanding the court's recognition that the mortgagor's purpose in incorporating and filing a petition was to frustrate the foreclosure, see \textit{In re Valley Gold Ranch, Inc.}, 13 Collier Bankr. Cas. 710 (Ref., N.D. Cal. 1977), abstracted at note 284 supra.

\textsuperscript{371} 188 F.2d 851 (2d Cir. 1951).


\textsuperscript{373} Pledger v. Red Carpet Corp., 11 Collier Bankr. Cas. 487, 490 (Ref., N.D. Fla. 1976); Northwestern Financial Investors v. O.K. Motels, 1 Collier Bankr. Cas. 416, 419-20 (Ref.,
(e). Hospitality for Proponents of Rehabilitation—Many opinions have given eloquent expression to the recognition of a congressional purpose to afford a debtor in financial distress a fair opportunity to rehabilitate his enterprise under the protection and with the assistance of the court.\textsuperscript{374} Although there is little or no support for the notion in either the language of the Act or its legislative history, a congressional preference for reorganization or rehabilitation over liquidation is sometimes declared.\textsuperscript{375} Since a stay that preserves the status quo is conducive if not indispensable to the exploration and exploitation of the opportunity to develop a viable plan,\textsuperscript{376} the party seeking prolongation of the stay in a chapter case is typically accorded a hospitable reception when he undertakes to show reasonable likelihood of success in the reorganization effort.\textsuperscript{377}

The predisposition of the courts in favor of reorganization is reinforced if the proponent of the stay can point to a public interest in the continuity of the debtor's enterprise. The public interest may be found in the economic dependence of a community on the continuation of the enterprise. The possibility of preserving jobs for a substantial number of people may be mentioned as a reason for staying a lienor from closing down a going enterprise.\textsuperscript{378} Provision of a needed service or manufacture of a needed article of commerce by the debtor is a factor favorable to the argument for a stay that will permit the troubled enterprise to continue.\textsuperscript{379}

\textsuperscript{374} See In re Bermec Corp., 445 F.2d 367, 369 (2d Cir. 1971), referring to "the Congressional mandate to encourage attempts at corporate reorganization where there is a reasonable possibility of success"; C.I. Mortgage Group v. Nevada Towers Assoc., 14 Collier Bankr. Cas. 146, 149, 151, 153 (Ref., S.D.N.Y. 1977), where the court speaks of "the national legislature's grand design for insolvencies."

\textsuperscript{375} See, e.g., Carlton Indus., Inc. v. Philadelphia Import Center, 2 Bankr. Ct. Dec. 1312, 1314 (Ref., E.D. Va. 1976) where it is stated that "as a principle of national economy, preservation of a business is preferred to its liquidation." The court inferred congressional support for this statement from a quotation from H.R. Rep. No. 479, accompanying H.R. 2517, 90th Cong., 1st Sess. (1967), which referred to the "object" of Chapters X, XI and XII "to reorganize and rehabilitate a business rather than to liquidate it."

\textsuperscript{376} See In re First Baptist Church, Inc., 564 F.2d 677, 680 (5th Cir. 1977), where the court speaks of the " Chapter X court's obligation to preserve the status quo in order to afford interested parties a reasonable opportunity to formulate and implement a plan designed to mend the debtor's failing financial structure."

\textsuperscript{377} See Chase Manhattan Mortgage & Realty Trust v. Bergman, 14 Collier Bankr. Cas. 222, 228 (Ref., S.D.N.Y. 1977), where the court said that a Chapter XII petition should be dismissed for "bad faith" only where it can be demonstrated that there "is not the slightest rehabilitation factor in the debtor's equation."


\textsuperscript{379} In re Bolton Hall Nursing Home, 14 Collier Bankr. Cas. 90 (D. Mass. 1977) (Chapter XI and XII cases involving several nursing homes); Chase Manhattan Mortgage & Realty Trust v. Bergman, 14 Collier Bankr. Cas. 222, 226-27 (Ref., S.D.N.Y. 1977) (involving a nursing home where trustee in Chapter XII case had taken action in interest of patients and creditors).
Cf). The "Balance of Hurt"—A related consideration is that foreclosure of a lien may sacrifice substantial value, to the detriment and injury of unsecured creditors and the debtor or its stockholders. When the court is persuaded that the stay will help to avoid that sacrifice, without inflicting a comparable injury on the lienor, the burden resting on the proponent of the stay is significantly mitigated. The bankruptcy courts sometimes talk of the "balance of hurt" in resolving the conflict between the secured creditor, who is subject to possible injury by being denied prompt realization on his collateral, and the debtor, who may lose the going concern value of his property if liens on it are enforced.

A factor of undoubted influence in favor of the proponent of a stay against lien enforcement is the greater risk of harm that a premature or erroneous decision terminating a stay may be supposed to inflict on the debtor and the unsecured creditors, compared to the effect on the lienor of a similarly ill considered decision continuing the stay. It is not demonstrable that undue leniency in prolonging a stay against lien enforcement generally damages the lienor less than undue strictness in terminating a stay damages the debtor and the unsecured creditors. The impact of a lien enforcement against the property of a going enterprise is nevertheless likely to be more palpable and irrevocable than is the continuation of the stay of the secured creditor.

C. Modes of Relief from an Automatic Stay

The automatic stay rules recognize that relief may take any of several forms: the stay may be terminated, annulled, modified, or conditioned.

380 Chase Manhattan Mortgage & Realty Trust v. Bergman, 14 Collier Bankr. Cas. 222, 228 (Ref., S.D.N.Y. 1977) (permitting foreclosure would extinguish debtor’s equity and interest of other creditors, and mortgagee would realize a windfall profit by bidding on property); C.I. Mortgage Group v. Castle Village Co., 13 Collier Bankr. Cas. 452, 463 ("While C.I. [the mortgagee] might be better off after foreclosure, that is not the test; and the effect on the debtor would be disastrous."); Hillsdale Foundry Co. v. Michigan, 2 Collier Bankr. Cas. 542, 551 (Ref., W.D. Mich. 1974), abstracted at note 162 supra. But cf. In re Cassidz, 6 Collier Bankr. Cas. 226, 229 (E.D.N.Y. 1974), where a threat of irreparable injury to the debtor from a denial of the stay and lack of irreparable injury resulting from the stay were held to be insufficient justification for continuing the stay. The district court remanded the case to the referee for findings on the debtor’s good faith, the feasibility of the plan, the existence of the debtor’s equity, and the reasonableness of the delay of the mortgagee.


Courts of equity have, of course, traditionally engaged in balancing the interests of the parties likely to be affected when exercising discretion in passing on requests for injunctive relief. 7 J. MOORE, FEDERAL PRACTICE ¶ 64.04[1], at 65-41 to 45 (2d ed. 1972); 11 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE ¶ 2948, at 431, 442-47 (1973).

When it is terminated, the creditor or other party liberated thereby is free to pursue whatever remedy had theretofore been stayed. Termination ordinarily operates only in favor of the party in whose favor the court has entered an order granting relief. There may be circumstances, however, where the order clears the way for other persons to pursue remedies against the debtor or its property without seeking specific relief from the court.

An order of annulment does not merely terminate a stay but declares it ineffective against actions, proceedings, or acts that occurred before the order of annulment was entered. The annulment prescribed by Rule 401(c) for a stay against any action or judgment of a creditor whose claim is neither scheduled nor filed is itself automatic and thus requires no request for relief by the creditor, who presumably has no knowledge of the pendency of the bankruptcy. If a debtor wishes to contest such an annulment, he should proceed pursuant to Rule 765 to obtain injunctive relief against the creditor, and perhaps a determination of dischargeability of the creditor's claim.383

A creditor may seek relief from the stay in order to satisfy a condition precedent to the liability of a surety or insurer. Such relief should be routinely available, and the court may protect the debtor while granting the relief by entering an injunction against the creditor's enforcement of any judgment he obtains against the debtor or the debtor's property.384

Bankruptcy courts have often been unwilling either to terminate or to continue the stay indefinitely. Realizing the potential harm a prolonged stay may inflict on a secured creditor, the court may place a time limit on the duration of the stay against lien enforcement.385 The limit may be fixed or flexible. The court may permit a pending action to continue to judgment but enjoin the enforcement of the judgment by levy386 or by sale.387 If the stay protects the debtor's possession of collateral and the debtor is using the collateral, the court may condition the stay on con-

383 See note 116 and accompanying text supra.
384 The Supreme Court originally suggested this technique in Hill v. Harding, 130 U.S. 699 (1889), in a case arising under the Bankruptcy Act of 1867, when a creditor of a discharged bankrupt wished to satisfy a condition precedent to the imposition of liability on an insurer.
385 See, e.g., Trust Co. v. Weems (In re Hamilton Mortgage Corp.), 13 Collier Bankr. Cas. 77, 100 (Ref., E.D. Tenn. 1977) (stay continued for 90 days to permit consummation of settlements).
386 See, e.g., Leavenworth Nat'l Bank v. Visoscky, 13 Collier Bankr. Cas. 688, 692 (Ref., D. Kan. 1977) ("reclamation" said to be granted but execution stayed during payments pursuant to Chapter XIII plan).
387 See, e.g., Associated Midwest, Inc. v. White Birch Park, Inc., 443 F. Supp. 1342, 1346 (E.D. Mich. 1978) (suggesting that on remand the bankruptcy judge might modify the stay to allow continuation of a mortgage foreclosure action but to remain operative against any execution or enforcement of a judgment for the mortgagee); In re Hartsdale Assoc., 13 Collier Bankr. Cas. 692, 694, 708 (Ref., S.D.N.Y. 1977) (second and third mortgagees allowed to foreclose "up to the point of sale").

In In re First Baptist Church, Inc., 564 F.2d 677 (5th Cir. 1977), the bankruptcy judge authorized a foreclosure to proceed in state court but reserved authority to review the sale results before authorizing issuance of a title certificate by the debtor. The court rejected an effort by the trustee to reinstate the stay of the foreclosure sale because notice to creditors of the sale did not conform to the requirements of Rule 203.
continued installment and interest payments to the secured creditor. A celebrated case, *In re Bermec*, conditioned the stay on the making of periodic payments to the secured creditor equal to the economic depreciation of the collateral during its use by the trustee of the debtor. Other conditions protective of the secured creditor's interest have been attached to the continuation of the stay.

The role of the automatic stay in Chapter XIII cases has been noteworthy. Although a Chapter XIII plan cannot deal with debt secured by real estate or, except when the creditor consents, with debt secured by personal property, bankruptcy courts have enjoined the enforcement of liens against both kinds of property pursuant to section 614 of the Act. As earlier indicated, issuance of such injunctions has generally been governed by restrictions formulated in *Hallenbeck v. Penn Mutual Life Insurance Co.* An injunction against lien enforcement will be granted if: the injunction is necessary to preserve the debtor's estate or to carry out the debtor's plan; the injunction does not impair the creditor's

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388 The opinion of Bankruptcy Judge Herzog is unpublished, but his finding that the trustees should pay the "economic depreciation" on the secured creditors' equipment in order to preserve the status quo was upheld in *In re Bermec Corp.*, 445 F.2d 367, 369 (2d Cir. 1971). The debtor's petition under Chapter X was upheld against an attack by secured creditors on the ground that it was not filed in good faith.

389 The secured creditor was also protected against economic depreciation during the period of stay in the following cases: Thompson v. Ford Motor Credit Co., 475 F.2d 1271, 1219 (5th Cir. 1973) (although delinquent in making installment payments, Chapter XIII debtor had made payments "roughly" covering the depreciation on the car during the pendency of the plan); General Motors Acceptance Corp. v. Garcia, 396 F. Supp. 518 (C.D. Cal. 1974) (stay conditioned on monthly payments covering economic depreciation and on liquidating secured debt during term of plan); Leavenworth Nat'l Bank v. Visocskey, 13 Collier Bankr. Cas. 688, 689 (Ref., D. Kan. 1977) (payments exceeded monthly depreciation on two motor vehicles and tractor under a Chapter XIII plan); Bank of Virginia Tidewater v. Porter, 8 Collier Bankr. Cas. 18, 19, 22 (Ref., S. D. Cal. 1976) (reduced installment payments more than covered economic depreciation of automobile, the value of which exceeded the debt).

390 Bankruptcy Act § 606(1) defines "claims" for the purpose of Chapter XIII to exclude those secured by estates in real property or chattels real.

391 Claims secured by personal property are included in § 606(1) of the Bankruptcy Act, but, before an application for confirmation can be made, § 652(1) requires a majority of creditors whose claims are dealt with by the plan to accept it in writing.


393 See notes 337-38 & 362-63 and accompanying text supra.

394 323 F.2d 566 (4th Cir. 1963).
security; and the secured creditor is not required to accept any reduction in the installment payments. The court added preliminarily that the court must also be satisfied of the debtor’s good faith and his ability to perform. The automatic stay of Rule 13-401 has generally been applied with due deference to the restrictions specified in Hallenbeck. Both before and since the promulgation of the Rules, however, the courts have been qualifying the third restriction. Thus, several cases have authorized continuation of the stay, notwithstanding a failure by the debtor to maintain a payment schedule in compliance with the security agreement. In particular, the courts have allowed the debtor to cure defaults by making installment payments within a fixed or a “reasonable” time. In several cases the courts reduced monthly payments to secured creditors. In three of them the creditors’ secured claims were reduced to the appraised value of their collateral, and the deficiencies were treated as unsecured claims. In two of the cases the court conditioned the continuation of the stay on the debtor’s making payments according to a schedule which would compensate for economic depreciation but which neither conformed to the security agreement nor constituted part of the Chapter XIII plan. The secured creditors in these cases had not con-

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395 Id. at 572. See note 330 and accompanying text supra.
396 Cases antedating the Rules include Thompson v. Ford Motor Credit Co., 475 F.2d 1217, 1219-20 (5th Cir. 1973), where the debtor was allowed to cure defaults by periodic payments along with the payments at the contract rate on his car-purchase contract; In re Pizzolato, 268 F. Supp. 353 (W.D. Ark. 1967), where a secured creditor was denied reclamation of his collateral and the Chapter XIII plan provided for payment of the secured debt according to the contract except for a balloon payment at the end. For cases since the advent of the Rules see notes 397-403 infra.
401 General Motors Acceptance Corp. v. Garcia, 396 F. Supp. 518, 524 (C.D. Cal. 1974); Bank of Virginia Tidewater v. Porter, 8 Collier Bankr. Cas. 18, 22 (Ref., S.D. Cal. 1976). The affirmance of the bankruptcy judge in Ford Motor Credit Co. v. McKee, 416 F. Supp. 652, 653 (E.D. Ark. 1976) presumably left the stay prescribed by Rule 13-401(a) in effect. Inferably the plans in McKee and Ford Motor Credit Co. v. Wall, 403 F. Supp. 357, 358 (E.D. Ark. 1975) provided for the payments to the secured creditor, and in Wall he was to receive interest on both the secured and unsecured portions of his claim at the contract rate.
sented to the resulting modifications of their contracts, and the courts appear to have subjected them to a kind of "cramdown" without a statutory provision for it in Chapter XIII.402 Since the creditors would receive full payment of their claims, however, the creditors were deemed not to be adversely affected.403

A grant or denial of relief from the automatic stay is appealable.404 When a secured creditor proceeded with a foreclosure within ten days after entry of the order granting relief, the fact that the order remained appealable during the period was held not to invalidate the sale.405

VI. EFFECTS AND ENFORCEMENT OF THE AUTOMATIC STAY

A. Effect of Acts in Violation of the Stay

As previously noted, a stay prescribed by the Bankruptcy Rules is effective without the entry of any court order against any person or act or proceeding subject to the stay. The fact that a person subject to the stay

402 In Wolff v. Wells Fargo Bank (In re Moralez), 400 F. Supp. 1352 (N.D. Cal. 1975), the court held that a secured creditor of a Chapter XIII debtor cannot be compelled to accept less than full payment of all installments provided by his contract, irrespective of the value of the collateral. The provision in Rule 13-307(d) authorizing allowance of a secured claim to the extent of the value of the security interest held by the creditor was declared to be invalid because it modified the secured creditor's substantive right to full performance of his contract. Id. at 1355. It is a stultifying construction of a provision of the Bankruptcy Act to attribute substantive significance to the interest of a creditor merely because he has used the form and phraseology of a security agreement, and to ignore the limitations inhering in the value of collateral, if any. See Anderson, Partially Secured Creditors: Their Rights and Remedies Under Chapter XI of the Bankruptcy Act, 37 LA. L. REV. 1003, 1018, 1021 (1977); Countryman, Partially Secured Creditors Under Chapter XIII, 50 AM. BANKR. L.J. 269 (1976); but cf. Williams, Chapter XIII: The (Partially) Secured Creditor and Bankruptcy Rule XIII-307(d), 32 PERS. FIN. L.Q. REP. 37 (1978).

403 See In re Wall, 403 F. Supp. 357, 360 (E.D. Ark. 1975); In re Pizzolato, 268 F. Supp. 353, 357 (W.D. Ark. 1967) (extending time of "balloon payment" acknowledged to be technically dealing with creditor's contract, but not materially and adversely affecting it); Sterchi Bros. Stores, Inc. v. Wilder, 225 F. Supp. 67, 69 (M.D. Ga. 1963) (postponement of last two installments said not to materially and adversely affect creditor); cf. General Finance Corp. v. Gamer, 556 F.2d 772, 779 (5th Cir. 1977) (secured creditor of Chapter XIII debtor held not materially and adversely affected by being compelled to accept $1000 credit on account of its violation of Truth-in-Lending Act and consequent reduction of monthly payments on its secured debt).

In Thompson v. Ford Motor Credit Co., 475 F.2d 1217, 1219 (5th Cir., 1973), the court said that notwithstanding some delay caused by the debtor's default, the secured creditor had not been required by the plan "to surrender any essential rights under his contract." See also Poulos, The Secured Creditor in Wage Earner Proceedings: Dream Versus Reality, 44 REF. J. 68 (1970); Note, Effectuating the Purposes of Chapter XIII of the Bankruptcy Act, 22 ME. L. REV. 401 (1970).

404 2 COLLIER ¶¶ 24.38[1], at 791 n.14 (1975); 2 id. ¶ 24.38[2], at 792 nn.17, 18 (1975); 13 id. ¶ 801.06 (1975). Cf. Reliance Standard Life v. Pembroke Manor Apts., 547 F.2d 805 (4th Cir. 1977) (stay held improperly terminated on premature appeal by mortgagee from order determining only that mortgagee was a partially unsecured creditor for purpose of voting his claim).


406 See text accompanying notes 5-6 supra.
has received no notice and has no knowledge of the filing of the petition does not negate the stay’s effectiveness, although lack of knowledge may have a bearing on the appropriate sanction to be applied to a violator of the stay.

The assumption underlying the stay rules is that any act or step taken in any proceeding in disregard of the stay is a nullity, unless the stay is itself annulled. Annulment is explicitly provided for an unscheduled creditor who does not file a claim before the lapse of the thirty-day period following the first day set for the first meeting of creditors. Moreover, the bankruptcy court may annul the stay in granting relief to a person subject to the stay. Otherwise the stay is intended to be operative according to its terms until it is terminated, modified, or conditioned as provided by the relevant rule.

Notwithstanding the usual assumption repeating the effect of a stay until modified, the courts are not bound to treat acts and proceedings that occur in violation of the automatic stay as nullities. Dismissal of an action commenced in violation of the stay is not mandatory, whether or not the stay itself is continued. The stay does not divest any court of

\[407\text{ See } In re \text{ Ducich, } 3 \text{ Collier Bankr. Cas. } 733, 738 (\text{C.D. Cal. 1974}).\]
\[408\text{ See note } 437 \text{ and accompanying text infra.}\]
\[409\text{ Zestee Foods, Inc. v. Phillips Foods Corp., } 536 \text{ F.2d } 334 (10th Cir. 1976) \text{ (service of garnishee summons nullified); } In re \text{ Mott, } 1 \text{ Bankr. Ct. Dec. } 1146 \text{ (Ref., D. Conn. 1975) (default judgment on } $20,000 \text{ gambling debt invalidated); } In re \text{ Kole din, } 1 \text{ Bankr. Ct. Dec. } 977 \text{ (Ref. N.D. Cal. 1975) (judgment for punitive damages for breach of warranty and deceit nullified); } In re \text{ Butcher, } 1 \text{ Bankr. Ct. Dec. } 913 \text{ (Ref., N.D. Ohio 1975) (judgment lien deemed invalid).}\]

Disregard of the automatic stay of § 148 or § 428 of the Bankruptcy Act has led to a similar result. See Meyer v. Rowen, 181 F.2d 715, 716 (10th Cir. 1950), and 195 F.2d 263, 266 (10th Cir. 1952), declaring sales in violation of the automatic stay of § 428 null and void; Potts v. Potts, 142 F.2d 883, 888 (6th Cir. 1944), cert. denied, 324 U.S. 868 (1945), holding state court foreclosure judgment in violation of automatic stay of § 428 to be without efficacy; In re Maier Brewing Co., 38 F. Supp. 806, 817-18 (S.D. Cal. 1941), construing the effect of the automatic stay of § 148 on a pending mortgage foreclosure suit in state court and citing Kalb v. Feuerstein, 308 U.S. 433, 438-39 (1940). But cf. George F. Weaver Sons Co. v. Burgess, 7 N.Y.2d 172, 164 N.E.2d 677, 196 N.Y.S.2d 641 (1959), recognizing that tax foreclosure proceedings against property of debtor after approval of its Chapter X petition were defective but holding that state statute of limitations barred debtor’s action to avoid deeds issuing pursuant to the foreclosure proceedings, 4½ years having intervened between dismissal of the Chapter X case and the debtor’s bringing of the avoidance action.

\[410\text{ Bankr. Rule } 401(c). \text{ See text accompanying note } 115 \text{ supra.}\]

The court may wish to grant such relief in order to remove any cloud as to the validity of an act done in technical violation of the stay and to eliminate the necessity for a formal repetition of the act.

\[412\text{ See, e.g., Moore v. U.S. Nat’l Bank (In re Tallyn), } 1 \text{ Bankr. Ct. Dec. } 487 \text{ (Ref., E.D. Va. 1975) (repossession and sale of automobile in violation of stay held to be punishable by fine but secured creditor allowed to keep proceeds of sale).}\]
\[413\text{ Willis v. Gladding Corp., } 567 \text{ F.2d } 630 (5th Cir. 1978); \text{ David v. Hooker Music, Ltd., } 14 \text{ Collier Bankr. Cas. } 303, 309 (9th Cir. 1977); \text{ Baum v. Anderson, } 541 \text{ F.2d } 1166, 1170 (5th Cir. 1976), cert. denied, 430 U.S. 932 (1977). In the petition for certiorari in Baum, the debtor argued that refusal to order dismissal of a foreclosure action commenced in violation of the stay constituted a denial of his right to equal protection of the laws. 45 U.S.L.W. 3545 (1977). Since the state court had ordered the sheriff to seize and sell property subject to the mortgage, the court of appeals thought it meet for the district court to enter a formal order of stay to reinforce the automatic stay. Such an order entered by the district judge avoids the troublesome question whether the filing of a petition with the bankruptcy court stays another court notwithstanding the proviso of § 2a(15) of the Bankruptcy Act, authorizing only a district judge to issue an injunction of another court.\]
jurisdiction of an action or proceeding subject to the stay,\textsuperscript{414} and contempt proceedings predicated on disobedience of a court order have been held not to be subject to the stay provided for in Rule 401.\textsuperscript{415} The stay is neither an order to a receiver in a nonbankruptcy proceeding to turn over the property nor a discharge of the receiver's responsibilities under the order that appointed him. The circumstances may dictate that the receiver seek and obtain instructions from the court that appointed him with respect to his future duties. If the stay was triggered by a petition in a chapter case, the exclusive jurisdiction of the debtor and its property vested in the bankruptcy court dictates that the receiver's acts respecting the debtor and the property must be taken with due deference to the paramount authority of the bankruptcy court.

\section*{B. Contempt and Other Sanctions}

The automatic stay rules do not themselves prescribe any sanction or procedure to be followed when a stay is disregarded, whether knowingly or innocently. A conventional remedy available against one who disobeys a stay ordered by a court is a citation for contempt.\textsuperscript{416} No case has been found imposing or considering the availability of contempt sanctions on a violator of any of the statutory stays referred to in the opening section of this article. Violations of the automatic stays prescribed by the Bankruptcy Rules have, however, been punished by fines and other monetary sanctions in a number of reported cases.\textsuperscript{417}


In First Wis. Nat'l Bank, the district court dismissed two Chapter X1 debtors from mortgage foreclosure proceedings pending against them. The dismissal order extended to these parties' counterclaim against the mortgagee for usury. When the debtors thereafter sought an amendment or vacation of the order of dismissal pursuant to Federal Rule of Civil Procedure 60(b) in order to revive their counterclaim, the court denied relief with the following observation: "Whether or not the district court had jurisdiction to dismiss Grandlich and Fisher as parties to the foreclosure suit, an order that could in no way prejudice them, it did have jurisdiction to dismiss their counterclaim." 565 F.2d at 880.

\textsuperscript{415} David v. Hooker Music, Ltd., 14 Collier Bankr. Cas. 303, 309 (9th Cir. 1977). The court followed earlier cases construing stays entered pursuant to §§ 2a(15) and 11 of the Bankruptcy Act as not effective to bar contempt proceedings in the nonbankruptcy court. In re Spagat, 4 F. Supp. 926, 927 (S.D.N.Y. 1933); In re Hall, 170 F. 721 (S.D.N.Y. 1909).

In David v. Hooker, the bankrupt had failed to answer interrogatories as ordered by a magistrate before the filing of the petition and as ordered by the district judge after the filing of the petition. The district court stayed the action but ordered discovery proceedings to continue. 14 Collier Bankr. Cas. at 304-05.

In the Spagat case, an order to appear for examination had been served on the bankrupt a few hours after the filing of the petition, and imposition of contempt sanctions was said not to frustrate any objective of the Bankruptcy Act. 4 F. Supp. at 927. In the Hall case, the act of disobedience had occurred prior to the filing of the petition and the punishment was determined and imposed later. 170 F. at 721.


An argument against the availability of the contempt sanction is predicated on the fact that section 2a of the Bankruptcy Act expressly grants jurisdiction to courts of bankruptcy only to "[e]nforce obedience . . . to all lawful orders, by fine or imprisonment or fine and imprisonment," and to "[p]unish . . . for contempts committed before referees." 418 Rule 920, governing contempt proceedings, provides a procedure only for conduct prohibited by section 41a of the Bankruptcy Act, and that section does not prohibit violations of the Rules. 419 Since a rule is not made enforceable by fine or imprisonment and its violation is not made punishable by the Act, and since no procedure is provided for governing contempt proceedings against violators of the Rules, it has been contended that bankruptcy courts lack any authority to enforce the automatic stay by contempt proceedings. 420

The courts have generally rejected arguments challenging their power to enforce the stay rules by holding violators in contempt. 421 The Court of


In Ben Hyman & Co. v. Fulton Nat'l Bank, 8 Collier Bankr. Cas. 145, 156-57 (Ref., N.D. Ga. 1976), a bank exercising setoff after the filing of a Chapter XI petition was ordered to restore funds by a deposit in a special trust account within five days or to pay a $200 fine for contempt. The district court reversed the judgment of contempt on review because the bank was deemed to be innocent of any willful action in view of the uncertainty of the law governing the bank's right of setoff. 423 F. Supp. 1006 (N.D. Ga. 1976).

418 Bankruptcy Act § 2a(13) and (16).

419 Section 41a of the Bankruptcy Act is substantially a paraphrase of the general federal statute defining criminal contempt, 18 U.S.C. § 401 (1970). Clause (3) of the latter section makes punishable by a court of the United States disobedience of "its lawful writ, process, order, rule, decree, or command." Section 41a(1) of the Bankruptcy Act refers to disobedience only of "any lawful order, process, or writ." As pointed out in In re Brown, 454 F.2d 999, 1006 n.33 (D.C. Cir. 1971), the legislative history of 18 U.S.C. § 401 is "totally unilluminating," but the inclusion of the word "order" in § 41a of the Bankruptcy Act is entirely consistent with a congressional intent to make disobedience of a general order in bankruptcy punishable. The omission of the word "rule" from the section is explicable for the reason that there were no Rules of Bankruptcy Procedure in 1898 when Congress enacted the section in substantially its present form. For a holding that violation of a court rule of practice and procedure may be punishable pursuant to 18 U.S.C. § 401(3), see Seymour v. United States, 373 F.2d 629, 631 (5th Cir. 1967); but see In re Brown, 454 F.2d 999, 1006 n.33 (D.C. Cir. 1971).


421 See id.; Verran v. United States, 13 Collier Bankr. Cas. 288, 302 (Ref., E.D. Mich. 1977), vacated on other grounds, 4 Bankr. Ct. Dec. 47 (E.D. Mich. 1978); contra Household Finance Corp. v. Smith, 6 Collier Bankr. Cas. 653, 657 (E.D. Va. 1975). The court of appeals in the Fidelity Mortgage Investors case regarded the argument of the contemners as "almost equivalent to saying that the courts cannot enforce the rules at all" and, in any event, inconsistent with the objective of the Bankruptcy Rules to secure the expeditious and speedy processing of petitions under the Act. 550 F.2d at 52. Effectiveness of the automatic stay is not so wholly dependent on the availability of the contempt sanctions as the court suggests. See cases cited in notes 406-15 and accompanying text supra. On the other hand, it is frequently impossible or impracticable to nullify acts in disregard of the stay. Judge
Appeals for the Second Circuit characterized the argument based on the lack of any literal reference to rules in section 41a of the Bankruptcy Act as "overly-formalistic" and "unpersuasive."\footnote{Fidelity Mortgage Investors, 550 F.2d at 52.} If only a violation of a court-issued order staying an act or proceeding can be punished as a contempt, the stay rules may be revised to include a requirement that the court sign an order written in the language of subdivisions (a) and (b) of those rules. As earlier indicated,\footnote{See note 78 and accompanying text supra.} many courts already supplement the automatic stays with formal orders restraining substantially the same conduct as that covered by the automatic stay. Limiting the enforceability of the stay to situations where this ritual was performed by the personnel of the bankruptcy court reduces the court to a mockery.

The argument would be more substantial if it insisted that no person can be held in contempt for violating a stay unless entered by a court after notice and hearing. Sustaining this position, however, would aggravate existing difficulties of protecting debtors' estates from dispersion and predation by aggressive claimants. It is not and ought not to be the law that any creditor or other person can bring any action and do any legal act to enforce his claim until he has been restrained by a court order issued after notice and hearing. The automatic stays seek to preserve the status quo,\footnote{See, e.g., Ex parte Tyler, 149 U.S. 164, 181, 182 (1893) (denying release on writ of habeas corpus to sheriff imprisoned for attempting to collect taxes out of property in custody of federal equity receiver); 1 R. Clark, Law of Receivers §§ 47, 58 (3d ed. 1959); 2 id. §§ 627, 631.} and the equity receivership cases contain numerous instances of the power of the court to protect its custody of the debtor's property from interference by any person, irrespective of the basis for his claim.\footnote{Id. at 75-6.} To require prior notice and hearing as a condition to the enforceability of a stay of proceedings against a debtor or of an act to enforce a lien against his property would give the aggressive creditor an advantage incompatible with the objectives and fundamental assumptions of a rational bankruptcy system.

The power of Congress to regulate punishment for contempt of federal courts has frequently been recognized by the Supreme Court,\footnote{See, e.g., Michaelson v. United States, 266 U.S. 42, 65-67 (1924).} but the Court has also carefully acknowledged the inherent power of the courts of the United States "when called into existence and vested with jurisdiction over any subject."\footnote{Id. at 75-6.} The inherent power of the bankruptcy courts to
punish for contempt was early and authoritatively recognized under the Bankruptcy Act of 1898.\textsuperscript{428} Although the Bankruptcy Act confers jurisdiction on courts of bankruptcy to enforce obedience to lawful orders and to punish persons for contempts committed before referees,\textsuperscript{429} section 41b required a referee to certify the facts concerning any act forbidden by that section to the district judge for summary hearing and disposition. This procedure has been modified by Rule 920 to authorize the referee as bankruptcy judge to punish any minor contempt by a fine of not more than $250 without certification to the district judge.

In \textit{Fidelity Mortgage Investors v. Camelia Builders, Inc.},\textsuperscript{430} Bankruptcy Judge Herzog, a referee sitting in the Southern District of New York where a Chapter XI petition was pending, conducted a hearing and determined that rival lienors, their officers, and counsel had violated the automatic stay that became operative on the filing of the petition by instituting litigation against the debtor in a federal court in Mississippi. After holding the parties in contempt, however, Judge Herzog "certified the matter" to the district judge for imposition of an appropriate punishment.\textsuperscript{431} The district judge conducted a hearing but accepted Bankruptcy Judge Herzog's findings of fact as not clearly erroneous. The contemners were ordered to pay costs, including reasonable attorneys' fees for the defense of the action in Mississippi and the prosecution of the contempt proceeding, and to obtain the return of a $76,000 deposit made in the Mississippi action.\textsuperscript{432}

The contemners appealed the judgment, urging a battery of grounds for reversal. All were rejected in a sweeping opinion by Circuit Judge Smith in which Judge Mansfield concurred but to which Judge Graafeiland dissented. A request for rehearing en banc was denied by the court of appeals, and a petition for certiorari was likewise denied by the Supreme Court.\textsuperscript{433} The court's rejection of the challenge to the power of the bankruptcy court has already been referred to.\textsuperscript{434} Because of the significance of the other rulings of the court of appeals on the points of challenge made to the contempt judgments, they are discussed briefly seriatim below.

First, the contemners contended that Rule 11-44 was unclear and could not therefore be the basis for a valid adjudication of contempt. The court agreed that a court order must be "specific and definite" in order for a

\begin{footnotes}
\item[428] Boyd \textit{v. Glucklich}, 116 F. 131, 135 (8th Cir. 1902).
\item[429] See note 418 \textit{supra}.
\item[430] 550 F.2d 47 (2d Cir. 1976).
\item[431] \textit{Id.} at 50.
\item[432] \textit{Id.} Circuit Judge Graafeiland, dissenting, noted that counsel for appellants from Texas "have been fined $20,000 for alleged violation of a rule governing the practice and procedure of a bankruptcy court in New York City in a proceeding in which they were not even parties." 550 F.2d at 58. Presumably the "$20,000 fine" was the aggregate of the joint and several liabilities imposed on all the defendants.
\item[433] 429 U.S. 1093 (1977). Thirteen issues were presented to the Court by the petition. 45 U.S.L.W. 3438 (Dec. 21, 1976). After denial of the petition for certiorari, rehearing was requested and denied. 430 U.S. 976 (1977).
\item[434] See notes 418-23 and accompanying text \textit{supra}.
\end{footnotes}
person to be guilty of contempt for violating it, but the court found it "difficult to conceive of a rule with a more apparent and certain meaning." Second, the contemners contended that they could not be punished for violating a stay of which they had no knowledge. The court of appeals agreed with that proposition but sustained Judge Herzog's finding that all the defendants had knowledge of the Chapter XI petition and the consequent stay.

Third, the contemners contended that the district judge erred in accepting the findings of the referee as not clearly erroneous rather than trying the facts de novo. Prior to the promulgation of Rule 920 there were rulings supporting the contention that a referee's findings of fact were not entitled to any weight on a certification to the district judge, even when the judge had referred the matter to the referee for report.

In conducting the hearing and determining the facts on the issue of whether the contemners were guilty of contemptuous conduct and in certifying the matter to the district judge for determination and imposition of the appropriate punishment, Judge Herzog adopted a novel procedure that is neither authorized nor prohibited by the Rules. Neither the district court nor the court of appeals found any fault with this procedure. The court of appeals appeared to think that Rules 752(a) and 810 required the district judge to accept the referee's findings of fact unless clearly erroneous. Rule 810 applies only to an appeal from a referee to the district judge, however, and Rule 752 is intended to govern the review of findings of fact in adversary proceedings and contested matters in bankruptcy cases, whether such findings are made by a referee or district judge. Nevertheless, as long as the power to impose an onerous penalty is vested in and exercised by a district judge, the facts of an alleged contempt committed in the bankruptcy court may appropriately be found by the referee, as they are by the district judge in a case involving contempt of his court. Since the contempt charged in the Fidelity Mortgage Investors case appeared not to involve disrespect to or criticism of the referee, his conduct of the hearing on the facts and the deference shown his findings by the district court and the court of appeals seem

435 550 F.2d at 51, citing In re Rubin, 378 F.2d 104, 108 (3d Cir. 1967).
436 550 F.2d at 50-51.
437 550 F.2d at 51. See also Wilson v. North Carolina, 169 U.S. 586, 600 (1898), requiring proof of knowledge by the contemner of the order he is charged with violating before he can be punished.
438 In re Rubin, 378 F.2d 104, 108 (3d Cir. 1967) (findings of fact by referee in a certification pursuant to § 41b of the Bankruptcy Act said to be "subject to a wholly independent judicial review"); O'Hagan v. Blythe (In re Liberty Return Loads Assoc., Inc.), 354 F.2d 83, 84 (2d Cir. 1965) (General Order 47, requiring a referee's findings of fact to be accepted by a district judge unless clearly erroneous, held inapplicable to a referee's certification of the facts to the judge pursuant to § 41b of the Act).
439 Rule 920 contemplates either (1) a determination of the facts and imposition of the punishment by the referee when the conduct appears to warrant punishment by a fine of not more than $250, or (2) a certification of the facts to the district judge when a more serious punishment is indicated. Judge Herzog thus followed a hybrid procedure.
440 550 F.2d at 51-52.
441 See Advisory Committee's Note to Rule 810.
consistent with sound judicial administration and with the need to protect the contemner from abusive use of the contempt power.\textsuperscript{442}

Fourth, the contemners argued that since they did not receive formal notice of the stay pursuant to Rule 602, they were not bound by it. The court ruled that notice is not required for a person who knowingly violates an order.\textsuperscript{443} The giving of notice of an automatic stay may nonetheless be a matter of some difficulty. The automatic stay rules themselves contain no provision for giving notice of the stay to persons affected, and the court properly declined to regard Rule 602 as relevant.\textsuperscript{444} The Advisory Committee's Note to Rule 401(a) points out that "[a]ll creditors receive notice of the effect of the petition as a stay along with notice of the first meeting of creditors." The official forms for notices of the first meeting of creditors all contain statements informing recipients of the stays,\textsuperscript{445} but the stays become operative from the time of the filing of the petition, which necessarily occurs prior to the mailing and receipt of this notice.\textsuperscript{446}

In view of the limitation on the enforceability of the stay by contempt proceedings against a person without knowledge of it, it behooves the party relying on the effectiveness of the stay to bring it to the attention of persons intended to be affected, and proof of effective notice is, of course, the best way of proving knowledge.

Fifth, counsel for one of the appellants in the case argued that the Supreme Court's ruling in \textit{Maness v. Meyers}\textsuperscript{447} protects attorneys from being held in contempt for the advice they give their clients, but the court

\textsuperscript{442} The contemners apparently also raised a due process objection to the division of the fact-finding process between Bankruptcy Judge Herzog and the district judge. While such a division is unusual, it is not unprecedented. Old General Order 47 contemplated that after a hearing and a determination of the facts and the law by the referee, the district judge might, on review, take additional evidence before making a final disposition of the case. The court of appeals in the \textit{Fidelity Mortgage Investors} case made short shrift of the constitutional objection to the bifurcated hearing by labeling the contemners' theory of due process "novel" and "unique" and declining to accept it. 550 F.2d at 56.

\textsuperscript{443} 550 F.2d at 52.

\textsuperscript{444} Rule 602, relied on by the contemners, imposes a duty on a receiver or trustee to take steps to give notice of a pending petition filed under the Bankruptcy Act, and apparently there had been no compliance with the rule in the \textit{Fidelity Mortgage Investors} case. The purpose of the rule is to protect the estate against postpetition transfers by the debtor, but the effect of such transfers is governed by \S\ S 21g and 70d of the Act, whether or not the rule is complied with. \textit{See} the Advisory Committee's Note accompanying Rule 602. Although Rule 11-49 makes Rule 602 applicable in a Chapter XI case, the court of appeals regarded it as inapplicable in its first published opinion in the case, because no receiver or trustee had been appointed. 2 Bankr. Ct. Dec. 1366, 1370. The reference to the inapplicability of the Rule was later deleted.

\textsuperscript{445} \textit{See} Official Bankr. Forms Nos. 12, 9-F2, 10-5, 11-F13, 12-F12, and 13-7. There is no notice of the first meeting of creditors in a railroad reorganization case under \$ 77, but notice of the automatic stay in such a case is included in Official Form No. 8-4 with the notice of the appointment of trustee and the proof-of-claim procedure.

\textsuperscript{446} Dissenting Judge Graafeiland thought that the inclusion of information about the stay in the official forms for notices of first meetings meant that "something more is required to call forth the punitive sanctions of contempt than the mere enactment of the rule." 550 F.2d at 61 n.5. When the applicable statute or rule prescribes that an act shall take effect at a specified time, a provision for giving notice does not, of course, postpone the effectiveness of the act until the notice is given or received. \textit{See}, e.g., Rule 77 of the Federal Rules of Civil Procedure and Bankr. Rules 804 and 922.

\textsuperscript{447} 419 U.S. 449 (1975).
declined to read *Maness v. Meyers* so broadly. The court appropriately noted that *Maness* involved a narrow issue as to the vulnerability of an attorney for contempt because of advice to a client to refuse to respond to a subpoena duces tecum in the exercise of the client's constitutional right not to incriminate himself. The Supreme Court did acknowledge in *Maness*, as the court of appeals observed, that lawyers can be cited for contempt for advising clients to disregard court orders. The context indicated, however, that the Court was referring to a courtroom setting where the court enters an order during trial, after counsel has had an opportunity to object.

The contempt order against the Texas counsel in *Fidelity Mortgage Investors* is particularly difficult to reconcile with the opinion of the Supreme Court in the early bankruptcy case, *In re Watts & Sachs*. In that case, counsel were convicted of contempt for advising their clients that certain property was subject to the jurisdiction of the state court rather than the bankruptcy court. In reversing the convictions, the Supreme Court made the following broad statement of the governing principle:

> In the ordinary case of advice to clients, if an attorney acts in good faith and in the honest belief that his advice is well founded and in the just interests of his client, he cannot be held liable for error in judgment. The preservation of the independence of the bar is too vital to the due administration of justice to allow the application of any other general rule.

The Supreme Court opinions in both *Maness* and *Watts & Sachs* emphasized the counsel's good faith, but neither the majority nor the dissenting opinion in *Fidelity Mortgage Investors* mentioned that element or indicated whether it was inquired into in the hearing before the bankruptcy judge or before the district judge. What constitutes "good faith" advice by counsel to disregard an order or rule is a troublesome issue, but in light of relevant Supreme Court precedents, it appears to be an appropriate inquiry in any proceeding to hold an attorney in contempt for the advice he has given. In several cases the court has declined to impose liability for violation of a stay because the contemner's conduct was

448 Id. at 459-60.
449 190 U.S. 1 (1903).
450 Id. at 29.
451 419 U.S. at 458, 467, 468, 470.
452 190 U.S. at 29.
453 In his opinion accompanying his finding of contemptuous conduct, Bankruptcy Judge Herzog noted that counsel knew that "some kind of 'bankruptcy' case was pending" and was "well aware of the automatic stay provisions of the Bankruptcy Rules." He concluded that "[t]he rule is equivalent to an order of the court and if acts are done in clear contravention thereof, the intention is of no consequence." *In re Fidelity Mortgage Investors*, 5 Collier Bankr. Cas. 386, 393 (Ref., S.D.N.Y. 1975). Curiously, the two rival lienors who commenced the litigation against the debtor in Mississippi raised an argument respecting "alleged conflicts of interest on the part of FMI's attorneys." 550 F.2d at 58 n.4. In seeking to be relieved of liability for the judgment entered against the lienors, their officers, and the counsel as joint and several obligors, the counsel was apparently involved in a conflict of interest with his own clients and the other appellants.
found not to be willful. 454

In a recent case 455 a bankrupt sought not only a contempt citation of a creditor for violating the automatic stay but also resultant damages under the Bankruptcy Act, the 1970 Civil Rights Act, the fourteenth amendment of the Constitution, and for tortious interference with his wages, fringe benefits, and reputation. The court rejected the defendant's jurisdictional objections to the bankrupt's complaint but found for the defendant on the ground that the stay was not operative under the circumstances presented. 456


456 14 Collier Bankr. Cas. at 333. The court cited as illustrative cases where the court had protected a bankrupt's rights in respect to his job. Rutledge v. Shreveport, 387 F. Supp. 1277 (W.D. La. 1975); In re Hicks, 133 F. 739 (N.D.N.Y. 1905); cf. In re Home Discount Co., 147 F. 538 (N.D. Ala. 1906). For a case recognizing the possibility of recovering damages against a party who registered a federal judgment in another district pursuant to 28 U.S.C. § 1963 and obtained issuance of a levy of execution, all in violation of a stay issued pending an appeal, see Ohio Hoist Mfg. Co. v. LiRocchi, 490 F.2d 105 (6th Cir.), cert. dismissed, 417 U.S. 938 (1974).