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JUNIOR SECURED CREDITORS AND THE AUTOMATIC STAY

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Suppose *D* grants a senior security interest to *A* and subsequently grants a junior security interest to *B*. If *D* files for bankruptcy, an automatic stay arises to enjoin *A* and *B* from foreclosing on the security interest—or so the world presumes.

What if *B* files for bankruptcy and *D* does not? Is *A* stayed from foreclosing against *D*, when the result of the foreclosure must be the termination of *B*'s security interest? *B*'s security interest is property of the estate, and Bankruptcy Code section 362(a)(4) prevents "any act to . . . enforce any lien against property of the estate."¹ That is precisely what *A* is doing when *A* sells *D*'s property free and clear of *B*'s security interest.

Only a few courts have considered the matter, but a majority of these have held that the automatic stay in *B*'s bankruptcy does not restrain *A* from destroying *B*'s security interest by foreclosing. The grounds for so concluding, however, are not satisfactory. The plain meaning of the Bankruptcy Code—admittedly a treacherous commodity—is against such a result. So are the policy reasons that inhabit the automatic stay in the first place. The majority view is based on some intuition that *B*'s security interest is too minor to justify protection by the automatic stay. Yet a close examination of this intuition shows that the majority view cannot logically be maintained.

The aim of this article is to describe the law of the automatic stay with regard to junior creditors. As a preliminary exercise, I will explore a theoretical difficulty deeply embedded in the text of the Bankruptcy Code. Part One of this Article will show that the Bankruptcy Code has an incoherent theory of property. Sometimes property means the relation of the debtor to a thing. At other times, property means the thing itself. On the former meaning, cotenancies of nondebtors are not property of the estate. On the latter meaning, cotenancies are swept into the estate, because the thing itself is within the estate. On this latter view, both the debtor's cotenancy and nondebtor cotenancies are in the estate. If we view a security interest as a kind of shared cotenancy, the security interest is beyond the jurisdiction of the bankruptcy courts on the former view and within that jurisdiction on the latter view.

Nevertheless, the automatic stay exceeds the scope of the bankruptcy estate.² It is therefore clear that a debtor's bankruptcy stays the foreclosure of a security interest on the whole of the collateral.

Part Two of this article will assume that *B* is bankrupt but *D* is not. It should be the case that *A* is stayed by *B*'s bankruptcy—both on the language of the Bankruptcy Code and the implicit policy behind debtor rehabilitation.

Part Three will reverse the presumption. Suppose *D* is bankrupt but *B* is not. *A* is clearly stayed, but *D*'s trustee may not choose to pursue enforcement remedies against *A*. Part Three inquires whether *B* has standing to enforce the automatic stay. Although the case law is divided on this point, the preferred view is that the Bankruptcy Code invests discretion with the trustee alone to enforce the stay. A grant of standing in *B* would interfere with that investment of discretion and therefore should not be permitted. Rather, *B* should be required to follow bankruptcy procedures against the trustee directly, to compel the trustee to perform her

fiduciary duty, when *B* feels such duty is being neglected.

I. THE AUTOMATIC STAY AND FORECLOSURE

We start with a very basic question. Suppose a debtor grants a security interest, defaults and files for bankruptcy. Does the automatic stay prevent the secured party from foreclosing? Bankruptcy lawyers are likely to perceive the question as an easy one,³ but, thanks to the Bankruptcy Code's club-footed prose, interpretive work is required to reach this obvious result.

A "devil's advocate" might make the following case that the automatic stay does not apply to prevent foreclosure by secured parties: the automatic stay prevents actions against "property of the estate."⁴ Yet, in defining "property of the estate," section 541(a)(1) brings in only "interests of the debtor in property as of the commencement of the case."⁵ In the simple case of a debtor who has granted a security interest in collateral to a secured party, the "debtor's interest" was only the equity interest. The security interest as such would seem to be outside the estate, thus, it is possible that the automatic stay would not prevent enforcement of the security interest. Since the security interest was outside the estate, it could be foreclosed. If the security interest had the effect of foreclosing the debtor's equity position, this could be overlooked as being an indirect or incidental effect. The loss of the debtor equity might then be viewed as a kind of condition subsequent on the debtor equity. By way of analogy, if a bankrupt debtor owned an estate that was defeasible, the estate goes out of existence if the defeasible event occurs, regardless of the automatic stay, which does not work to prevent conditions from occurring.⁶ Likewise, if a debtor equity goes out of existence because the secured party chooses to foreclose, the automatic stay is in no way offended. So ends the catechism of the devil's advocate.⁷

What makes this argument work is that section 541(a) brings into the bankruptcy estate the debtor's interest in a thing, not the thing itself. The courts, however, have gone beyond the literal language of section 541(a) to expand the parameters of the bankruptcy estate. In the important case of *United States v. Whiting Pools, Inc.*⁸ Justice Harry Blackmun found it worthwhile to explain why the thing, not just the debtor's interest in the thing, is part of the estate:

Although these statutes could be read to limit the estate to those "interests of the debtor in property" at the time of the filing of the petition, we view them as a definition of what is included in the estate, rather than as a limitation.⁹

The point of this remark is to establish that the bankruptcy estate exceeds the words of section 541(a). Thus, the estate includes not only the debtor's interest but the secured party's share of an encumbered thing. Under this dictum, since the trustee can use "property of the estate,"¹⁰ the trustee can use the whole of a thing, not just the debtor's equity in the thing. And to protect this power to use, the automatic stay prevents a secured party from foreclosing on the collateral after a debtor files for bankruptcy. Thanks to the supplement provided by *Whiting Pools* to the language of section 541(a), the automatic stay prevents foreclosure of the security interest after all.

A different point clinches the matter. Section 541(a) defines property *of* the estate. Section 362(a)(3) stays "any act to obtain possession of property *of* the estate or of property *from* the estate or to exercise control over property of the estate."¹¹ This language protects not only the debtor's interest in the thing but the whole thing itself. An attempt to control the whole thing would constitute an attempt to control the debtor's limited interest in the thing. Thus, the scope of section 362(a)(3)'s prohibition exceeds the reach of section 541(a) to stay foreclosure sales.¹² Similarly, section 362(a)(4) prevents "any act to . . . enforce any lien against property of the estate."¹³ Hence, even if the lien is *beyond* the estate, enforcement of lien *against* property of the estate is stayed.¹⁴ Fortunately, we need not wrestle with the inadequacies of section 541(a). The scope of the automatic stay exceeds the scope of section 541(a).¹⁵

It is hoped the overly basic nature of these remarks will be excused, as they will be useful in fathoming the difficult issues in the next section, pertaining to the automatic stay arising from the bankruptcy of a debtor's

transferee.

II. THE JUNIOR SECURED CREDITOR AS BANKRUPT

Suppose *D* conveys a perfected security interest to *A*. This security interest is a *power of sale* (and, in the case of receivables and the like, a power to liquidate by collecting). More precisely, *A* is empowered to sell whatever *D* had at the time *A*'s lien was created.¹⁶ This formula indicates that, if *D* had an absolute interest at the time *A*'s lien was created, *A* may convey an absolute title in the collateral to a buyer in a foreclosure sale. This is so even if the debtor has made subsequent conveyances to *B*, whether those conveyances be total alienation, junior liens, or leasehold interests. Any such conveyance is made subject to *A*'s lien.

To test this out, suppose, after *D* grants a security interest to *A*, *D* alternately grants (1) the equity to *B*, (2) a junior security interest to *B*, or (3) a leasehold to *B*. *D* defaults, and *A* sells to *X*. *X* takes whatever *D* had at the time *A*'s lien was created. Since *D* had an absolute title at that time, *X* likewise has an absolute title. And if *X* has an absolute title, *B* must have nothing, regardless which of the three interests *D* granted to *B*. *B*'s property interest—be it large or small—has been effectively foreclosed.¹⁷

A. The Argument in Favor of the Automatic Stay

We are concerned with the extent of the automatic stay arising from *B*'s bankruptcy, and whether it prohibits action by *A*. A good argument exists that a uniform rule should apply to any conveyance that *D* might make to *B*. Suppose *D* quitclaims all right, title and interest to *B*, and then *B* goes bankrupt. Whatever rule we apply to *B*'s automatic stay should likewise apply when *D* conveys a lesser interest to *D*—a security interest or lease, for example.

Let's start with the basic case of *D*'s quitclaim of all right, title and interest to *B*. Upon such a conveyance, *B* owns the equity, and *A* has become a nonrecourse creditor of *B*.¹⁸ Indeed, under Article 9, *B* is even defined as a "debtor."¹⁹ Clearly, *A* is stayed from foreclosing on *B*'s equity when *B* files for bankruptcy.²⁰

Now why should this be so? First, the language of section 362(a) exceeds the scope of the bankruptcy estate. Hence, the plain meaning of the Bankruptcy Code demands it.²¹ Second, whether *D* or *B* owns the equity, the basic policy of the Bankruptcy Code is that the bankruptcy trustee of the equity owner should have the opportunity to maximize the value of the equity. *A* has no good incentive to do so. *A*, holding a senior lien, will seek a price only insofar as the price pays *A*'s senior lien. A trustee for the equity owner, however, has an incentive to seek more. Anything that this trustee obtains above *A*'s lien enriches the unsecured creditors of the bankrupt owner of the equity.

This policy of putting the trustee in charge when appreciation value can be coaxed from collateral is on display in section 362(d)(2), which provides that the secured party may have relief from the stay if *both* the following are true: (1) "the debtor does not have an equity in such property,"²² and (2) "such property is not necessary to an effective reorganization."²³ These two principles end up describing the Bankruptcy Code's criteria for a trustee's control of collateral claimed by secured parties.

Though the matter is rarely articulated, Judge Stephen Gerling has suggested that the fundamental key to bankruptcy policy is the possibility of appreciation value.²⁴ When a creditor claims any sort of lien on property that goes up in value, the creditor's immediate liquidation of such property effectively deprives the debtor (and her unsecured creditors) of any potential upside. The secured creditor must therefore suffer the law's delay and the insolence of office, because bankruptcy jurisdiction hopes to nurture appreciation value in favor of unsecured creditors.²⁵

If appreciation value describes when a trustee should retain control over collateral, the principle holds whether or not *D* or *B* is the owner of the equity. Furthermore, it holds whether *B* has bought the equity outright, or whether *B* has a mere lien on *D*'s equity. Suppose that *D* conveys a junior security interest to *B*, and *B* files for bankruptcy. Does *B*'s bankruptcy trustee have any incentive to increase the value of *D*'s equity? The answer is

clearly yes. Any amount that exceeds *A*'s lien adheres to the benefit of *B*'s unsecured creditors. The policy favoring *B*'s bankruptcy trustee applies whether *B* owned the equity outright or whether *B* owned a junior lien on *D*'s equity. ²⁶ —

At least one prominent pre-Code case has held that *B*'s bankruptcy petition stays *A*. In *Fidelity Mortgage Investors v. Camelia Builders, Inc. (In re Fidelity Mortgage Investors)*, ²⁷ Judge Joseph Smith cited many of the same policies that motivate trustee power over encumbered property in general. ²⁸ In particular, the trustee of *B* would like to take over the foreclosure proceeding in order to maximize the value of the estate. Whether *B* owns equity or is a junior secured party, the general creditors of *B* will benefit if *B*'s trustee runs the sale. In neither case can the senior secured party be trusted to maximize the interests of junior parties.

Furthermore, a right of redemption has usually been considered powerful evidence that a thing is in the bankruptcy estate. ²⁹ It may be pointed out that junior secured parties usually have the right to redeem the property from the senior secured party, in order to preserve residual value the senior secured party has no incentive to realize. Thus, U.C.C. section 9-506 provides:

At any time before the secured party has disposed of collateral or entered into a contract for its disposition under Section 9-504 or before the obligation has been discharged under Section 9-505(2) the debtor or *any other secured party* may . . . redeem . . . ³⁰ —

Since redemption coheres with the policy of the Bankruptcy Code to maximize property for the benefit of the general creditors, the policy is equally concerned with *B* as secured creditor as it is with *B* as equity owner. ³¹ —

B. The Arguments Against the Automatic Stay

Nevertheless, while courts universally hold *A* is stayed when *B* owns the equity, ³² some courts believe otherwise when *B* owns a mere lien on *D*'s equity. The arguments for this position, however, are not successful.

According to Judge Rebecca Beach Smith in *Farmers Bank v. March (In re March)*, ³³ the automatic stay does *not* prevent foreclosure of *B*'s junior security interest. In so deciding, Judge Smith quoted the following words of Justice Harry Blackmun from *United States v. Whiting Pools*: ³⁴ —

Section 541(a)(1) speaks in terms of the debtor's "interests . . . in property," rather than property in which the debtor has an interest, but this choice of language was not meant to limit the expansive scope of the section. The legislative history indicates that *Congress intended to exclude from the estate property of others in which the debtor had some minor interest such as a lien or bare legal title*. Similar statements to the effect that § 541(a)(1) does not expand the rights of the debtor in the hands of the estate were made in the context of describing the principle that the estate succeeds to no more or greater causes of action against third parties than those held by the debtor. These statements do not limit the ability of a trustee to regain possession of property in which the debtor had equitable as well as legal title. ³⁵ —

In short, *B*'s security interest is a "minor" property right, and so is not to be considered part of the bankruptcy estate at all.

The context of this dictum from *Whiting Pools* ³⁶ merits careful explication. We saw in the last section how Justice Blackmun felt compelled to explain that, even though Section 541(a) puts only the debtor's interest in a thing in the estate—not the entire thing—the trustee could nevertheless use the entire thing, if useful to maximize the return for unsecured creditors. That is, the estate included the entire thing, not just the debtor's interest in the thing. For this reason, a secured party is expected to donate collateral to the rehabilitation of debtors. ³⁷ But Justice Blackmun equally saw the danger in bringing in the whole thing when the debtor owned only a scrap of the thing. For example, Blackmun's untrammelled doctrine of the thing might suggest

that, if a debtor owned a security interest in someone else's thing, the debtor's trustee could use the thing in order to rehabilitate the debtor. Imagine, if you will, that General Motors Acceptance Corp. ("GMAC") filed for bankruptcy, and the trustee could use all the cars in which GMAC held a security interest. The automatic stay would then apply to prevent consumers from using the cars. The cars could be repossessed, and GMAC could go into the car rental business at the expense of consumers.³⁸ Such a thought being monstrous, Justice Blackmun introduced, in the passage just quoted, the idea of "minor" debtor interests, "such as a lien."³⁹ Thus, section 541(a)(1) brings in the "whole thing" when the debtor owns a "major" interest—such as debtor equity. It does not bring in the whole thing when the debtor claims only a "minor" interest—such as a security interest or lien.

How does this dictum affect the question at hand? *D* has granted a senior security interest to *A* and a junior security interest to *B*. *B* has filed for bankruptcy. *B*'s security interest in the "thing" is a minor interest, and so, per Blackmun's instruction, *B*'s trustee cannot use *D*'s thing to rehabilitate *B*. But this dictum does not really answer the question whether *A* may foreclose *A*'s security interest in *D*'s thing. *D* has never filed for bankruptcy. *A* is not prevented by *D*'s bankruptcy from repossessing the thing and foreclosing. But *A*'s foreclosure would also have the effect of foreclosing *B*. Thus, *B*'s security interest in *D*'s thing may be "minor" insofar as *D* is concerned. But it does not necessarily follow that *B*'s interest is minor insofar as *A* is concerned. *A* and *B* are equally minor to *D*, but perhaps vis-à-vis each other, they are "major." Some legislative history makes this explicit. According to Congressman Don Edwards:

The addition of this provision by the House amendment merely clarifies that section 541(a) is an all-embracing definition which includes charges on property, such as liens held by the debtor on property of a third party⁴⁰

Whiting Pools

, then, cannot serve as the ultimate justification of the principle that *A* may foreclose on the collateral free and clear of the automatic stay generated by *B*'s bankruptcy. Rather, *Whiting Pools* suggests only that *B* may not expropriate *D*'s equity interest for the purpose of enriching *B*'s unsecured creditors.

Other contrary arguments in favor of holding senior secured parties free and clear of the junior secured party's automatic stay usually end up being unjustified assertions. According to one commentator, the automatic stay should not apply to *A* because

there were no "financial pressures" on [*B*] with respect to the subject collateral . . . that drove [*B*] into bankruptcy. [*B*] is, in fact, a "creditor" with respect to the property . . . [*B*] has no "repayment" that it must make to the senior secured creditor. It is obvious that the purpose of enacting the automatic stay was not intended to protect a debtor who is actually a "creditor."

⁴¹

None of these allegations is true or even relevant. *B* may be bankrupt because the equity owner has defaulted on its obligations to *B*. Therefore, financial pressures related to the collateral may well be to blame for *B*'s bankruptcy. If not, so what? The automatic stay does not apply only to the property that *causes* the bankruptcy. If a secured party claims a speed boat from a debtor who went bankrupt speculating on commodity futures, the automatic stay prevents foreclosure on the boat even if the boat is unrelated to the market for commodities.⁴² Furthermore, all debtors are also creditors of other debtors, but that has never made a difference to the scope of the automatic stay. If a secured party claims accounts receivable, the debtor is a creditor of the account debtor, but the automatic stay prevents the secured party from collecting the accounts all the same.⁴³ That *B* has no *in personam* payment obligation to *A* is irrelevant. Any time *B* buys the debtor equity outright, *A* is a nonrecourse creditor with respect to *B*, and yet the automatic stay clearly applies. Many real estate bankruptcies involve nonrecourse mortgages, yet the automatic stay still applies.⁴⁴ Indeed, none of the reasons offered against the automatic stay of the senior security interest is convincing.⁴⁵

A challenging idea in favor of holding *A's* foreclosure immune from *B's* automatic stay comes from a pre-Code case, *First Federal Savings & Loan Ass'n of Chicago v. Holiday Lodge, Inc. (In re Holiday Lodge, Inc.)*,⁴⁶ where *D* conveyed a mortgage to *A* and then leased the premises to *B*. *B* was bankrupt and *D* was not. Judge Elmer Schnackenberg ordered that the stay should be vacated:

[T]he first mortgage here constitutes a lien on the property in question superior to debtor's leasehold interest and, to the extent of that lien, the debtor had no interest in the real estate. It took its lease subject to that mortgage lien. That being so, the district court, as a bankruptcy court, had not jurisdiction to restrain a state court proceeding to enforce [*A's*] lien on the property to the extent that it was superior to any interest belonging to the debtor in that property.⁴⁷

The idea here is that, since the lease is entirely subject to the lien, and since the lien is beyond the bankruptcy estate, the security interest can be enforced without any offense to bankruptcy jurisdiction. But this is precisely the "devil's advocate" argument presented in the last section to explain why the automatic stay might *never* apply to any security interest of any sort.⁴⁸ It is true enough that *B's* lease is entirely encompassed in *A's* lien. It is also true that *B* owns nothing beyond *A's* lien. But these are the attributes of *any* debtor equity just as much of *B's* limited interest in debtor equity.

A contrary case exists, however, under the Bankruptcy Code. In *48th Street Steakhouse, Inc. v. Rockefeller Group, Inc. (In re 48th Street Steakhouse, Inc.)*,⁴⁹ *A* owned a reversion and *D* owned a leasehold. *D* then subleased to *B*. *B* was bankrupt, but *D* was not. Judge Frank Altieri held that the automatic stay prevented *A's* termination of *D's* lease.⁵⁰ His reasoning was phrased quite broadly:

While it is true that [*D*] is an incidental beneficiary of our decision, this result is permissible where a non-debtor's interest in property is intertwined, as in the present case, with that of a bankrupt debtor. If action taken against the non-bankrupt party would inevitably have an adverse impact on property of the bankrupt estate, then such action should be barred by the automatic stay.⁵¹

Thus, because *B* had an interest in the "thing," *A* could take no action whatsoever against *D* with regard to *D's* interest in the "thing", thanks to the automatic stay arising out of *B's* bankruptcy.⁵² This is so, at least, where the termination of *D's* interest implies the termination of *B's* junior interest. Such reasoning applies just as much to *B's* security interest as it does to *B's* sublease.⁵³

C. Relations Between the Nonbankrupt Entities

Back to the case of the junior secured party, if the automatic stay prevents *A* from foreclosing against *B*, does it thereby follow that *A* is enjoined from foreclosing against *D* who is not bankrupt?

For example, suppose the collateral is worth \$100 in its unencumbered state, and *A* and *B* both claim \$60. *B* is bankrupt but *D* is not. *A* may not sell the collateral free and clear of *B's* junior security interest, because to do so would violate the automatic stay. But might *A* sell *D's* residual interest?

One case suggesting so is *Roslyn Savings Bank v. Comcoach Corp. (In re Comcoach Corp.)*,⁵⁴ where a borrower (*D*) encumbered real estate and then leased premises to a tenant (*B*). *B* filed for bankruptcy and the secured creditor (*A*) moved to lift the automatic stay in *B's* bankruptcy.⁵⁵ Judge Richard Cardamone ruled that the stay should not be lifted, because *A* was not even a party in interest in *B's* bankruptcy.⁵⁶ In Cardamone's view, *A* was not a creditor of *B* because *B* owed rent to *D*—not to *A*.⁵⁷ However mistaken this view is,⁵⁸ Judge Cardamone went on to suggest that the foreclosure sale against *D* was not stayed:

First, the state foreclosure action, as presently constituted, is not stayed. Until [*B*] is named as a party-defendant the action does not affect the bankrupt estate. New York law provides that lessees are necessary parties in foreclosure actions. Necessary parties are not always

indispensable parties, however, whose absence mandates dismissal of the action. The absence of a necessary party in a foreclosure action simply leaves such party's rights to the premises unaffected. By failing to name [B] as a party—defendant in its foreclosure action, [A] has left the debtor in exactly the same position as it was in prior to commencement of the suit. Since no interest of the bankrupt estate has been affected, no automatic stay prohibiting the continuance of the state foreclosure action exists. ⁵⁹

In other words, the automatic stay in *B's* bankruptcy does not prevent foreclosure of *A's* interest against *D*, so long as the foreclosure sale does not affect *B's* junior interest. ⁶⁰

How can this case be reconciled with *48th Street Steakhouse* previously discussed? ⁶¹ In *48th Street Steakhouse*, *A* wished relief from the automatic stay to foreclose the interests of both *B* and *D*. In *Comcoach*, *A* wished the same relief, but Judge Cardamone indicated that foreclosure against *D* was permissible, so long as *B's* junior interest was left intact. ⁶²

The ability to sell *D's* equity interest (but not *B's* junior security interest) is potentially harmful to *A*, unless care is taken in analyzing the consequences of such a sale. Suppose *A* sells the collateral to *X* in a foreclosure sale. *X* then has the right to possess the property against *B* and *B's* bankruptcy trustee. Between *D* and *B*, *B's* security interest was minor. *B's* trustee could not seize beneficial possession from *D*. Since *X* now owns what *D* had, *X* is likewise privileged against *B's* trustee.

X

knows, however, that she buys subject to *B's* security interest. Otherwise, *A* has violated the automatic stay. On the numbers presented earlier, *X* rationally pays a maximum of \$40. Ironically, \$40 is the value of the junior lien on the collateral. That is, if *A* were merely the junior secured party, *X* also would have paid \$40. The inability to foreclose *B* thereby subordinates *A* to *B*.

It should not be forgotten, ⁶³ however, that *A* has a security interest on *B's* junior security interest in *X's* property. *D* could only convey to *B* a title that *A's* security interest encumbers. Thus, if *D* had conveyed absolute title to *B*, *B* would take title subject to *A's* lien. The same is true if *D* conveys a junior security interest to *B*. That is, *B's* security interest is itself encumbered by *A's* lien. ⁶⁴

Now *A* has already recovered \$40 and has only a \$20 claim remaining. Meanwhile, *B's* bankruptcy trustee may realize on the property by inducing *X* to redeem (for \$60) or by selling *X's* property at auction to some buyer (*Y*) for \$100. If *X* redeems for \$60, *A* is senior for \$20. *B's* trustee is entitled only to the surplus of \$40. Equilibrium is happily restored. If *B's* trustee forecloses against *X*, *A* obtains \$20, *B's* trustee obtains \$40, and *X* obtains a surplus of \$40—exactly what *X* paid for *D's* equity interest.

The problem with this view is that it works only when the parties have perfect information. If *X* has no knowledge of *B's* bankruptcy and takes no warranties of title, it is *X*, not *A*, who bears the risk of *B's* bankruptcy. *X* pays \$100 but obtains *D's* equity (worth nothing) and *A's* lien (worth only \$60). Of course, *A* only claims \$60 and must return the \$40 surplus to *B's* bankruptcy trustee (who owns *B's* junior lien). This \$40 distribution reduces the junior lien from \$60 to \$20. *X* still owes \$20 on a nonrecourse basis to *B's* bankruptcy trustee because *X* did not understand that *B's* automatic stay prevented *A* from selling good title to *X*. Such a conundrum results if *B's* automatic stay prevents *A* from foreclosing against *B* and permits *A* to foreclose against *D*.

Against this result, however, stands the strange and unaptly named case of *Harsh Investment Corp. v. Bialac (In re Bialac)*, ⁶⁵ where the debtor was a one—sixth cotenant of a promissory note. All the cotenants jointly borrowed money, and the note was pledged to a bank. Upon default a surety paid the bank and took over the bank's position as pledgee. The pledgee then began a foreclosure sale. Hours before the sale, the one—sixth owner of the note filed a deftly timed bankruptcy petition. The secured party decided to go ahead with the sale of five—sixths of the note, exactly as envisioned here. In this sale, the secured party, bidding in its claim,

emerged as buyer of five-sixths of the note. ⁶⁶ —

Judge Otto Skopil ruled that the sale of the five-sixths violated the automatic stay. ⁶⁷ The sale was void, and the nonbankrupt cotenants were reestablished as owners of the note. The justification: the debtor had a redemption right under U.C.C. Section 9-506. ⁶⁸ This redemption right applied not just to the debtor's one-sixths cotenancy but to the entire note. Hence, the sale of the note—a "disposition" that terminates the redemption right—interfered with the debtor's property right. Hence, the entire thing—not just the debtor's interest in the thing—was deemed protected by the automatic stay. ⁶⁹ —

Under the U.C.C., can a cotenant of a thing redeem the whole thing—or just the cotenancy? No case law pre-existed *Bialac* to support this proposition, but Judge Skopil analogized to real estate law, where the right of a cotenant to redeem the whole thing is recognized. If this occurs, the other cotenants are reestablished as owner, but these others must reimburse the redeeming cotenant within a reasonable time or else lose the cotenancy. ⁷⁰ Sometimes it is said that the redeeming cotenant is subrogated to the mortgage. That is to say, the other cotenants are deemed to be equity owners of the redeemed cotenancies, but the redeeming cotenant is a secured creditor with a lien on those cotenancies. ⁷¹ —

Applying these principles to *Bialac*, the debtor was already the one-sixth owner of the promissory note, because the automatic stay prevented the sale of this cotenancy. Indeed, the secured party did not purport to sell this one-sixth interest. If the debtor were to redeem the other five-sixths, the other cotenants would still own the debtor equity in these cotenancies, but the debtor would have legal title to or perhaps an Article 9 security interest on the five-sixths.

That the automatic stay should protect this redemption right translates into this proposition: If (1) *D* grants a lien to *A*, if (2) *B* guarantees it, and if (3) *B* files for bankruptcy, the automatic stay restrains *D* from foreclosing against *A*. *B* has the right to be subrogated to *A*'s mortgage against *D*. *Bialac* ⁷² states that the subrogation right is property of the estate, and any interference with it violates the stay. ⁷³ —

That the bankruptcy of a surety should stay foreclosure of a security interest against the obligor sounds disturbing, and so some courts have attempted to distinguish *Bialac*. Thus, in *Saratoga Group, Ltd. v. Peoples National Bank (In re Geris)*, ⁷⁴ a surety filed for bankruptcy. The principal obligor (not a bankrupt) intervened to claim that foreclosure of a mortgage against the obligor would violate the stay in the surety's bankruptcy. ⁷⁵ Judge Dickson Phillips ruled that the stay did not impede the foreclosure. ⁷⁶ Phillips distinguished *Bialac* on the ground that *Bialac* involved a debtor with an "ownership" interest in a thing, whereas *Geris* surety had only the right of subrogation. ⁷⁷ But surely a contingent interest in a mortgage is "ownership." Judge Phillips overlooks the fact that the reason the stay restrained the pledgee in *Bialac* was that the debtor could redeem his own cotenancy *and* the cotenancy of others. If such a redemption were to be made, the debtor would have a security interest on these cotenancies. *Bialac* was nothing more than an ordinary suretyship case. Judge Phillips's distinction therefore fails.

Judge Phillips fully understood the consequence of holding that the surety's bankruptcy stays foreclosure against the principal obligor:

Certainly [the surety] has an interest, and a material one, in having the value of the . . . property maximized, insofar as it bears directly on the size of the deficiency . . . But if we were to accept this interest as sufficient to invoke in [the principal obligor's favor] the automatic stay provision . . . we would be cutting off foreclosure rights of secured creditors in any property standing as security for a debt that happened to be guaranteed by a bankrupt. This cannot have been an intended function of the automatic stay provision, any more than it was intended to prevent a secured creditor from collecting from or foreclosing on the property of a bankrupt debtor's guarantors. ⁷⁸ —

This last point is a disturbing one. The principal obligor's bankruptcy is not supposed to restrain collection against the surety, ⁷⁹ yet the surety's bankruptcy, under *Bialac*, powerfully prevents foreclosure against the

principal obligor. *Bialac* therefore resembles the notorious *Deprizio* case,⁸⁰ in which a guaranty by an insider extended the preference period to one year for the obligee. In both cases, the lender is worse off for having taken the guaranty.⁸¹

Nevertheless, the idea of debtor rehabilitation is that bankruptcy trustees should be able to administer assets whenever a senior secured party lacks the incentive to maximize value.⁸² These goals fully apply to bankrupt sureties. Thus, Judge Phillips point, though powerful, contradicts the principle on which bankruptcy jurisdiction over collateral is premised. The surety's automatic stay therefore shields the principal obligor on both the plain meaning of the Bankruptcy Code and its policy reserving appreciation value to the unsecured creditors of bankruptcy debtors.⁸³

III. JUNIOR SECURED CREDITORS AND STANDING

One last matter remains. Suppose *D* grants a senior security interest to *A* and a junior security interest to *B*. *D* then files for bankruptcy. May *B* (quite solvent) protest violations of *D*'s automatic stay by *A*?

Most courts believe that the junior secured party does not have standing.⁸⁴ In *City of Farmers Branch v. Pointer (In re Pointer)*,⁸⁵ a secured party sought a declaration that superpriority tax liens on its collateral would violate the automatic stay in the debtor's bankruptcy.⁸⁶ Judge Carolyn Dineen King ruled against the secured party on the theory that the creditor did not have standing. Judge King also emphasized that the creditor's theory was a disguised avoidance of a postpetition transfer under section 549. As this section gives only bankruptcy trustees standing, the creditor must therefore not be entitled to it.⁸⁷ On the other hand, if one believes that actions in violation of the stay are "void *ab initio*,"⁸⁸ the creditor's action need not be viewed as a theft of turf granted to trustees under section 549.⁸⁹

The following difference exists between section 549 avoidance and voidness *ab initio*. If the superpriority lien is avoided under section 549, the lien is preserved for the benefit of the estate under section 551 and can be asserted against the junior secured party. But if the superpriority lien is merely void for violating the stay, the lien is deemed never to have arisen, in which case the junior secured party wins the promotion that section 551 is designed to prevent. By denying the junior secured party standing, Judge King, in *Pointer*, preserved for the bankruptcy trustee the right to avoid *and preserve* the voidable superpriority lien.⁹⁰

Some cases do recognize junior creditor standing. In *Barnett Bank v. Trust Co. Bank (In re Ring)*,⁹¹ Judge Lamar Davis ruled that a solvent junior secured party had standing to bring an adversary proceeding against a senior secured party who had violated an automatic stay arising from the equity owner's bankruptcy. In so ruling, he noted that other creditors are the ultimate beneficiaries of the stay:

[A] creditor honors the stay with the expectation that it is not losing ground to other creditors because the bankruptcy court will not allow a violation of the stay to stand and will punish any party that violates it.⁹²

Davis saw two bad consequences in denying junior secured parties standing to enforce the stay against the senior secured party. First, it would signal to the senior secured party that she could violate the automatic stay with impunity, so long as an undersecured junior lienor exists.⁹³ Second, the denial of standing would make a mockery of the principle that acts taken in violation of the automatic stay are void *ab initio*.⁹⁴

The problem with this view is that it interferes with the trustee's discretion to administer the estate. If the trustee has good reason not to pursue sanctions against the senior secured creditor, this reason should be respected. If the junior secured party thinks that the trustee is breaching her fiduciary duty by not pursuing these sanctions, the junior secured party should pursue the remedies given to any creditor to force a trustee to perform. These might include the removal of a trustee or the delegation of the adversarial action to a creditor's committee.⁹⁵

IV. CONCLUSION

A bankruptcy trustee is deemed to be a judicial lien creditor who represents all unsecured creditors. As such, the trustee is a junior creditor whenever there exists a senior perfected security interest on property of the estate. At state law, junior secured creditors may not usually interfere with the senior creditor's right of foreclosure. But bankruptcy law and policy reverses this presumption, so that a bankruptcy trustee might maximize value for the benefit of the unsecured creditors.

When a debtor has bought collateral subject to a lien that was created before the debtor's purchase, the debtor is a nonrecourse debtor against the existing secured creditor. The automatic stay clearly restrains the secured creditor, even though no privity exists between the creditor and the debtor. The same rule should apply when the debtor buys an interest that is less than an absolute title. Thus, if the debtor is a junior secured creditor of some non-bankrupt entity, the automatic stay should restrain the senior secured creditor from foreclosure. Any such foreclosure would destroy property of the estate, in violation of Bankruptcy Code section 362(a)(4), which prevents "any act to . . . enforce any lien against property of the estate."⁹⁶

The Supreme Court has proclaimed in dictum that a lien owned by a bankrupt is a "minor" interest that does not enter the bankruptcy estate. But this remark is limited to the relations between an equity owner and a bankrupt secured creditor. When two secured creditors have claims against the collateral of a nonbankrupt entity, each lien may be minor insofar as the nonbankrupt entity is concerned, but vis-à-vis each other, the two liens are "major" in their relation. Hence, in the bankruptcy of the junior secured creditor, an automatic stay arises that prevents the senior secured party from foreclosing on the property of a nonbankrupt entity. Such foreclosure would destroy property of the junior creditor's bankruptcy estate.

Both the plain language and the implicit policy of the Bankruptcy Code dictate this result. The unsecured creditors of the junior secured party would benefit from the accrual of appreciation value in the junior lien if the junior's bankruptcy trustee is allowed to administer the foreclosure sale. The junior lien cannot be distinguished from a bankrupt's nonrecourse ownership of collateral. The rule for the one should also be the rule for the other.

FOOTNOTES:

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¹ 11 U.S.C. § 362(a)(4) (1994). [Back To Text](#)

² See *infra* text accompanying notes 11–15. [Back To Text](#)

³ But see *In re Karis*, 208 B.R. 913, 916–17 (Bankr. W.D. Wis. 1997) (finding secured creditor could foreclose on cattle because debtors had no right to redeem collateral). In *Karis*, Judge Thomas Utschig inexplicably overlooked U.C.C. § 9–506, which expressly provides the redemptive right Utschig thought was lacking. See U.C.C. § 9–506 (1977). [Back To Text](#)

⁴ 11 U.S.C. § 362(a)(3). [Back To Text](#)

⁵ 11 U.S.C. § 541(a)(1). [Back To Text](#)

⁶ For this reason, the automatic stay does not prevent time from running on redemption periods and the like. See *Counties Contracting & Constr. Co. v. Constitution Life Ins. Co.*, 855 F.2d 1054, 1058–59 (3d Cir. 1988) (Mansmann, J.) (acknowledging most courts hold section 362's prohibition against actions taken to obtain possession of estate's property does not affect tolling). [Back To Text](#)

⁷ Such an argument was actually used for a time in a different context. According to section 522(f)(1)(B), a debtor could avoid nonpossessory nonpurchase money security interests in certain exempt property "to the extent that such lien impairs an exemption." Often, state law allowed for an exemption of debtor equity in a thing—not the thing-in-itself. If so, secured parties successfully argued that the security interest stopped just

short of the exemption and so did not impair it. The security interest therefore could not be avoided under section 522(f)(1)(B), if this argument was accepted. Although the Supreme Court and Congress both acted to squelch this theory, it did carry the day in many circuits. *See, e.g.*, 11 U.S.C. § 522(f)(2) (defining impairment in such a way as to obviate this argument); *Owen v. Owen*, 500 U.S. 305, 313–14 (1991) (Scalia, J.) (overruling this argument on pre–1994 version of section 522(f)); *see also* David Gray Carlson, *Security Interests on Exempt Property After the 1994 Amendments to the Bankruptcy Code*, 4 Am. Bankr. Inst. L. Rev. 57, 64–67 (1996) (discussing concept of impairment).[Back To Text](#)

⁸ 462 U.S. 198 (1983).[Back To Text](#)

⁹ *Id.* at 203.[Back To Text](#)

¹⁰ 11 U.S.C. § 363(b)(1) (providing trustee may use, sell, or lease property of the estate in ordinary course of business).[Back To Text](#)

¹¹ 11 U.S.C. § 362(a)(3) (emphasis added).[Back To Text](#)

¹² *See* Rhonda S. Berliner, Note, *Bankruptcy and Subleases: The Depravity of Privity*, 14 Cardozo L. Rev. 193, 202 (1992) (explaining bankruptcy estate is "exclusively" property described in section 541(a), but if property does not come under section 541(a), it can not be "from" or "of" estate).[Back To Text](#)

¹³ 11 U.S.C. § 362(a)(4).[Back To Text](#)

¹⁴ *See* *Mann v. Alexander Dawson, Inc. (In re Mann)* 907 F.2d 923, 926–27 (9th Cir. 1990) (discussing stay of all proceedings related to foreclosure); *Phoenix Bond & Indem. Co. v. Shamblin (In re Shamblin)*, 890 F.2d 123, 125 (9th Cir. 1989) (stating that any foreclosure sale that violates automatic stay under section 362 is void); *Harsh Inv. Corp. v. Bialac (In re Bialac)*, 712 F.2d 426, 430 (9th Cir. 1983) (acknowledging right of redemption under section 541 that is covered by automatic stay).[Back To Text](#)

¹⁵ *See supra* note 12 and accompanying text.[Back To Text](#)

¹⁶ *See* David Gray Carlson, *Death and Subordination Under Article 9 of the Uniform Commercial Code: Senior Buyers and Senior Lien Creditors*, 5 Cardozo L. Rev. 547, 565–71 (1984) (discussing typical foreclosure statutes governing rights which judgment debtor had when judicial lien arose).[Back To Text](#)

¹⁷ *See* U.C.C. § 9–504(4) (1977) ("When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto.").[Back To Text](#)

¹⁸ A "nonrecourse" secured party is one who has the right to foreclose on the collateral but does *not* have the right to sue the debtor personally for the underlying debt. *See, e.g.*, *Vintero Corp. v. Corporacion Venezolana de Fomento (In re Vintero Corp.)*, 735 F.2d 740, 742 (2d Cir. 1984). Nonrecourse debt can arise in various ways. First, the secured creditor and the debtor may contract for no recourse. This is commonly done in commercial real estate lending for tax reasons. *See, e.g.*, *Resolution Trust Corp. v. Swedeland Dev. Group, Inc. (In re Swedeland Dev. Group, Inc.)*, 16 F.3d 552, 567 (3d Cir. 1994) (*en banc*) (Greenberg, J.). Second, the debtor may have obtained a bankruptcy discharge from all personal debts. The security interest, however, may have been left intact. In light of the discharge, the creditor has a nonrecourse security interest. *See, e.g.*, *Johnson v. Home State Bank*, 501 U.S. 78, 85 (1991) (Marshall, J.) (finding creditor who has claim enforceable only against the debtor's property nonetheless has "claim against the debtor" for purposes of section 102(2)); *In re Stanley*, 185 B.R. 417, 426 (Bankr. D. Conn. 1995) (Shiff, J.) (opining section 506(a) is not intended to be used to deprive nonrecourse creditors of either automatic right to recourse treatment granted by section 1111(b)(1)(A) or of right to elect to have its claim treated as fully secured claim). Finally, the debtor may have bought encumbered collateral from the person who granted the original security interest. After the sale, the security interest continues to encumber the collateral, but, as the buyer did not promise to

pay the debt, the secured creditor has recourse against the buyer. *See, e.g., 680 Fifth Ave. Assocs. v. Mutual Benefit Life Ins. Co. in Rehabilitation (In re 680 Fifth Ave. Assocs.)*, 29 F.3d 95, 98 (2d Cir. 1994) (Walker, J.).

The Bankruptcy Code's definitional machinery for describing nonrecourse claims is cumbersome. "[C]laim" is defined as "right to payment . . . secured, or unsecured." 11 U.S.C. § 101(5) (1994). Whether nonrecourse lenders have a claim under this definition is hard to say. Fortunately, creditors *do* have claims against the debtor by virtue of 11 U.S.C. § 102(2) (stating "'claim against the debtor' includes claim against property of the debtor"). If nonrecourse lenders have "claims," then it follows that they are "creditors." A "creditor" is:

(A) [an] entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor; [or]

(B) [an] entity that has a claim against the estate of a kind specified in section 348(d), 502(f), 502(g), 502(h) or 502(i)

11 U.S.C. § 101(10).

Nonrecourse lenders have a claim against property of the estate, but these claims are *not* described in sections 348(d), or 502(f) through (i). But, because their claim against property of the debtor is deemed to be a claim against the debtor personally, it follows, for those who take definitions seriously, that nonrecourse lenders are creditors. The syllogism, though inelegant, ultimately works.[Back To Text](#)

¹⁹ *See* U.C.C. § 9–105(1)(d) (defining debtor).[Back To Text](#)

²⁰ *See 680 Fifth Ave. Assocs.*, 29 F.3d at 97 ("The statute thereby puts the Chapter 11 debtor who wishes to retain collateral property in the same position as a person who purchased property 'subject to' a mortgage lien").[Back To Text](#)

²¹ *See supra* notes 7–10 and accompanying text.[Back To Text](#)

²² 11 U.S.C. § 362(d)(2)(A).[Back To Text](#)

²³ *Id.* § 362(d)(2)(B).[Back To Text](#)

²⁴ *See In re Amodio*, 155 B.R. 622, 623–25 (Bankr. N.D.N.Y. 1993) (discussing possibility of turnover of debtor's funds only if part of debtor's bankruptcy estate).[Back To Text](#)

²⁵ *See* Lee R. Bogdanoff, *The Purchase and Sale of Assets in Reorganization Cases—Of Interest and Principal, of Principles and Interest*, 47 Bus. Law. 1367, 1404 n.129 (1992) (noting unsecured creditors have compelling arguments in favor of bankruptcy estate benefiting from appreciation because this increases value of unsecured creditor's claims).[Back To Text](#)

²⁶ *See* Monumental Life Ins. Co. v. Bibo, Inc. (*In re Bibo, Inc.*), 200 B.R. 348, 351 (B.A.P. 9th Cir. 1996) (Alley, J.) (explaining debtor's interest does not have to be some type of "ownership" for automatic stay to be affected by foreclosure).*See also In re Village Rathskeller, Inc.*, 147 B.R. 665, 673–74 (Bankr. S.D.N.Y. 1992) (Brozman, J.) (modifying stay where *B* held junior leasehold, and where no equity existed and property was not necessary for effective reorganization).[Back To Text](#)

²⁷ 550 F.2d 47 (2d Cir. 1976).[Back To Text](#)

²⁸ If *A*'s foreclosure sale is subject to the automatic stay, it follows that the postpetition attempt at a foreclosure sale is a voidable postpetition transfer under section 549(a). *See* Coben v. Hahn (*In re Golden Plan of Cal., Inc.*), 39 B.R. 551, 555 (Bankr. E.D. Cal. 1984), *vacated*, 72 B.R. 205 (Bankr. E.D. Cal. 1986).[Back](#)

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²⁹ See *Austein v. Schwartz (In re Gerwer)*, 898 F.2d 730, 732 (9th Cir. 1990).[Back To Text](#)

³⁰ U.C.C. § 9–506 (1977) (emphasis added).[Back To Text](#)

³¹ See *In re Capital Mortgage & Loan, Inc.*, 35 B.R. 967, 971 (Bankr. E.D. Cal. 1983) (Dahl, J.) (explaining *A* not in violation of stay when it received quitclaim deed from *O* that did not affect *B*'s lien).[Back To Text](#)

³² See *supra* text accompanying notes 19–21.[Back To Text](#)

³³ 140 B.R. 387 (E.D. Va. 1992), *aff'd*, 988 F.2d 498 (4th Cir. 1993).[Back To Text](#)

³⁴ 462 U.S. 198 (1983).[Back To Text](#)

³⁵ *Id.* at 205 n.8 (emphasis added) (citations omitted).[Back To Text](#)

³⁶ Upon this dictum rests the intellectual foundation of securitization. See David Gray Carlson, *The Rotten Foundations of Securitization*, 39 Wm. & Mary L. Rev. (forthcoming 1998).[Back To Text](#)

³⁷ See *id.*[Back To Text](#)

³⁸ Something like this was proposed in *First Fed. Bank of Cal. v. Cogar (In re Cogar)*, 210 B.R. 803, 805–12 (B.A.P. 9th Cir. 1997). In that case, the junior secured party filed a chapter 11 case. The trustee for the junior secured party proposed a plan in which the defaulting equity owners would deed the property to the bankruptcy estate in lieu of foreclosure. The plan would then cram down the senior secured party. The junior secured party would then sell back the equity to the very same owners. To make matters worse, the trustee's junior lien was valueless because it was considerably under water.

This case differs from the GMAC example in the text, in that the equity owners were willing to convey their property to the chapter 11 trustee. Given that willingness, there is nothing in chapter 11 that prevents reorganizing the equity owners through the chapter 11 proceeding of the junior secured party. Nevertheless, Judge Lawrence Ollason would not allow it for three reasons: (1) it had never been done before; (2) the obtainment of the equity owners' interest would be "after-acquired property" in the bankruptcy estate and hence not property of the estate; (3) the senior secured party was not a creditor in the junior secured party's bankruptcy and so could not be affected by the chapter 11 plan.

None of these reasons are convincing. (1) Just because something has never been done does not mean it cannot be done, when the statute allows for it. The Bankruptcy Code has not enacted Egyptianism as one of its principles. (2) The equity interest may be "after-acquired property," but it is nevertheless property of the estate under section 541(a)(6) because it is proceeds of the security interest that the bankruptcy trustee would be foreclosing. (3) The senior secured creditor was indeed a nonrecourse creditor in the junior secured party's bankruptcy. A senior lien is always a lien on the junior lien, by its very nature. No one doubts that if the owner of equity were to convey all the equity to a person who files for bankruptcy, the senior secured party would be a nonrecourse creditor in the bankruptcy. See *supra* text accompanying notes 11–12. Why does the principle change when the equity owners convey a lesser interest—a security interest—to the same person?

In truth, nothing in the Bankruptcy Code prohibits the plan proposed in *Cogar*. The plan was undoubtedly an outrage to intuition. Perhaps the best view of the case is that it goes to the bad faith of the plan. Plans can only be confirmed when they are in good faith. See 11 U.S.C. § 1129(a)(3) (1994).[Back To Text](#)

³⁹ *Whiting Pools*, 462 U.S. at 205 n.8 (emphasis added).[Back To Text](#)

⁴⁰ 124 Cong. Rec. 32,399 (daily ed. Sept. 28, 1978) (statement of Congressman Edwards).[Back To Text](#)

⁴¹ Thomas J. Holthus, *A Debtor as a "Creditor" and the Automatic Stay*, 62 Am. Bankr. L.J. 377, 380 (1988).[Back To Text](#)

⁴² Of course, the stay might be lifted in such a case, if the speed boat is unnecessary to the right proceeding. See 11 U.S.C. § 362(d)(2)(B); *In re Walters*, 188 B.R. 582, 586 (Bankr. E.D. Ark. 1995) (Fussell, J.) (lifting stay on speed boat); see also *supra* note 23 and accompanying text (discussing relief of stay if "such property is not necessary to an effective reorganization"). This is a different question from whether the stay applies in the first instance.[Back To Text](#)

⁴³ See David Gray Carlson, *Turnover of Collateral in Bankruptcy: Must a Secured Party in Possession Volunteer?*, 6 J. Bankr. L. & Prac. 483, 506–07 (1997).[Back To Text](#)

⁴⁴ See, e.g., *Sapir v. Hudson Realty Co.*, (*In re Rosalind Gardens Assocs.*) 157 B.R. 75, 77 (Bankr. S.D.N.Y. 1993) (noting nonrecourse mortgagee was granted relief from automatic stay in accordance with section 362(d)); *In re Fuller*, 111 B.R. 660, 662 (Bankr. S.D. Ohio 1989) (discussing motion for relief from automatic stay by nonrecourse mortgagee).[Back To Text](#)

⁴⁵ Other arguments in this article are similarly unpersuasive. See Holthus, *supra* note 41, at 383. For instance:

An analogous situation is where a debtor owns all or nearly all of the outstanding shares of stock in a corporation. Such ownership does not make the corporation itself property of the estate, and the automatic stay does not apply to prevent any action against the corporation or its assets. The technical and legal distinction between the debtor and the corporation must be respected. Likewise, the technical and legal distinction between a security interest . . . and . . . property held by a debtor must be respected.

Id. (footnote omitted). In fact, the relation between shareholder and corporation is *not* analogous to that between a security interest and an equity interest. A shareholder and a corporation are separate juridical persons. A security interest and an equity ownership are both property interests; the former inclusive in the latter.[Back To Text](#)

⁴⁶ 300 F.2d 516 (7th Cir. 1962).[Back To Text](#)

⁴⁷ *Id.* at 519.[Back To Text](#)

⁴⁸ See *supra* Part I. (discussing automatic stay and foreclosure).[Back To Text](#)

⁴⁹ 835 F.2d 427 (2d Cir. 1987).[Back To Text](#)

⁵⁰ See *id.* at 431.[Back To Text](#)

⁵¹ *Id.* [Back To Text](#)

⁵² A close examination of the facts in *48th Street Steakhouse* reveals that Judge Altamari confused *A* with *D*. In fact, *D*, a prime tenant of *A*, conveyed the leasehold to *B*, who then subleased back to *D*. *D* was bankrupt. So viewed, the application of the automatic stay was straightforward. But Judge Altamari analyzed the case as if *B* (not *D*) was the bankrupt. See Berliner, *supra* note 12, at 207–13. In addition, it is not clear that *D*, as subtenant, could assume the prime lease to which, according to Altamari's wrong analysis, it was not a party. *Id.* at 213–14.[Back To Text](#)

⁵³ See *In re Capital Mortg. & Loan, Inc.*, 35 B.R. 967, 973 (Bankr. E.D. Cal. 1983) (finding senior lienholder violated automatic stay by taking quitclaim deed from trustee in lieu of foreclosure when junior lienholder was debtor in possession).[Back To Text](#)

⁵⁴ 698 F.2d 571 (2d Cir. 1983).[Back To Text](#)

⁵⁵ *See id.* at 572–73.[Back To Text](#)

⁵⁶ *See id.* at 575; *see also* 11 U.S.C. § 1109(b) (1994) (defining "party in interest"); *Vieland v. First Fed. Savs. Bank (In re Vieland)* 41 B.R. 134, 138 (Bankr. N.D. Ohio 1984) (noting a party in interest must be determined on case by case basis).[Back To Text](#)

⁵⁷ *See Comcoach*, 698 F.2d at 574 (stating that bank was not creditor because it had "no right to payment from the bankrupt, since the bankrupt has no obligation on the mortgage").[Back To Text](#)

⁵⁸ A has a lien on the leasehold itself. According to Bankruptcy Code section 102(2), "claim against the debtor includes claim against property of the debtor." Hence, A was a creditor of B after all and had standing to seek removal of the automatic stay.[Back To Text](#)

⁵⁹ *Comcoach*, 698 F.2d at 574 (citations omitted).[Back To Text](#)

⁶⁰ *Compare Brizendine v. Humboldt Express, Inc. (In re Brown Transp. Truckload, Inc.)*, 118 B.R. 889, 893 (Bankr. N.D. Ga. 1990) (distinguishing *Comcoach*).[Back To Text](#)

⁶¹ *See 48th St. Steakhouse, Inc. v. Rockefeller Group, Inc. (In re Rockefeller Group, Inc.)*, 835 F.2d 427, 431 (2d Cir. 1987) (Altimari, J.) (finding lease termination notice was void because it violated automatic stay); *see supra* notes 49–52 and accompanying text.[Back To Text](#)

⁶² *See Comcoach*, 698 F.2d at 574. *Accord In re Village Rathskeller, Inc.*, 147 B.R. 665, 669 (Bankr. S.D.N.Y. 1992) (Brozman, J.) (noting stay prevents any foreclosure that affects junior leasehold interest); *see also Irving Byelas Irrevocable Trust v. KDT Indus., Inc. (In re KDT Indus., Inc.)*, 32 B.R. 852, 856 (Bankr. S.D.N.Y. 1983) (concluding automatic stay would not be lifted because of minor difficulties).[Back To Text](#)

⁶³ As was done in *First Fed. Bank v. Cogar (In re Cogar)*, 210 B.R. 803, 812 (B.A.P. 9th Cir. 1997) (Ollason, J.). On this case, *see supra* note 38 and accompanying text.[Back To Text](#)

⁶⁴ One might say that the security agreement between D and B is "chattel paper" insofar as A is concerned, if the collateral is goods. *See* U.C.C. § 9–105(1)(b) (1977) (defining chattel paper as "writings which evidence both a monetary obligation and a security interest in . . . specific goods"). Hence, the creation of a junior security interest on goods implies that a proceeds security interest in chattel paper.[Back To Text](#)

⁶⁵ 712 F.2d 426 (9th Cir. 1983).[Back To Text](#)

⁶⁶ *See id.* at 428. Oddly, the surety was the shareholder of the note's maker, so that the surety was in effect the assignee of a claim against its own subsidiary.[Back To Text](#)

⁶⁷ *See id.* at 432.[Back To Text](#)

⁶⁸ *See* U.C.C. § 9–506 (1977). According to this provision:

At any time before the secured party has disposed of collateral . . . the debtor or any other secured party may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition

Id.[Back To Text](#)

⁶⁹ See *In re Capital Mortgage & Loan, Inc.*, 35 B.R. 967, 971 (Bankr. E.D. Cal. 1983) (Dahl, J.) (noting that automatic stay was violated when senior lienholder accepts lien deed thereby injuring junior's right of redemption pre-foreclosure).[Back To Text](#)

⁷⁰ The loss of the cotenancy is sometimes justified on grounds of laches or estoppel. See 2 American Law of Property § 6.16, at 71 (James A. Casner ed., 1952) (discussing statutory right of cotenants to redeem after foreclosure sale).[Back To Text](#)

⁷¹ See *id.* § 6.17, at 77 (noting the tactics of cotenants in enforcing contributions when one has discharged mortgage or other encumbrance); *cf.* *Fundaburk v. Cody*, 72 So.2d 710, 718 (Ala. 1954) (adjusting equities of parties by giving occupying cotenants compensation for money spent on mortgage debt).[Back To Text](#)

⁷² In so holding, Judge Skopil wrote of the debtor's redemption right over the five-sixths that it is not "within protections afforded by a literal interpretation of section 362, yet they should be protected by the stay if the purposes of the [Bankruptcy Code], the orderly disposition of all property in which the debtor has some interest, are to be achieved." 712 F.2d at 432 (citations omitted). In fact, the literal words of section 362(a) do support the result. Thus, section 362(a)(4) stays "any act to . . . enforce any lien against property of the estate." 11 U.S.C. § 362(a)(4) (1994). If the debtor's right to redeem the five-sixths is conceived as property of the estate, and if the secured party's postpetition sale ends that right to redeem, then the literal words of section 362(a)(4) prevent the sale. On the theory that acts in violation of stay are void, the sale of the five-sixths may be set aside. See, e.g., *Schwartz v. United States (In re Schwartz)*, 954 F.2d 569, 571 (9th Cir. 1992) (Wiggins, J.) (demonstrating that acts in violation of the stay are void). See generally Robert R. Niccolini, Note, *The Voidability of Actions Taken in Violation of the Automatic Stay: Application of the Information-Forcing Paradigm*, 45 Vand. L. Rev. 1663, 1677-86 (1992) (preferring "voidable" over "void" on policy grounds).[Back To Text](#)

⁷³ See *Harsh Inv. Corp. v. Bialac (In re Bialac)*, 712 F.2d 426, 431 (9th Cir. 1983). For other cases in which the surety's bankruptcy petition stayed foreclosure against the nonbankrupt principal obligor, see *Coben v. Hahn (In re Golden Plan of Cal., Inc.)*, 39 B.R. 551, 555 (Bankr. E.D. Cal. 1984) (Dahl, J.), *vacated*, 72 B.R. 205 (Bankr. E.D. Cal. 1986); *Capital Mortgage & Loan, Inc.*, 35 B.R. at 971.[Back To Text](#)

⁷⁴ 973 F.2d 318 (4th Cir. 1992).[Back To Text](#)

⁷⁵ See *id.* at 321. On standing of nondebtors to invoke the automatic stay, see *supra* text accompanying notes 54-64.[Back To Text](#)

⁷⁶ See *Geris*, 973 F.2d at 320.[Back To Text](#)

⁷⁷ See *id.* [Back To Text](#)

⁷⁸ *Id.* at 321 (citation omitted).[Back To Text](#)

⁷⁹ See *Union Trust Co. v. Willsea*, 275 N.Y. 164, 169 (1937) (stating liability of a surety for bankrupt principal is not altered by discharge of principal bankruptcy proceeding); Michael H. Rubin, *Ruminations on Suretyships*, 57 La. L. Rev. 565, 585 (1997) (stating that sureties are bound even where creditor has no way to collect from the principal obligor); Gary L. Monserud, *The Privileges of Suretyship For Delegating Parties Under U.C.C. Section 2-210 in Lights of the New Restatement of Suretyship*, 37 Wm. & Mary L. Rev. 1307, 1370 (1996) (discussing obligee retaining rights against secondary obligor after release of primary obligor).[Back To Text](#)

⁸⁰ See *Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186 (7th Cir. 1989).[Back To Text](#)

⁸¹ At least *Deprizio* is limited to insider guaranties. *Bialac's* logic applies to any kind of suretyship whatsoever.[Back To Text](#)

⁸² On this premise, see *supra* text accompanying notes 21–23 (discussing trustee's control of collateral claimed by secured parties).[Back To Text](#)

⁸³ See Patrick Fitzgerald, Note, *Bankruptcy Code Section 506(a) and Undersecured Creditors: What Date For Valuation?*, 34 UCLA L. Rev. 1953, 1959 (1987) (discussing appreciating collateral with respect to unsecured creditor's goals); see also Mary Josephine Newborn, *Undersecured Creditors in Bankruptcy: Dewsnup, Nobleman, and the Decline of Priority*, 25 Ariz. St. L.J. 547, 549–50 (1993) (discussing claims of unsecured creditors).[Back To Text](#)

⁸⁴ See *Tilley v. Vucurevich (In re Pecan Groves of Arizona)*, 951 F.2d 242, 245 (9th Cir. 1991) (Tang, J.) (finding where trustee abandoned appeal from decision upholding secured party's foreclosure sale, other creditors did not have standing to pursue it).[Back To Text](#)

⁸⁵ 952 F.2d 82, 89 (5th Cir. 1992) (finding liens voidable and secured creditor lacked standing to pursue avoidance actions on behalf of original bankruptcy estate).[Back To Text](#)

⁸⁶ Many courts had held that a postpetition tax lien accruing automatically on property was "void" for violating the automatic stay. See, e.g., *United States v. Fuller (In re Fuller)*, 134 B.R. 945, 949 (B.A.P. 9th Cir. 1992) (concluding automatic stay prevents attachment or perfection of tax lien); *Lincoln Savs. Bank v. Suffolk County Treasurer (In re Parr Meadows Racing Ass'n)*, 880 F.2d 1540, 1545 (2d Cir. 1989) (stating "even if it were possible to create and perfect a lien without any action by the [taxing authority], that lien, attaching to the property postpetition, would still violate the automatic stay."); Carl L. Bueki, *The Automatic Stay and Real Property Tax Liens*, 66 Am. Bankr. L.J. 233, 235 (1992) (noting Second and Third Circuit decisions held that automatic stay precludes perfection of these liens). However, in 1994, Congress solved the controversy by enacting section 362(b)(18), exempting the attachment postpetition tax liens from the automatic stay. See 11 U.S.C. § 362 (b)(18) (1994) (allowing for perfection of postpetition ad valorem tax).[Back To Text](#)

⁸⁷ See *Pointer*, 952 F.2d at 88. A junior secured party tried a different tactic in *McRoberts v. S.I.V.I. (In re Bequette)*, 184 B.R. 327, 334–35 (Bankr. S.D. Ill. 1995), by convincing a chapter 13 trustee to challenge a senior tax lien with priority over a fixtures priority interest. The debtor did not redeem during the statutory period, and the buyer applied for a deed in the circuit court of the county, without moving to lift the automatic stay. Judge Kenneth Meyers held that, though it was a technical violation, the court would issue no sanctions. In fact, it was probably not even that. The debtor's title simply did not exist once the redemption period ran out. In any case, Judge Meyers also refused to declare the deed void, since the debtor had no grounds to resist the deed. But he also complained that the chapter 13 trustee had no business using its power to benefit a junior secured creditor.[Back To Text](#)

⁸⁸ See *supra* note 68 and accompanying text; see also *Constitution Bank v. Tubbs*, 68 F.3d 685, 692 n.6 (3d Cir. 1995) ("Generally, judicial actions and proceedings against the debtor are void *ab initio* absent relief from the stay.") (citation omitted); *Schwartz v. United States (In re Schwartz)*, 954 F.2d 569, 572–73 (9th Cir. 1992) (asserting that IRS tax assessment violated stay and was void; ability to annul stay retroactively under section 362(d) is inconsistent with stay provisions being void and not merely voidable).[Back To Text](#)

⁸⁹ See *Barnett Bank v. Trust Co. Bank (In re Ring)*, 178 B.R. 570, 578 (Bankr. S.D. Ga. 1995) (Davis, J.) (criticizing *Pointer* for not adhering to voidness *ab initio*). In *Schwartz*, 954 at 573–74, Judge Charles Wiggins ruled that involuntary liens are void *ab initio*, but this did not deprive section 549 of its turf, because section 549 required voluntary conveyances by the debtor.[Back To Text](#)

⁹⁰ Cf. *Coben v. Hahn (In re Golden Plan of Cal., Inc.)*, 39 B.R. 551, 555 (Bankr. E.D. Cal. 1984) (Dahl, J.) (equating foreclosure in violation of automatic stay with illegal section 549 transfer), *vacated*, 72 B.R. 205 (Bankr. E.D. Cal. 1986).[Back To Text](#)

⁹¹ 178 B.R. 570 (Bankr. S.D. Ga. 1995).[Back To Text](#)

⁹² *Id.* at 577.[Back To Text](#)

⁹³ *See id.* (noting unfortunate consequences in denying corporate creditor standing to initiate contempt proceedings).[Back To Text](#)

⁹⁴ *See id.*; *see also In re Franck*, 171 B.R. 893, 894 (Bankr. D. Idaho 1994) (Pappas, J.) (granting standing to junior secured party harmed by senior foreclosure).[Back To Text](#)

⁹⁵ *See* 11 U.S.C. §324 (1994) (providing for removal of trustee or examiner for cause); *see also* *Glenny v. Langdon*, 98 U.S. 20, 30 (1878) (allowing creditors to petition court to remove and replace trustee); Marcy J. K. Tiffany, *A Time of Change—A Two Year Retrospective on the Office of the United States Trustee*, 21 Cal. Bankr. J. 13, 18 (1993) (discussing remedial actions that result from trustee's failure to meet their fiduciary responsibilities); Kenneth N. Klee & K. John Shaffer, *Creditors' Committees Under Chapter 11 of the United States Bankruptcy Code*, 44 S.C. L. Rev. 995, 999–1001 (1993) (discussing role of creditor's committee's under bankruptcy code).[Back To Text](#)

⁹⁶ 11 U.S.C. § 362(a)(4).[Back To Text](#)