

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS**

IN RE:

In Proceedings
Under Chapter 13

KENNETH OLDHAM
JENNIFER OLDHAM

Case No. 04-41692

Debtor(s).

KENNETH OLDHAM
JENNIFER OLDHAM

Plaintiff(s),

Adv. No. 05-4117

v.

HEIGHTS FINANCE CORPORATION

Defendant(s).

OPINION

This case presents the issue of whether a lien perfected in violation of the automatic stay is void or merely voidable in a subsequently filed bankruptcy case. The facts of this case are undisputed. On August 20, 2002, debtors Kenneth and Jennifer Oldham (hereinafter “Debtors”) executed a note and security agreement in favor of defendant Heights Finance Corporation (hereinafter “Creditor”) for the purchase of a 1989 Baja Islander boat and a 1989 Oklahoma trailer. Debtors did not provide the creditor with the titles to the boat and trailer at the time that the loan documents were executed. On February 3, 2003, the debtors filed a petition under Chapter 13 of the Bankruptcy Code. Creditor was listed on the debtors’ schedules and received notice of the bankruptcy filing at its office in Marion, Illinois. On March 28, 2003, the debtors provided the titles to the boat and trailer to the creditor, which the creditor then immediately forwarded to the Illinois

Secretary of State for recording. However, creditor did not seek relief from the automatic stay prior to perfecting its lien nor, at any point during the debtors' bankruptcy proceeding, did it request that the automatic stay be annulled.

On July 9, 2004, the Court dismissed the debtors' bankruptcy case for failure to make plan payments. Debtors then filed the instant Chapter 13 case on July 24, 2004. While the debtors' Schedule D classified creditor's claim as secured, it also indicated that the creditor's lien may be invalid. On September 2, 2004, debtors filed an adversary complaint to determine the validity of the creditor's lien (Adv. No. 04-4142). The complaint alleged that creditor had not properly perfected its lien and requested that creditor's claim be treated as a general unsecured claim. Creditor failed to respond and, consequently, on October 19, 2004, default judgment was entered in favor of the debtors and against the creditor on the complaint. The judgment order allowed creditor's claim as a general unsecured claim, but made no determination as to the validity of the creditor's lien.¹

On August 26, 2005, the debtors filed the instant adversary complaint against the creditor demanding turnover of the boat title and requesting that sanctions be imposed for creditor's violation of the automatic stay in the first bankruptcy proceeding. Debtors assert that because the creditor's lien was perfected during the pendency of the debtors' original bankruptcy proceeding, the lien is void and, therefore, may not be enforced against the debtors in the instant bankruptcy case. The creditor admits that its lien was perfected after the filing of the debtors' original bankruptcy petition. However, it maintains that its lien was merely voidable, and upon the

¹Although styled as a complaint to determine the validity of lien, the debtors' complaint only requested that the Court treat creditor's claim as an unsecured, non-priority claim in the amount of \$10,745.38. It did not request that the Court void creditor's lien.

dismissal of the debtors' previous case, its lien became wholly valid.

The initial inquiry for the Court is whether the creditor's perfection of its lien after the filing of the debtors' initial Chapter 13 bankruptcy petition constituted a violation of the automatic stay. The filing of a petition in bankruptcy automatically invokes a stay of certain actions by creditors. Section 362(a)(5) of the Bankruptcy Code specifically prohibits creditors from taking

any act to create, perfect, or enforce against property of the debtor
any lien to the extent that such lien secures a claim that arose before
the commencement of the case under this title.

11 U.S.C. § 362(a)(5). The stay remains in effect until the case is either dismissed or completed or until the debtor obtains a discharge. 11 U.S.C. § 362(c)(2). In the instant case, there is no question that the creditor perfected its lien on the debtors' property after the imposition of the automatic stay. Hence, the creditor's actions constituted a violation of § 362(a)(5) of the Bankruptcy Code.

Having determined that creditor's lien was perfected in violation of the stay, the Court must now address whether creditor's actions constituted a void or voidable act. There is a split of authority on the issue of whether actions taken in violation of the automatic stay are void or merely voidable. However, the vast majority of courts that have addressed this issue, including this Court, have concluded that actions taken in violation of the automatic stay are void and without effect. *Soares v. Brockton Credit Union*, 107 F.3d 969 (1st Cir. 1997); *Smith v. First America Bank N.A.*, 876 F.2d 524 (6th Cir. 1989); *In re Prine*, 222 B.R. 610 (Bankr. N.D. Iowa 1997); *In re Moler*, 152 B.R. 561 (Bankr. S.D. Ill. 1993). In *Moler*, the creditor mailed its judgment to the county recorder of deeds for recording. However, the next day, prior to the actual recordation of creditor's lien, the debtor filed his Chapter 7 bankruptcy petition. This Court ruled that because debtor's bankruptcy was filed before the creditor's judgment was placed on record to become a lien on debtor's real

estate, the automatic stay was effective against the creation of the lien and, consequently, the lien was “void and of no effect as a charge upon the debtor’s property.” *Moler*, 152 B.R. at 563.

This conclusion is consistent with the overriding purpose of the automatic stay. The automatic stay is a vital element of bankruptcy. As Congress has stated:

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.

H.R. Rep. No 595, 95th Cong., 1st Sess. 340 (1978) *reprinted in* 1978 U.S. Code Con. & Admin. News 5787, 5963, 6296-97. If violations of the stay were merely avoidable, the debtor would be placed under the additional obligation to litigate and avoid unlawful claims. As the Court of Appeals for the Ninth Circuit noted in *In re Schwartz*, “[t]he Bankruptcy Code does not burden the debtor with a duty to take additional steps to secure the benefit of the automatic stay. Those taking post-petition collection actions have the burden of obtaining relief from the automatic stay.” *In re Schwartz*, 954 F.2d 569, 572 (9th Cir. 1992).

Not only does voiding such unlawful acts relieve debtors of the responsibility of further action, it also prevents unscrupulous creditors from intentionally violating the stay. “Concluding that acts in violation of the automatic stay were merely avoidable would have the effect of encouraging disrespect for the stay by increasing the possibility that violators of the automatic stay may profit from their disregard for the law, provided it goes undiscovered for a sufficient period of time. This may be an acceptable risk to some creditors when measured against a delayed pro-rata distribution.” *In re Garcia*, 109 B.R. 335, 340 (N.D. Ill. 1989).

The Court is aware that there is a contrary line of cases which support creditor’s contention

that acts in violation of the stay are voidable rather than void. These cases reason that voiding acts committed in violation of the stay is inconsistent with both the bankruptcy court's power to annul the automatic stay pursuant to 11 U.S.C. § 362(d) and with the trustee's obligation to void unauthorized transfers under 11 U.S.C. § 549. *In re Jones*, 63 F.3d 411, 412 (5th Cir. 1995). *See also Picco v. Global Marine Drilling Co*, 900 F.2d 846, 850 (5th Cir. 1990); *Sikes v. Global Marine, Inc.*, 881 F.2d 176 (5th Cir. 1989). However, a review of these two sections does not mandate such a conclusion. Section 362(d) authorizes the bankruptcy court to grant creditors relief from the automatic stay under certain circumstances. 11 U.S.C. § 362(d) states:

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay. . . , such as by terminating, *annulling*, modifying, or conditioning such stay. . . .

11 U.S.C. § 362(d) (emphasis added). Some courts have reasoned that because the bankruptcy court may grant retroactive relief from the automatic stay, actions in violation of § 362(a) cannot be absolutely void, for if they were, § 362(d) would be rendered a nullity. *See Sikes* at 178-79. However, § 362(d) merely provides the court with the authority to make exceptions to the stay's applicability. By including a provision that the court may annul the stay, § 362(d) is simply authorizing the bankruptcy court, in certain circumstances, to validate actions which would otherwise be void *ab initio*. As this Court noted in *Tri-City Redi Mix, Inc.*, "a court may under extraordinary circumstances, annul the automatic stay retroactively, thereby giving effect to an action taken in violation of the automatic stay and rendering it "voidable" rather than simply void" *Tri City_Redi Mix, Inc. v. Energy Transport Systems, Inc*, BK 99-40991, Adv. No. 00-4006, slip op. at 4, n.2 (Bankr. S.D. Illinois April 18, 2000) (citing 2 *Collier on Bankruptcy*, ¶ 362.11[1] at 362-115 (15th ed. Rev. 1999)). *See also Matthews v. Rosene*, 739 F.2d 249 (7th Cir. 1989) (while

orders entered in violation of the automatic stay are generally void, an exception may exist in rare cases on equitable grounds). Therefore, the adoption of a general rule which voids acts taken in violation of the automatic stay does not conflict with § 362(d).

The cases in support of creditor's position also posit that voiding actions committed in violation of the automatic stay creates a conflict with § 549 of the Bankruptcy Code. Section 549 authorizes the trustee to avoid certain post-petition transfers of estate property.² Courts taking the position that acts in violation of the automatic stay are merely voidable reason that, because § 549 indicates that some post-petition transactions will be deemed valid unless otherwise challenged by the trustee, voiding all post-petition actions would render § 549 moot and conflict with § 362. See Sikes, 881 F.2d at 179. This Court disagrees. Due to the broad definition of the word "transfer" under the Bankruptcy Code,³ there may, in fact, be situations in which a creditor's actions constitute

²(a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate--

- (1) that occurs after the commencement of the case;
and
- (2) (A) that is authorized only under section 303(f) or 542(c) of this title; or
(B) that is not authorized under this title or by the court.

* * *

(d) An action or proceeding under this section may not be commenced after the earlier of --

- (1) two years after the date of the transfer sought to be avoid; or
- (2) the time that the case is closed or dismissed.

11 U.S.C. § 549(a), (d).

³Section 101(54) defines a "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's

both a violation of § 362(a) and an avoidable post-petition transfer pursuant to § 549. However, as the court explained in *In re Schwartz*:

Section 362's automatic stay does not apply to sales or transfers of property initiated by the debtor. Thus, section 549 has a purpose in bankruptcy beyond the potential overlap with section 362. In other words, the automatic stay can void any violation and still leave section 549 with a valid and important role in bankruptcy. Section 549 exists as a protection for creditors against unauthorized debtor transfers of estate property. Although there are circumstances where § 362 overlaps with § 549 and renders it unnecessary, this overlap falls far short of rendering § 549 meaningless.

954 F.2d at 574 (9th Cir. 1992). Because § 362(a) prohibits *involuntary* transfers of the debtor's property and § 549(a) primarily provides a remedy for the avoidance of unauthorized *voluntary* transfers, a rule that voids actions committed in violation of the automatic stay in no way compromises § 549 and, accordingly, the Court rejects this argument.

As this Court concludes that the creditor's act of perfecting its lien in violation of the automatic stay renders its lien void *ab initio*, the fact that the debtors' initial bankruptcy case was dismissed is of no consequence. While creditor asserts that its otherwise invalid lien became valid when the debtors' original bankruptcy case was dismissed, such an argument is based, again, on the premise that actions committed in violation of the stay are *voidable*. It is well established that the dismissal of a prior case does not serve to validate acts taken in violation of the automatic stay and that such acts remain void during a debtor's subsequent bankruptcy case. *In re Prine*, 222 B.R. 610, 613 (Bankr. N.D. Iowa 1997). *See also In re Olson*, 101 B.R. 134, 145 (Bankr. D. Neb. 1989); *Richard v. City of Chicago*, 80 B.R. 451, 454 (Bankr. N.D. Ill. 1987).

For the reasons set forth above, this Court concludes that the creditor's lien on the debtors'

equity of redemption. 11 U.S.C. § 101(54) (2004).

boat and trailer is invalid. Judgment shall enter in favor of the debtors on the complaint and the creditor shall immediately return the title to the boat and trailer to the debtors. However, the Court denies the debtors' request for sanctions, as the creditor's violation of the automatic stay occurred during the pendency of the debtors' original bankruptcy and any request for sanctions should have been brought during that proceeding.

SEE WRITTEN ORDER.

ENTERED: March 23, 2006

/s/ Kenneth J. Meyers
UNITED STATES BANKRUPTCY JUDGE

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ORDER

For the reasons set forth in the Opinion entered this date, IT IS ORDERED that judgment is entered in favor of the plaintiffs and against the defendant on the complaint. Defendant Heights Finance Corporation is ordered to turnover to the debtors' the titles to the 1989 Baja Island boat and 1989 Oklahoma trailer.

ENTERED: March 23, 2006

/s/ Kenneth J. Meyers
UNITED STATES BANKRUPTCY JUDGE