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The Voidability of Actions Taken in Violation of the Automatic Stay: Application of the Information-Forcing Paradigm

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INTRODUCTION

The automatic stay[1] is undeniably one of the most important elements of the bankruptcy process.[2] In fact, the expansion of the stay was one of the major changes that the 1978 Bankruptcy Reform Act initiated.[3] Despite the integral nature of the automatic stay, however, courts have yet to reach a consensus regarding the conceptualization and subsequent effect of actions taken in violation of the stay. Presently, a substantial majority of the circuits hold that such actions are void ab initio and of no legal effect.[4] A small but significant number of courts, how-

1. 11 U.S.C. § 362 (1988).

2. See *In re Lampkin*, 116 Bankr. 450, 453 (Bankr. D. Md. 1990) (calling the stay "a bedrock policy upon which the Code is built"). See also *Grady v. A.H. Robins Co.*, 839 F.2d 198, 200 (4th Cir. 1988) (stating that "the importance of § 362 cannot be over-emphasized").

3. See Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101 to 1330 (1988). For a brief discussion of the nature of this expansion, see Daniel Keating, *Offensive Uses of the Automatic Stay*, 45 Vand. L. Rev. 71, 75 (1992).

4. The First, Second, Third, Sixth, Ninth, Tenth and Eleventh Circuits all currently hold that violations of the stay are void. See *In re Smith Corset Shops, Inc.*, 696 F.2d 971 (1st Cir. 1982); *In re 48th Street Steakhouse, Inc.*, 835 F.2d 427 (2d Cir. 1987); *Maritime Elec. Co. v.*

ever, decline to follow the majority rule. These courts instead hold that violations of the stay are voidable and capable of cure.[5]

The debate between the advocates of these two opposing rules can best be understood as a conflict between bankruptcy policy concerns, on the one hand, and the demand for coherent Code interpretation on the other.[6] The proponents of the void rule, relying mainly upon policy concerns, argue that courts should hold stay violations absolutely void in order to deter such violations, and thereby further the overriding protective purposes of the automatic stay.[7] The proponents of the voidable rule, however, argue that such a characterization is overly broad, inflexible, and inconsistent with various provisions of the Bankruptcy Code. The voidable rule advocates contend that the voidable rule is a statutorily consistent and theoretically superior alternative.[8] The caselaw has consistently presented the void-voidable controversy as a conflict between these two opposing viewpoints.[9] As a result, the debate thus far

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United Jersey Bank, 959 F.2d 1194 (3d Cir. 1991); *In re Ward*, 837 F.2d 124 (3d Cir. 1988); *Smith v. First American Bank, N.A.*, 876 F.2d 524 (6th Cir. 1989); *Ellis v. Consolidated Diesel Elec. Corp.*, 894 F.2d 371 (10th Cir. 1990); *In re Albany Partners, Ltd.*, 749 F.2d 670 (11th Cir. 1984); *Borg-Warner Acceptance Corp. v. Hall*, 685 F.2d 1306 (11th Cir. 1982).

The Ninth Circuit was, for a short period, in a state of relative uncertainty on this issue. Prior to 1990, the Ninth Circuit courts had consistently held stay violations void. See *In re Taylor*, 884 F.2d 478 (9th Cir. 1989); *In re Shamblin*, 890 F.2d 123 (9th Cir. 1989); *In re Stringer*, 847 F.2d 549, 551 (9th Cir. 1988); *In re Sambo's Restaurants, Inc.*, 754 F.2d 811, 816 (9th Cir. 1985); *In re Wingo*, 89 Bankr. 54 (9th Cir. (BAP) 1988). In 1990, however, the Ninth Circuit Bankruptcy Appellate Panel concluded that, for various reasons of statutory consistency, the Ninth Circuit decisions actually supported the position that violations of the stay are voidable, not void. See *In re Schwartz*, 119 Bankr. 207, 209-11 (9th Cir. 1990). Other courts criticized this fairly liberal interpretation of Ninth Circuit precedent. See, for example, *In re Williams*, 124 Bankr. 311 (Bankr. C.D. Cal. 1991), and ultimately the decision was reversed. See *In re Schwartz*, 954 F.2d 569 (9th Cir. 1992). With this decision, the Ninth Circuit once again clearly supports the void rule. Id. at 571.

Lower courts that have followed the void rule include the following: *In re Advent Corp.*, 24 Bankr. 612 (1st Cir. 1982); *Anglemyer v. United States*, 115 Bankr. 510 (D. Md. 1990); *Matter of Dexter*, 116 Bankr. 92 (Bankr. S.D. Ohio 1990); *In re Clark*, 69 Bankr. 885 (Bankr. E.D. Pa. 1987); *In re Davis*, 74 Bankr. 406 (Bankr. N.D. Ohio 1987); *In re Funket*, 27 Bankr. 640 (Bankr. M.D. Pa. 1982); *Matter of Holland*, 21 Bankr. 681 (Bankr. N.D. Ind. 1982); *In re Johnson*, 18 Bankr. 755 (Bankr. S.D. Ohio 1982); *In re Young*, 14 Bankr. 809 (Bankr. N.D. Ill. 1981).

5. The only circuit court that holds that stay violations are voidable is the Fifth. See *Sikes v. Global Marine, Inc.*, 881 F.2d 176 (5th Cir.1989); *Picco v. Global Marine Drilling Co.*, 900 F.2d 846 (5th Cir. 1990). Other courts that have followed the voidable rule include: *In re Still*, 117 Bankr. 251 (Bankr. E.D. Tex. 1990); *In re Sapp*, 91 Bankr. 520 (Bankr. E.D. Mo. 1988); *In re Clark*, 79 Bankr. 723 (Bankr. S.D. Ohio 1987); *In re Oliver*, 38 Bankr. 245 (Bankr. D. Minn. 1984); *In re Fuel Oil Supply and Terminaling, Inc.*, 30 Bankr. 360 (Bankr. N.D. Tex. 1983). See also *In re Brooks*, 79 Bankr. 479 (9th Cir. 1987); *In re Schwartz*, 119 Bankr. 207 (9th Cir. (BAP) 1990), rev'd, 954 F.2d 569 (9th Cir. 1992).

6. See Part V.A.

7. See, for example, *Schwartz*, 954 F.2d at 571; *Williams*, 124 Bankr. at 316-17. See generally Part III.A.

8. See, for example, *Fuel Oil Supply*, 30 Bankr. at 362. See generally Part III.B.

9. For examples of the scope of the debate's presentation, see *Schwartz*, 954 F.2d at 571-74; *Williams*, 124 Bankr. at 316-17.

has been constrained by the terms of its own proponents. Neither side has ever examined the incentives that the different rules create, nor the effect that these incentives have upon information transfer between the debtor and the creditor concerning the debtor's filing of a bankruptcy petition.[10]

This Note addresses that gap in the void-voidable debate. Part II examines the broad scope and underlying protective purposes of the automatic stay and suggests that while the importance of the stay is significant, its reach is not necessarily unlimited. Part III outlines the different rationales that support the two conflicting rules. Part IV discusses the famous case of *Hadley v. Baxendale* and describes how the economic analysis of *Hadley* leads to the derivation of the information-forcing paradigm. Part V first argues that the current debate between the two rules has become an intractable conflict resulting from different approaches to Code interpretation. The section then concludes that, based upon the information-forcing paradigm and the problem of moral hazard, courts should hold that violations of the automatic stay are voidable rather than void.

II. Scope and Purpose of the Automatic Stay

Section 362(a) of the Bankruptcy Code defines the scope of the automatic stay by specifically listing various acts that the commencement of a bankruptcy case stays.[11] The stay is self-operating and takes effect

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10. A select number of courts have alleged that the voidable rule places upon the debtor the unfair financial and evidentiary burdens of persuading the court that it should set aside the violative action. See, for example, *Schwartz*, 954 F.2d at 571; *Williams*, 124 Bankr. at 316-17. This analysis, however, relates only to the burdens created after a violation of the stay has occurred. This Note focuses instead upon how the voidable rule, through the threat of these burdens, can create a previolation incentive for the debtor to convey information concerning the filing of the bankruptcy petition. The exclusively postviolation burden analysis of *Schwartz* and *Williams* does not address this issue.

11. 11 U.S.C. § 362(a) (1988) provides:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

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

the moment a debtor files its bankruptcy petition.[12] The protection that the stay provides is, in most regards, extremely broad,[13] so broad that even activities such as dumping garbage on a debtor's lawn may violate the stay.[14] The stay protects the debtor from both secured and unsecured creditors,[15] and from both formal and informal actions they may bring against the debtor or the bankruptcy estate.[16]

Nevertheless, the Bankruptcy Code also establishes several categories of exceptions to the automatic stay.[17] Congress has drawn these exceptions quite narrowly, however, and most courts strictly interpret them in order to facilitate the extensive relief that the stay provides.[18]

One of the major purposes underlying the automatic stay is debtor protection,[19] a purpose the Code's drafters themselves articulated.[20] By

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(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

12. See *In re Elder*, 12 Bankr. 491, 494 (Bankr. M.D. Ga. 1981); John Francis Murphy, *The Automatic Stay in Bankruptcy*, 34 Cleve. St. L. Rev. 567, 567 (1986) (explaining that the mere filing of the petition triggers the stay).

13. See *In re Stringer*, 847 F.2d 549, 552 (9th Cir. 1988) (footnote omitted) (stating that "Congress clearly intended the automatic stay to be quite broad"). See generally Murphy, 34 Cleve. St. L. Rev. at 571 (cited in note 12). According to one group of legal commentators, creditors generally summarize Section 362(a) as meaning that "[i]f something is worth doing, you can't do it because it will be stayed." David G. Epstein, Jonathan M. Landers, and Steve H. Nickles, *Debtors and Creditors: Cases and Materials* 757 (West, 1987).

14. See *In re Reed*, 11 Bankr. 258 (Bankr. D. Utah 1981).

15. See *In re Holtkamp*, 669 F.2d 505, 508 (7th Cir. 1982).

16. See *In re Smith*, 876 F.2d 524, 525-26 (6th Cir. 1989) (stating that the stay "extends to virtually all formal and informal actions"); *Ass'n of St. Croix Condo. Owners v. St. Croix Hotel Corp.*, 682 F.2d 446, 448 (3d Cir. 1982).

17. See 11 U.S.C. § 362(b) (1988) (listing specific exceptions to the automatic stay).

18. See, for example, *Stringer*, 847 F.2d at 552 (footnote omitted) (stating that the Section 362(b) exceptions "should be read narrowly to secure the broad grant of relief to the debtor"). See also Epstein, Landers, and Nickles, *Debtors and Creditors* at 757 (cited in note 13).

19. Most legal commentators agree that debtor protection is a major goal of the stay. See, for example, Benjamin Weintraub and Alan N. Resnick, *Bankruptcy Law Manual* § 1.09[1] at 1-31 (Warren, Gorham & Lamont, 1986); Murphy, 34 Cleve. St. L. Rev. at 567 (cited in note 12).

20. The legislative history of Section 362(a) declares that:

> 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 (1977), reprinted in 1978 U.S.C.C.A.N. at 6296-97. Courts following the void rule have frequently cited this passage from the legislative history of Section 362 with approval. See, for example, *In re Smith*, 876 F.2d 524, 525 (6th Cir. 1989); *In re Albany Partners, Ltd.*, 749 F.2d 670, 675 n.9 (11th Cir. 1984); *In re Williams*, 124 Bankr. 311, 316 (Bankr. C.D. Cal. 1991).

prohibiting creditor action, the stay gives debtors a breathing spell from financial pressure,[21] which in turn affords them an opportunity to "regain their financial footing."[22] For corporate debtors, this means time to regroup, restructure their affairs, and create a plan of reorganization to submit to the court.[23] For the individual debtor, breathing room from creditor pressure facilitates the chance for a fresh start.[24]

A second purpose of the automatic stay is creditor protection.[25] The stay prevents creditors from racing to the courthouse steps in an uncontrolled scramble for the debtor's assets.[26] Such a race would not only quickly deplete the bankruptcy estate,[27] but also would defeat the important bankruptcy goal of treating all creditors equitably.[28] The stay is the statutory barrier that prevents individual creditors from acting in their own self-interest to the detriment of other creditors.[29] With this race stalled, the bankruptcy court is able to harmonize the interests of all creditors involved.[30]

Given the protective functions that the automatic stay serves for both the debtor and the creditor, the scope and importance of the stay

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21. See *Williams*, 127 Bankr. at 316. See generally *In re American Mariner Indus.*, 734 F.2d 426, 431 (9th Cir. 1984) (stating that the overriding purpose of the stay is to provide the debtor with a "breathing spell").

22. *Schwartz*, 954 F.2d at 571.

23. See *Matter of Baldwin-United Corp.*, 48 Bankr. 901, 902 (Bankr. S.D. Ohio 1985) (explaining that Chapter 11 debtors must have "breathing room" in order to reorganize, and that the stay's importance increases exponentially with the magnitude of the case). See generally Epstein, Landers, and Nickles, *Debtors and Creditors* at 754 (cited in note 13).

24. See *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (stating that "[o]ne of the primary purposes of the bankruptcy act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes' ").

25. See H.R. Rep. No. 595, reprinted in 1978 U.S.C.C.A.N. at 6297 (cited in note 20) (stating that "[t]he automatic stay also provides creditor protection, and that "[w]ithout it, certain creditors would be able to pursue their own remedies against the debtor's property . . . in preference to and to the detriment of other creditors").

26. See id.; *American Mariner Industries*, 734 F.2d at 431 (explaining that one of the stay's purposes is protecting creditors from injuring each other in a race of diligence).

27. See *Martin-Trigona v. Champion Fed. Sav. & Loan Assn.*, 892 F.2d 575, 577 (7th Cir. 1989) (citation omitted) (arguing that the stay "protect[s] the bankrupt's estate from being eaten away by creditors' lawsuits and seizures of property"). See also Murphy, 34 Cleve. St. L. Rev. at 568 (cited in note 12).

28. See *Hunt v. Bankers Trust Co.*, 799 F.2d 1060, 1069 (5th Cir. 1986) (footnote omitted) (stating that "[t]he purpose of the automatic stay is to protect creditors in a manner consistent with the bankruptcy goal of equal treatment"); Weintraub and Resnick, *Bankruptcy Law Manual* § 1.09[1] at 1-31 (cited in note 19) (stating that the "orderly liquidation and fair and equal distribution of the estate to creditors would be frustrated" by a race of diligence).

29. See Murray Tabb, *Competing Policies in Bankruptcy: The Governmental Exception to the Automatic Stay*, 21 Tulsa L. J. 183, 184 (1985) (proposing that one of the stay's purposes is to prevent creditors from having to enter a race of diligence).

30. See *Fidelity Mortg. Investors v. Camelia Builders, Inc.*, 550 F.2d 47, 55 (2d Cir. 1976).

may appear all-encompassing.[31] There are, however, significant limitations on the stay's application. For instance, only actions against the debtor itself trigger the stay.[32] The stay does not extend to protect third parties or individuals who are jointly liable on debts with the debtor.[33] Furthermore, courts sometimes limit the debtor's ability to manipulate the stay's application, as exemplified by the general judicial prohibition against offensive uses of the stay.[34]

Despite these and other limitations on the stay, many courts view the power and scope of the stay as virtually unlimited.[35] Some courts even tend to wax poetic whenever the stay is invoked. For example, courts have described the stay as the "protective armor" of the debtor,[36] the "shield" that safeguards the bankrupt,[37] and even as the "ship upon which debtors embark on their fresh start."[38] Such language reveals the powerful assumption many courts make, the assumption that the protective purposes of the stay are, in all circumstances, paramount. This assumption has in turn created what one commentator has termed "a certain judicial gloss" with respect to the expansiveness of Section 362(a).[39] In other words, rather than analyzing stay violations on a case-by-case basis, many courts react with the knee-jerk response that the purposes of the stay override all else.[40] As a result, these courts often have overlooked facts that might require, or even demand the application of a different rule.

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31. Courts themselves often succumb to this view. See, for example, *Matter of Dexter*, 116 Bankr. 92, 95 (Bankr. S.D. Ohio 1990) (stating that "[t]he automatic stay is integral to the bankruptcy process and its importance cannot be overemphasized").

32. See 11 U.S.C. § 362(a)(1) (1988) (stating that only a "proceeding against the debtor" triggers the stay); *Freeman v. Commissioner*, 799 F.2d 1091, 1092 (5th Cir. 1986).

33. Among the third parties and individuals that the stay does not protect are codefendants, sureties and guarantors of the debtor. See *Lynch v. Johns-Manville Sales Corp.*, 710 F.2d 1194, 1196-97 (6th Cir. 1983); Murphy, 34 Cleve. St. L. Rev. at 559 (cited in note 12); Epstein, Landers, and Nickles, *Debtors and Creditors* at 745 (cited in note 13).

34. See generally Keating, 45 Vand. L. Rev. 71 (cited in note 3). For a list of courts holding that offensive uses of the stay are not authorized, see id. at 72 n.6.

35. See, for example, the *Lampkin*, *Grady*, and *Dexter* decisions, cited previously in notes 2 and 31.

36. *Williams*, 124 Bankr. at 316.

37. See Keating, 45 Vand. L. Rev. at 72 nn.4-6.

38. *Lampkin*, 116 Bankr. at 453.

39. Murphy, 34 Cleve. St. L. Rev. at 568 (cited in note 12) (stating that "[t]he reputation of the pervasiveness of § 362(a) among legal practitioners and members of the bench has done much to add a certain judicial gloss to the expansiveness afforded that provision in some of the cases under which it is construed").

40. Not all courts, however, yield to this view. See, for example, *Price & Pierce Int'l, Inc. v. Spicers Int'l Paper Sales, Inc.*, 50 Bankr. 25, 26 (S.D.N.Y. 1985) (citation omitted) (explaining that "[a]lthough the scope of the automatic stay 'is undeniably broad', . . . it does not operate to stay all actions involving the bankrupt," and that "[t]he reach of the automatic stay is limited by its purposes").

These observations are not meant to deny the broad purpose and scope of the automatic stay. Rather, they are made to suggest that when courts address stay violations, they should not immediately dismiss the concepts of incentive and cost as being antithetical to the protective purposes of the stay. Commentators have already recognized the role that such concepts play with respect to discharge.[41] Application of cost and incentive analysis to the operation of the automatic stay seems to be a logical extension, particularly if the costs are low and the benefits are substantial. Thus, when examining the void-voidable debate, the mere mention of the protective purposes of the automatic stay does not and should not foreclose all other modes of analysis. Rather, the protective purposes of the stay are merely the prologue to the discussion.

III. PARAMETERS OF THE VOID-VOIDABLE DEBATE

A. *Actions Taken in Violation of the Stay as Void*

One of the most important decisions to hold that actions in violation of the bankruptcy stay are null and void is *Kalb v. Feuerstein*.[42] In *Kalb*, a mortgagee foreclosed upon a family farm. The county court confirmed the subsequent sheriff's sale, even though the debtor had a petition pending under the Bankruptcy Act at the time of the confirmation.[43] After being evicted from their property, the debtors brought an action in equity.[44] The Wisconsin Supreme Court held that the Bankruptcy Act did not operate as an automatic statutory stay triggered by filing, and that, absent a formal judicial stay, the confirmation of sale did not violate the Act.[45]

The U.S. Supreme Court reversed.[46] Relying heavily upon legislative history and congressional intent,[47] the Court found that Congress had created a "general plan" for relieving debtors from the necessity

41. See, for example, Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 Harv. L. Rev. 1393, 1427 (1985) (arguing that the question of whether "exercise of the right of discharge should come at *some* cost, however, is not—or at least should not be—an open question"). For an excellent discussion of costs associated with discharge, as well as the effect of perverse incentives, see Keating, 45 Vand. L. Rev. at 125-28 (cited in note 3).

42. 308 U.S. 433 (1940).

43. See id. at 435-36. The Bankruptcy Act in force in 1940 was the Frazier-Lemke Act, 11 U.S.C. § 203 (superseded by the Bankruptcy Reform Act of 1978).

44. The action, brought in the Circuit Court of Walworth County, Wisconsin against the mortgagees who had purchased the farm, sought restoration of possession, cancellation of the sale, and removal of the mortgagees. The circuit court dismissed the case for failure to state a cause of action, and the debtors appealed. See *Kalb*, 308 U.S. at 436.

45. See id. at 437.

46. See id. at 444.

47. See id. at 441-42.

and expense of litigation. In accordance with this plan, the Bankruptcy Act conveyed exclusive jurisdiction over the debtor and his property to the bankruptcy court.[48] As a result, the Supreme Court held that the confirmation of sale, made in violation of the stay, was issued "without authority of law,"[49] and was therefore void.[50]

Although *Kalb* was decided almost forty years before Congress adopted the current Bankruptcy Reform Act, most of the courts that follow the void rule cite *Kalb* as precedent.[51] Though the factual situations before these courts have varied greatly,[52] they have all concluded that actions taken in violation of the automatic stay are void ab initio and, therefore, without legal effect.[53] This holding generally extends even to situations in which a creditor has not received notice of the bankruptcy filing and therefore lacks knowledge of the stay.[54]

Courts most often justify the void rule by emphasizing the primary importance of the automatic stay.[55] Courts adopting the void rule typically employ the following reasoning. First, they find that the protective purposes of the automatic stay are central to the goals of the Bankruptcy Code.[56] Second, they reason that the void rule provides debtors with strong protection from creditors, and also encourages respect for

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48. Id. at 443. See also id. at 442 (citing House Rep. No. 1808, 74th Cong., 1st Sess.) (stating that "it was the intention of Congress . . . that the farmer-debtor and all of his property should come under the jurisdiction of the court of bankruptcy").

49. Id. at 443.

50. See id. at 438 (stating that the county court's action "was not merely erroneous but was beyond its power, void, and subject to collateral attack").

51. See, for example, *Stringer*, 847 F.2d at 551; *In re Ward*, 837 F.2d 124, 126 (3d Cir. 1988); *Borg-Warner Acceptance Corp.*, 685 F.2d at 1308. In contrast, the courts that hold stay violations voidable do not consider *Kalb* binding precedent. See notes 82-84 and accompanying text.

52. See, for example, *In re Eisenberg*, 7 Bankr. 683, 686 (Bankr. E.D.N.Y. 1980) (holding a postpetition tax lien sale void); *In re Miller*, 10 Bankr. 778, 780 (Bankr. D. Md. 1981) (holding a postpetition car repossession void); *In re Advent Corp.*, 24 Bankr. 612, 614 (1st Cir. 1982) (holding an insurer's postpetition bond cancellation "of no effect"); *In re Grosse*, 68 Bankr. 847, 850 (Bankr. E.D. Pa. 1987) (holding a postpetition garnishment of debtor's bank account void); *In re Ellis*, 66 Bankr. 821, 823 (N.D. Ill. 1986) (holding the Department's commencement of a civil action against the debtor void).

53. See notes 4 and 52.

54. See, for example, *In re Young*, 14 Bankr. 809, 811 (Bankr. N.D. Ill. 1981) (citations omitted) (stating tbat "[t]he stay created by §362(a) is an automatic statutory stay and acts taken in violation of the stay are void *ab initio* regardless of notice"); *Advent Corp.*, 24 Bankr. at 614 (citations omitted) (stating that actions "done in violation of the stay are void ab initio regardless of lack of knowledge of the filing of the petition"). See also *In re Smith*, 876 F.2d 524, 526 (6th Cir. 1989); *Miller*, 10 Bankr. at 780.

55. See, for example, *In re Garcia*, 109 Bankr. 335, 340 (N.D. Ill. 1989) (holding that "the fundamental importance of the automatic stay to the purposes sought to be accomplished by the Bankruptcy Code requires that acts in violation of the automatic stay be void, rather than voidable").

56. See generally notes 19-30 and accompanying text.

the stay while discouraging its violation.[57] Finally, in order to support the Code's overriding goal of debtor protection, these courts adopt the void rule.[58]

Even under this view, however, the void rule is not absolute. Both the caselaw and the Bankruptcy Code itself provide exceptions to the rule. The most obvious of these is Section 549(c) of the Code, which provides protection to a good faith postpetition purchaser of real property.[59] In a similar vein, Section 542(c) protects an entity who, with no knowledge of the bankruptcy filing, transfers property of the estate without proper permission.[60]

Within the caselaw, the courts have developed two limited exceptions. First, the stealthily silent debtor exception holds that a debtor may not abuse the automatic stay by remaining stealthily silent and allowing a creditor to unknowingly violate the stay.[61] The second exception applies to technical violations of the stay. This exception suggests that, in limited circumstances, a mere technical stay violation, such as the postpetition correction of a mistake in a deed, will not necessarily render the action void.[62] Courts have not yet clearly defined or widely applied this exception, however, and its scope, therefore, is difficult to determine.[63] Regardless, the exact parameters of these exceptions are not overly important. Rather, what is important is the recognition that even courts which hold stay violations void ab initio nevertheless acknowledge the necessity for exceptions to the rule.

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57. See, for example, *Schwartz*, 954 F.2d at 571 (stating that "[i]f violations are void . . . debtors are afforded better protection and can focus their attention on reorganization"); *Maritime Elec. Co., Inc. v. United Jersey Bank*, 959 F.2d 1194, 1207 (3d Cir. 1991) (stating that "by treating judicial acts and proceedings in violation of the stay as void acts, we deter non-bankruptcy courts from continuing proceedings against a debtor who bas sought federal bankruptcy protection").

58. See note 55.

59. See 11 U.S.C. § 549(c) (1988). Courts and commentators that follow the void rule tend to view parts of the Code such as § 549(c) as limited statutory exceptions to the void rule, and not as indicative of tbe general voidability of stay violations. See, for example, Murphy, 34 Cleve. St. L. Rev. at 592 (cited in note 12) (discussing §§ 549(c)-(d) as discrete statutory exceptions to the *Kalb* rule); *In re Wingo*, 89 Bankr. 54, 57 (9th Cir. 1988). In contrast, courts following the voidable rule interpret such sections within a broader context. See notes 75-77 and accompanying text.

60. See 11 U.S.C. § 542(c) (1988).

61. This exception was first enunciated in *In re Smith Corset Shops, Inc.*, 696 F.2d 971, 976-77 (1st Cir. 1982). Courts generally enforce the exception under traditional equitable doctrines of laches and estoppel. See *Williams*, 124 Bankr. at 316-17.

62. See *In re Brooks*, 124 Bankr. 311, 316-17 (9th Cir. 1987); *Wingo*, 89 Bankr. at 57.

63. See *Schwartz*, 954 F.2d at 574-75 (refraining from addressing the validity of the technical violation exception).

B. *Actions Taken in Violation of the Stay as Voidable*

The courts that hold violations of the automatic stay to be voidable rather than void are members of a definite minority.[64] This minority is, however, significant and vocal.[65] The rationales supporting the decision of these courts to adopt the voidable rule can be broken down into three general categories.

First, the courts following the voidable rule pay close attention to the legal definitions of the terms "void" and "voidable." Defined literally, the term void implies an absolute nullity. A void act, therefore, is utterly incapable of cure.[66] In contrast, the term voidable merely suggests a defective transaction which ultimately may be either declared void and invalid, or cured by ratification.[67] These courts then argue that the various statutory and common-law exceptions to the void rule[68] are inconsistent with the definition of a void act as an absolute nullity.[69] Legal accuracy, therefore, requires that courts deem stay violations voidable.[70]

Second, these courts look to Section 362(d), which empowers bankruptcy courts to grant relief from the stay "by terminating, annulling, modifying, or conditioning" the stay.[71] Whereas termination of the stay results only in a present negation, annulment of the stay means that the court has the ability to fashion relief with retroactive effect.[72] The

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64. See note 5 and accompanying text.

65. See *Williams*, 124 Bankr. at 316 (referring to the sharp split among the jurisdictions on this issue, with "a significant minority" following the voidable rule).

66. See *In re Oliver*, 38 Bankr. 245, 247 (Bankr. D. Minn. 1984) (stating that "[b]y strict, literal definition, a void instrument or transaction is one which is wholly ineffective, inoperative, and incapable of ratification," and thus, "[a] void act would . . . have no force or effect 'so that nothing could cure it' ") (quoting *Black's Law Dictionary* 1411 (West, 5th ed. 1979)).

67. See id. at 247 (explaining that "[t]he word voidable . . . describes a defective transaction or act that may be declared void, yet may be cured by confirmation or ratification"); *Schwartz*, 119 Bankr. at 209.

68. See notes 59-63 and accompanying text.

69. See *Schwartz*, 119 Bankr. at 209 (citation omitted) (explaining that "[t]he application of such limitations to allow 'void' acts to become effective [such as § 549(c) and various equitable exceptions] is inconsistent with the definition of the term and reflects the imprecision often involved in the use of these terms").

70. See, for example, *Sikes v. Global Marine, Inc.*, 881 F.2d 176, 178 (5th Cir. 1989) (citations omitted) (stating "that when technical accuracy is desired, the term 'void' can only be properly applied to those [transactions] that are of no effect whatsoever, mere nullities, . . . and therefore incapable of confirmation or ratification"). See also *Schwartz*, 119 Bankr. at 209.

71. 11 U.S.C. § 362(d) (1988).

72. For example, as the court in *Sikes* explained:

> The difference between the two [annulling and terminating] is that an order annulling the stay could operate retroactively to the date of the filing of the petition which gave rise to the stay, and thus validate actions taken by the party at a time when he may have been unaware of the existence of the stay. On the other hand, an order terminating the stay would be operative only from the date of its entry.

annulment power is thus inconsistent with a rule that declares all stay violations incurable.[73] As a result, these courts read Section 362(d) as clear congressional intent that courts deem stay violations voidable, not void.[74]

Similarly, the proponents of the voidable rule interpret Sections 542(c) and 549(c) of the Code[75] not as exceptions to the void rule, but rather as further indication that Congress intended stay violations to be voidable.[76] Furthermore, some courts have stressed the discretionary nature of the trustee's power to avoid postpetition transfers under Section 549. If all postpetition transfers in violation of the stay were absolutely void, these courts argue, then Section 549 would serve no purpose.[77] Therefore, since Section 549 is inconsistent with the void rule, courts must deem violations of the stay voidable.

Finally, the voidable rule proponents criticize the void rule as being unnecessarily broad and unyielding.[78] In contrast, the voidable rule provides courts the flexibility necessary to accommodate circumstances that the exceptions specified in the Code do not cover.[79] Therefore, the voidable rule provides a more equitable alternative to the harsh results that the void rule often creates.[80] Although the voidable rule may hamper the protective purposes of the stay, at least one court has argued that such a result can be overcome by application of Section 362(h),

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Sikes, 881 F.2d at 179 (quoting 2 *Collier's Bankruptcy Manual* § 362.06 (Matthew Bender, 3d ed. 1983)). See also Murphy, 34 Cleve. St. L. Rev. at 597 (cited in note 12) (stating that "only annulment reaches back in time to reverse the prior effect of the stay," while "[a] 'termination' or 'modification' is effective only upon entry on the docket of the order granting such relief").

73. See *Oliver*, 38 Bankr. at 248 (stating that "[i]n light of this power to validate [retroactively], violations of the stay are voidable rather than void because a *void* act could not be ratified or cured") (citation omitted).

74. See *Brooks*, 79 Bankr. at 482 (explaining that "acts taken in violation of the stay are not void but voidable," because "[o]therwise, there would be nothing to modify or condition").

75. See notes 59-60 and accompanying text.

76. See, for example, *Brooks*, 79 Bankr. at 482.

77. See, for example, *Sikes*, 881 F.2d at 179; *Oliver*, 38 Bankr. at 248; *Clark*, 79 Bankr. at 725.

78. See, for example, *In re Fuel Oil Supply and Terminaling, Inc.*, 30 Bankr. 360, 362 (Bankr. N.D. Tex. 1983) (stating that "the characterization of every violation of § 362 as being absolutely void is inaccurate and overly broad"); *Oliver*, 38 Bankr. at 248; *Sikes*, 881 F.2d at 178. Courts do not, however, utilize this argument as frequently as the other arguments already discussed.

79. See Weintraub and Resnick, *Bankruptcy Law Manual* § 1.09[10] at 1-50 n.100 (cited in note 19) (referring to the voidable rule as a more flexible view).

80. See, for example, *Clark*, 79 Bankr. at 725 (stating that although a lack of notice "doesn't affect the existence of the stay; as a practical matter, it impacts upon the equities of the situation"); *Oliver*, 38 Bankr. at 248-49 (finding the application of the void rule inappropriate when the debtor failed to give notice for almost seven months after filing).

which provides a cause of action for debtors injured by willful stay violations.[81]

It should also be noted that the courts following the voidable rule do not regard the Supreme Court's decision in *Kalb v. Feuerstein*[82] as binding.[83] The courts adopt this view because the Supreme Court decided *Kalb* prior to the enactment of the Bankruptcy Code of 1978, and consequently before the annulment power of bankruptcy courts had even been conceived.[84] Because *Kalb* was decided within a statutory context that no longer exists, it does not prohibit courts from adopting the voidable rule.

IV. Delineation of the Information-Forcing Paradigm

A. Hadley v. Baxendale

In the famous case of *Hadley v. Baxendale*,[85] the plaintiffs operated a mill in Gloucester. The plaintiffs hired the defendants, a common-carrier firm, to transport a broken crank shaft to the original manufacturer in Greenwich. The shaft was to serve as a pattern for the replacement part. The plaintiffs, apparently having no spare shafts, had to close the mill down until the new shaft arrived. The defendants, however, failed to deliver the new shaft within the promised time, thus forcing the plaintiffs to close the mill for several days longer than they had previously expected. As a result, plaintiffs lost profits they would otherwise have received had the defendants delivered the shaft on time. Plaintiffs brought an action for recovery of these lost profits.[86]

The court reasoned that, in the vast majority of cases, the cessation of mill operation would not result from a delay in the delivery of a crankshaft. The court then held that since plaintiffs never communicated the unique circumstances and risks involved, lost profits were not an appropriate measure of damages.[87] If the carrier had known of the

81. See *Schwartz*, 119 Bankr. at 211. The Bankruptcy Code provides that "[a]n individual injured hy any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." 11 U.S.C. § 362(h).

82. 308 U.S. 433 (1940).

83. See, for example, *Sikes*, 881 F.2d at 179 n.2.

84. See id. (stating that "[w]hen the Supreme Court decided *Kalb* in 1940, bankruptcy referees had the express statutory power only to modify or terminate the automatic stay. The power to annul the stay had not been authorized. . . . That scenario no longer applies"). See also *Schwartz*, 119 Bankr. at 210.

85. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

86. This discussion of the facts of *Hadley* is drawn from *Hadley v. Baxendale* as reprinted in Friedrich Kessler, Grant Gilmore, and Anthony T. Kronman, *Contracts: Cases and Materials* 106-109 (Little, Brown, 3d ed. 1986), with reference to Judge Posner's discussion of *Hadley* in *Rardin v. T. & D. Machine Handling, Inc.*, 890 F.2d 24, 26-27 (7th Cir. 1989).

87. See *Hadley v. Baxendale*, reprinted in Kessler, Gilmore, and Kronman, *Contracts* at 108

special circumstances in this case, it might have taken extra precautions to assure timely delivery, such as making a special trip solely to transport the shaft. Since the defendants were never fully appraised of the circumstances involved, however, they did not know special precautions were necessary. The court, therefore, denied the plaintiffs' request for recovery of lost profits.

From *Hadley*, the general rule has developed that courts should disallow consequential damages unless the plaintiff clearly and fully informs the defendant of the special circumstances that might produce such damages.[88] Courts often state this rule in terms of foreseeability, declaring that only damages which are reasonably foreseeable are recoverable in an action for breach of contract.[89] Regardless of the principle's exact formulation, however, the *Hadley* rule is firmly entrenched within contract law.[90]

B. Economic Understanding of Hadley

The use of terminology such as "foreseeability" and "special circumstances" is not the only way to understand and justify the *Hadley* rule. Rather, the limitation upon recovery of consequential damages in breach of contract cases may also be understood as an issue of efficient incentive creation through the application of a penalty default rule.[91]

In general, default rules are contractual gapfillers. These rules serve as implicit terms of a contract unless specifically contracted around.[92] Penalty default rules are an extension of this basic concept.[93] Penalty defaults are intentionally set by the courts in order to penalize parties to a contract. The possibility of a judicially imposed penalty creates a strong incentive for parties to opt out of the default rule by ex-

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(stating that "in the great multitude of cases of millers sending off broken shafts to third persons by a carrier under ordinary circumstances, such consequences [cessation of mill operation resulting in lost profits] would not, in all probability, have occurred; and these special circumstances were here never communicated by plaintiffs to the defenc ants").

88. See *EVRA Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 955-56 (7th Cir. 1982).

89. See, for example, Marvin A. Chirelstein, *Concepts and Case Analysis in the Law of Contracts* 151 (Foundation, 1990) (defining the *Hadley* rule as being that "damages are not recoverable for loss that was not reasonably foreseeable by the party in breach at the time of contracting"). Judge Posner, however, criticizes this conceptualization of the rule as being "maddeningly vague." Richard A. Posner, *Economic Analysis of Law* at 115 (Little, Brown and Co., 3d ed. 1986).

90. See *Restatement (Second) of Contracts* § 351 (1981). See also Arthur Linton Corbin, *Corbin on Contracts* § 1007 at 70-73 (West, 1964); Samuel Williston, *Treatise on the Law of Contracts* § 1357 at 292-98 (Baker, Voorhis & Co., 3d ed. 1968).

91. See, for example, Posner, *Economic Analysis of Law* at 114 (cited in note 89) (discussing incentive allocation explicitly and penalty defaults implicitly).

92. See Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L. J. 87 (1989).

93. The term "penalty default" was first used by Ayres and Gertner. See id. at 91.

plicitly providing an alternative contractual term.[94] As a result, penalty default rules encourage discussion between the parties and facilitate the efficient transfer of important information.[95]

The *Hadley* rule is such a penalty default.[96] Though the miller in *Hadley* suffered substantial consequential damages, the court did not allow him to obtain redress from the carrier. Rather, the court penalized the miller for not revealing the specialized information that he possessed, specifically, the possibility of substantial lost profits from a delay in delivery.[97] The *Hadley* decision creates a significant incentive not only for future millers, but also future contractual parties, to reveal information concerning the possibility of unusually large consequential losses.[98] This penalty default rule, therefore, encourages contractual parties to transfer information in order to opt-out of the default rule. Furthermore, as a result of the increased information flow, one of the parties will eventually take adequate precautions against the risk of loss.[99] Therefore, the final result of the *Hadley* rule is to place the risk of loss upon the shoulders of the party best able to bear such loss: the least-cost avoider.

The general conclusions of this information transfer analysis constitute the information-forcing paradigm.[100] The underlying concept of this model, that the limitation upon unforeseeable consequential damages encourages efficient information revelation and transfer, is the "established economic understanding" of the *Hadley* rule.[101]

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94. See id.

95. See id. (stating that "penalty defaults are purposefully set at what the parties would not want—in order to encourage the parties to reveal information to each other or to third parties (especially the courts)").

96. See id. at 101 (explaining that "[t]he holding in *Hadley* operates as a penalty default"); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 Yale L. J. 615, 616 (1990).

97. See Johnston, 100 Yale L. J. at 616 (explaining that the *Hadley* "rule penalizes a promisee who will suffer high consequential loss . . . by denying her recovery of much of her loss").

98. See Ayres and Gertner, 99 Yale L. J. at 101 (cited in note 92) (positing that the *Hadley* rule is "a purposeful inducement to the miller as the more informed party to reveal that information to the carrier").

99. See Posner, *Economic Analysis of Law* at 114 (cited in note 89) (stating that *Hadley* "induces the party with knowledge of the risk either to take appropriate precautions himself or, if he believes that the other party might be the more efficient preventor or spreader (insurer) of the loss, to reveal the risk to that party and pay him to assume it").

100. Although information incentives have been discussed in connection with *Hadley* for years, the specific term "information-forcing paradigm" was first used by Johnston. See Johnston, 100 Yale L. J. at 621 (cited in note 96).

101. Id. For examples of this theoretical acceptance, see William Bishop, *The Contract-Tort Boundary and the Economics of Insurance*, 12 J. Legal Stud. 241, 254 (1983) (stating that *Hadley* "concerns . . . the efficient transfer of information"); Lucian Ayre Bebchuk and Steven Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of* Hadley v. Baxendale, 7 J. L. Econ. & Organ. 284, 285-86 (1991); Posner, *Economic Analysis of Law* at 114 (cited in note

V. JUSTIFICATION OF THE VOIDABLE RULE

A. *The Void-Voidable Debate and Conflicting Models of Statutory Interpretation*

The void rule proponents generally base their conclusions upon policy considerations.[102] In their view, because the protective purposes of the automatic stay are fundamental to the goals of the Bankruptcy Code, courts must hold violations of the stay null and void.[103] The void rule, therefore, stems from a purposivist theory of statutory interpretation. The purposivist theory contends that unless statutory language clearly resolves an interpretive issue, courts should adopt the interpretation that best advances the statute's purpose.[104] A court that adheres to the purposivist theory, therefore, will generally support the void rule.

In contrast, the voidable rule represents a textualist approach to Code interpretation.[105] Textualism strives for horizontal coherence[106] by maintaining interpretive consistency and continuity throughout the statute's text, the entire statutory scheme, and any analogous stat-

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89). In partial opposition to this general acceptance, see Johnston, 100 Yale L. J. at 615 (cited in note 96) (discussing how strategic incentives in the bargaining context can at times conflict with informaiton relevation principles).

102. See, for example, *Schwartz*, 954 F.2d at 571 (stating that "[i]n light of the automatic stay's purpose, the [void-voidable] issue . . . requires some analysis of the relevant policy considerations") (footnote omitted).

103. See notes 55-58 and accompanying text.

104. Purposivism is based on the premise that since every statute was created with some purpose in mind, "identifying that purpose and deducing the interpretation with which it is most consistent resolves interpretive ambiguities." William N. Eskridge, Jr. and Philip P. Frickey, *Statutory Interpretation as Practical Reasoning*, 42 Stan. L. Rev. 321, 333 (1990). Some scholars believe that purposivism has become the "traditional" theory of statutory interpretation. See, for example, Jonathan R. Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 Colum. L. Rev. 223, 250-51 (1986).

105. The term "textualism" as used here refers to the "new textualism" discussed in William N. Eskridge, Jr., *The New Textualism*, 37 U.C.L.A. L. Rev. 621 (1990). Traditional textualism argues that "under ordinary principles of grammar and dictionary definitions of its words, the statutory provision has only one meaning." Id. at 660. See also Eskridge and Frickey, 42 Stan. L. Rev. at 340 (describing strict textualism). New textualism expands upon this definition, and explicitly includes consideration of the statute's structure in determining the text's meaning. Eskridge, 37 U.C.L.A. L. Rev. at 621. Justice Scalia employs this interpretive scheme. See, for example, *United Savings Ass'n of Texas v. Timbers of Inwood Forest Ass'n*, 484 U.S. 365, 371 (1988) (explaining that "[s]tatutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because the same terminology is used elsewhere in a context that makes its meaning clear"). See generally Nicholas S. Zeppos, *Justice Scalia's Textualism: The "New" New Legal Process*, 12 Cardozo L. Rev. 1597 (1991).

106. See Zeppos, 12 Cardozo L. Rev. at 1621 (stating that "textualism . . . strives for overall coherence in the law by borrowing from other provisions of the United States Code"); Eskridge, 37 U.C.L.A. L. Rev. at 678 (pointing out that Scalia's textualism "emphasizes horizontal coherence in statutory interpretation").

utes.[107] If one interpretation of a statute contradicts or renders inoperative another part of the statute, textualism rejects that interpretation.[108] Therefore, when proponents of the voidable rule argue that the void rule renders the annulment power of Section 362(d) meaningless,[109] or that Sections 542 and 549 reveal implicit congressional approval of the voidable rule,[110] they are arguing for horizontal coherence[111] within a textualist framework.[112]

The void rule proponents have made several responses to these horizontal coherence arguments. First, with regard to Section 362(d), they contend that when a court grants retroactive relief to a creditor, this negates the existence of the stay violation. The void-voidable question, therefore, is no longer an issue.[113] Under this interpretation, the void rule represents the normal operation of the stay, and the annulment power of Section 362(d) is nothing more than a specific statutory exception to that operation.[114]

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107. Legal scholars have defined horizontal coherence as a demonstration of continuity between the interpretation and "legal sources existing at the time of the interpretive event—namely, the current version of the statutory text, the whole statute in which it is found, analogous statutory texts and their current judicial interpretations, and the canons of statutory construction." Eskridge, 37 U.C.L.A. L. Rev. at 678 (cited in note 105). This is opposed to vertical coherence, which addresses continuity between the interpretation and sources preceding the interpretation, such as legislative history. See id.

108. See id. at 661 (noting that textualists closely examine whether one interpretation of a statute renders another provision meaningless).

109. See notes 71-74 and accompanying text.

110. See notes 75-77 and accompanying text.

111. The argument made by these courts concerning the correct definition of void and voidable may also be viewed as a demand for horizontal coherence. Rather than relating to horizontal coherence within the interpretation of the Bankruptcy Code, however, this argument addresses horizontal coherence and accuracy within the caselaw surrounding the void-voidable distinction generally.

112. It is interesting to note that the arguments based upon flexibility and equity made by some of the courts supporting the voidable rule are not what one might normally expect of a strict textualist. See notes 78-80 and accompanying text. One can either contend that the flexibility and equity provided by the voidable rule are merely beneficial consequences of application of a textualist approach in this situation, or that these courts are applying textualist arguments for the sole purpose of achieving what they view as the equitable result. This is a recurring problem in textualist interpretation. In accord, Eskridge and Frickey, 42 Stan. L. Rev. at 343 (cited in note 104) (arguing that "current values cannot easily be excluded from statutory interpretation"). The first contention appears to be more probable, however, given that not all courts following the voidable rule invoke the equity argument, and those that do fail to place primary importance upon it. See, for example, *Sikes*, 881 F.2d at 178 (discussing the argument in a single sentence). Therefore, the existence of this argument does not deny that the proponents of the voidable rule generally adopt a textualist approach.

113. See, for example, *Schwartz*, 954 F.2d at 573. In fact, this argument only seems to beg the question. If a void act is an absolute nullity, then retroactive negation under Section 362(d) is redundant and therefore unnecessary. Thus, the question is not rendered moot, but merely sidestepped.

114. See, for example, id.

Second, with regard to Section 549, courts following the void rule argue that this section generally applies to transfers which the debtor willingly makes.[115] Since the automatic stay does not specifically prevent debtors from willingly transferring property postpetition, the void rule does not render Section 549 duplicative.[116] Rather, it clarifies the role of Section 549.

Despite these specific responses to the arguments supporting the voidable rule, the void rule proponents almost always fall back upon the underlying protective purposes of the automatic stay.[117] Thus, while the void courts may sometimes engage the voidable courts in limited debate upon textualist ground, they ultimately retreat to a purposivist defensive posture. The result is, in many ways, a lively debate between two parties speaking different languages, with the outcome determined by which language one finds preferable. For a purposivist court, the purpose of the stay prevails, and violations of the stay must be void. For a textualist court, the need for horizontal coherence and interpretive accuracy prevails, and violations of the stay must be voidable.

Because a court's method of statutory interpretation generally dictates its resolution of the void-voidable issue, a choice between these two interpretive strategies seems required.[118] An alternative path of reasoning, however, which the courts have not yet fully considered, also exists. This path approaches statutory interpretation in terms of interpretive compromise and practical reason, not intractable adherence to purposivism or textualism.[119] Application of such a result-oriented approach to the void-voidable debate is particularly appropriate, given the specific circumstances involved. It is possible to demonstrate that the voidable rule, by penalizing inactive and silent debtors, encourages debtors to inform creditors when they file their bankruptcy petitions.[120] Because this transfer of information is of low cost to the debtor, the protective purposes of the stay are only minimally affected, and hori-

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115. See *Garcia*, 109 Bankr. at 339.

116. See id.; *Schwartz*, 954 F.2d at 573-74.

117. See, for example, *Garcia*, 109 Bankr. at 340:

> [T]o the extent any inconsistency may exist between an interpretation of § 362(a) as making actions in violation of the automatic stay void and § 549, the court concludes that the fundamental importance of the automatic stay to the purposes sought to be accomplished by the Bankruptcy Code requires that acts in violation of the automatic stay be void, rather than voidable.

118. This choice is not as easy as it might appear. Purposivism and textualism both have their difficulties, and some commentators have even suggested that the use of foundationalism in statutory interpretation is itself a flawed approach. See generally Eskridge and Frickey, 42 Stan. L. Rev. at 321 (cited in note 104).

119. See id.

120. See Part V.B.1.

zontal coherence is maintained.[121] Overcoming the barrier between interpretive modes may thus be possible simply by developing a different perspective on the problem. That perspective is the information-forcing paradigm.

B. *Application of the Information-Forcing Paradigm*

1. Penalty Aspects of Voidability

Application of the penalty default and information-forcing analysis derived from *Hadley v. Baxendale* is not limited to the arena of contractual damage rules.[122] In fact, some legal commentators have already suggested that the same type of default rule analysis should apply to the debtor-creditor relationship.[123] In general, under the information-forcing paradigm, a penalty default is appropriate when:

1. Party A possesses information unknown to Party B.
2. Party B might alter its behavior to make breach or violation less likely if it knows the information.
3. The cost to Party A of transferring the information is low.
4. Party A fails to transfer such information.[124]

When these four standards are met, the value of the information in question to Party B is greater than the cost to Party A of transferring the information. The efficient transfer of this information, therefore, should be encouraged.[125]

By applying these standards to the circumstances surrounding stay violations, application of penalty default rule analysis can be justified. With regards to the first standard, debtors usually have the best information regarding their own financial troubles. Debtors are aware they may file a bankruptcy petition long before most of their creditors. Fur-

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121. See id.

122. See Ayres and Gertner, 99 Yale L. J. at 129 (cited in note 92) (explaining that such analysis is "quite general and can be applied to a wide range of legal issues"). For example, this form of analysis has been applied within the context of statutory interpretation, see id., and tort, see *EVRA Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982).

123. In accord, see Douglas G. Baird and Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 Vand. L. Rev. 829, 835-36 (1985) (stating that "[t]he ambition of the law governing the debtor-creditor relationship, including fraudulent conveyance law, should provide all the parties with the type of contract that they would have agreed to if they had had the time and money to bargain over all aspects of their deal").

124. These standards are based upon those set forth by Bishop, 12 J. Legal Stud. at 254-55 (cited in note 101), who in turn credits John H. Barton's *The Economic Basis of Damages for Breach of Contract*, 1 J. Legal Stud. 277 (1972), and Richard A. Posner's *Economic Analysis of Law* 94-95 (Little, Brown, 2d ed. 1977) for providing the essence of his guidelines. The guidelines presented by Bishop deal only with *Hadley*'s denial of recovery of consequential damages, and not with penalty defaults in general. Given the broad applicability of the *Hadley* penalty default analysis, however, the extrapolation seems appropriate. See note 122.

125. See Bishop, 12 J. Legal Stud. at 255 (cited in note 101).

thermore, because the vast majority of bankruptcy petitions are filed voluntarily,[126] most debtors have precise and immediate information regarding the commencement of their bankruptcy case. A creditor, however, will not receive the equivalent information officially for several weeks or more.[127] Therefore, if a debtor chooses not to give notice of filing, the only way a creditor can realistically obtain this information is to check the bankruptcy case filings every day. Since such activity obviously involves prohibitive transaction costs, the creditor will in all probability remain uninformed.

With regards to the second standard, most creditors with knowledge of a bankruptcy petition filing would indeed alter their behavior to avoid violating the stay. Often, stay violations are simply the honest mistakes of creditors whom have not been notified of the commencement of the bankruptcy case.[128] Many of these creditors would not have acted had they been aware of the bankruptcy filing. Furthermore, a creditor with notice of the filing who nevertheless violates the stay is subject to both a finding of contempt[129] and the penalties of Section 362(h).[130] Once notice triggers those penalties, they serve as strong de-

126. See Epstein, Landers, and Nickles, *Debtors and Creditors* at 720 (cited in note 13) (estimating that 99% of all bankruptcy petitions filed are voluntary).

127. While Section 342(b) does require the clerk of the court to send notice to all creditors listed by the debtor, this notice "is usually not received until several weeks after the petition is filed." Weintraub and Resnick, *Bankruptcy Law Manual* § 1.09[1] at 1-49 (cited in note 19). This time lag, an inevitable result of bureaucracy, often results in serious problems for creditors. See, for example, note 137.

128. See, for example, *In re Lampkin*, 116 Bankr. at 451, 453 (Bankr. D. Md. 1990) (deciding a case involving a creditor who received no notice prior to foreclosure; the court acknowledged that some creditors are "innocent parties").

129. Section 362(a) effectively constitutes a court order with sufficient specificity for contempt purposes. See *Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d 47, 51 (2d Cir. 1976); *In re Mealey*, 16 Bankr. 800 (E.D. Pa 1982). A finding of contempt can result in awarding of attorneys' fees and the imposition of fines. See *Borg-Warner Acceptance Corp.*, 685 F.2d at 1309. A court may only find contempt, however, if the creditor had knowledge of the bankruptcy case. See *In re Zartun*, 30 Bankr. 543, 546 (9th Cir. 1983) (holding that knowledge of the petition's filing without knowledge of the stay is sufficient for a finding of contempt); *Fidelity Mortgage*, 550 F.2d at 51; *Miller*, 10 Bankr. at 779-80. Thus, the transfer of information concerning filing by the debtor to the creditor invokes the specter of contempt.

130. Section 362(h) permits an individual harmed by a willful stay violation to recover actual damages, including costs, attorneys' fees, and possibly punitive damages. See 11 U.S.C. § 362(h) (1988). When the debtor informs the creditor of the filing and of the stay's commencement, any subsequent action by that creditor in violation of the stay becomes willful for the purposes of Section 362(h). See *In re Bloom*, 875 F.2d 224, 227 (9th Cir. 1989) (explaining that "[a] willful violation does not require a specific intent to violate the automatic stay. Rather, the statute provides for damages upon a finding that the defendant knew of the automatic stay and that the defendant's actions which violated the stay were intentional").

terrents to stay violations.[131]

Further, once a creditor has notice of the filing, a court could reasonably estop the creditor from gaining a benefit by violating a stay of which it was clearly aware.[132] Under this view, then, once a debtor transfers the pertinent information, the void-voidable question is moot. The debtor has acted properly, thereby avoiding the need for imposition of a penalty.[133] By combining the equitable concept of estoppel with the deterrent effects of contempt and Section 362(h), the second guideline is met. Therefore, since creditors cannot gain an advantage by violating the stay and would only incur serious penalties, notice alters creditor behavior.

In regard to the third standard, the cost to the debtor of both obtaining and transferring information concerning its bankruptcy filing is not only low, but virtually negligible. The debtor expends no resources in discovering this information, since it makes the decision to file bankruptcy.[134] More importantly, giving timely notice to creditors generally

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The Second Circuit, applying the plain meaning rule to the term "individual" used in Section 362(h), held that corporations cannot recover damages under this section. See *In re Chateaugay Corp.*, 920 F.2d 183 (2d Cir. 1990). Other courts, however, have held that corporate debtors can obtain redress under Section 362(h). See *In re Atlantic Business & Community Corp.*, 901 F.2d 325 (3d Cir. 1990); *Budget Serv. Co. v. Better Homes of Va., Inc.*, 804 F.2d 289 (4th Cir. 1986).

131. See note 81 and accompanying text. At least one court has questioned the deterrent effect of Section 362(h). See *Williams*, 124 Bankr. at 317. The *Williams* court argued that Section 362(h) applies only to willful violations, that it does not provide a remedy for corporate debtors, and that the low level of damages usually afforded under this section provides little deterrent effect. Id. As to the first argument, since the voidable rule results in the debtor giving notice to creditors, a court could reasonably view any subsequent creditor action as prima facie evidence that the violation was "willful." As to the second argument, the trend in the caselaw seems to support application of Section 362(h) to corporate debtors. See note 130. Regardless, the contempt power still protects corporate debtors. See note 129.

Finally, the *Williams* court's contention that in the past Section 362(h) has resulted in low damage recoveries does not necessarily apply under a voidable rule. If courts are assured that virtually all creditors have knowledge of the stay, as the information-forcing effect of the voidable rule guarantees, then higher levels of damages and imposition of punitive damages would be far more likely. Moreover, the contempt power of the court still remains a secondary protection.

132. Section 105(a) provides courts with the power to issue whatever order is necessary to carry out the provisions of the Code. See *Smith Corset Shops, Inc.*, 696 F.2d at 976 (stating that "[t]here is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction") (quoting with approval *Bank of Marin v. England*, 385 U.S. 99, 103 (1966)); *In re Young*, 14 Bankr. 809, 812 (Bankr. N.D. Ill. 1981). See also note 81.

133. Adopting a rule that the debtor's act of giving notice presumptively precludes application of the voidable rule is especially appropriate given that "[t]he only thing that the debtor can do [to prevent creditor action] is to make certain that all entities involved know about the filing of the bankruptcy case." *In re Elder*, 12 Bankr. 491, 494 (Bankr. M.D. Ga. 1981).

134. Therefore, use of penalty default analysis does not result in "reducing the amount of socially useful information." Ayres and Gertner, 99 Yale L. J. at 107 (cited in note 92). Rather, this is information a debtor must inevitably acquire in order to enter bankruptcy, and therefore disincentive effects are not a concern. See id. (discussing instances involving negligible disincentive effects).

results in minimal cost to the debtor's estate. For example, the debtor's attorney can simply mail a telegram,[135] or, if creditor action is imminent, call creditor's counsel.[136] The cost of a phone call, made immediately before or after filing, hardly constitutes an unbearable burden on the debtor.

Finally, with respect to the fourth standard, the caselaw is replete with examples of debtors who fail to give prompt notice of the bankruptcy filing to their creditors before creditor action occurs in violation of the stay.[137] In fact, even when a debtor's main motivation for filing bankruptcy is halting specific creditor action, such as a scheduled foreclosure sale, many debtors still fail to provide proper notice.[138] Given the frequency of such cases, the creation of information-forcing incentives for debtors seems necessary.

Because all of the applicable standards are met, applying a penalty default rule in the stay violation context is appropriate.[139] The voidable rule cannot be termed an actual penalty default rule, however, given that neither debtors nor creditors are able to contract around the Bankruptcy Code[140]. Nevertheless, the operation of the voidable rule is still analogous to the operation of penalty default rules in general, and the same information-forcing justifications apply.[141]

The analogous reasoning involved in the punitive function of the voidable rule is straightforward. If a debtor does not give notice to its

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135. See Weintraub and Resnick, *Bankruptcy Law Manual* § 1.09[1] at 1-49 (cited in note 19) (explaining that if creditor action is about to occur, "the debtor's attorney should notify the creditor's attorney by mail or telegram instead of waiting for the clerk to send out notices").

136. See *In re Clark*, 79 Bankr. 723, 724 (Bankr. S.D. Ohio 1987), in which the debtor's attorney called the creditor's counsel. In this example, however, the debtor's attorney waited until five days after filing to give notice, and called on the afternoon of the fifth day, knowing that a foreclosure sale had been scheduled for that morning. See id. This was not, therefore, timely notice. The debtor's attorney should have instead made the call on the day of filing, or at least in advance of the sale.

137. See, for example, *Smith Corset Shops*, 696 F.2d at 973-74 (involving a tenant's eviction and removal of his inventory by the sheriff in violation of the stay, in which the creditor did not receive notice until almost a month after filing); *Ward*, 74 Bankr. at 466 (involving a mortgage foreclosure and sheriff's sale in violation of the stay, in which the creditor did not receive notice prior to the sale, 15 days after filing, even though debtor had been aware of the impending sale for months); *Oliver*, 38 Bankr. at 248-49 (holding the void rule inapplicable since the debtor failed to give notice for almost seven months after filing); *Lampkin*, 116 Bankr. at 451 (involving a debtor who filed bankruptcy the day before the scheduled foreclosure sale of his property, and failed to notify creditors). For further examples of factual circumstances in which prompt notice could have prevented creditor action in violation of the stay, see *Smith*, 876 F.2d at 525; *Clark*, 79 Bankr. at 724; *Sikes*, 881 F.2d at 177 (involving a tort claim that arose almost three years prior to filing).

138. See, for example, *Lampkin*, 116 Bankr. at 451 (explained in note 137).

139. See notes 124-25.

140. For an interesting proposal advocating a bankruptcy system in which debtors would indeed be able to contract around the Code, see Robert K. Rassmussen, *Debtor's Choice: A Menu Approach to Bankruptcy*, 71 Tex. L. Rev. (forthcoming, November 1992).

141. In accord, see notes 124-25.

creditors immediately before or after filing its bankruptcy petition, and creditor action subsequently occurs in violation of the stay, then the court will apply the voidable rule. It does not necessary follow, however, that bankruptcy courts will hold every stay violation that occurs without proper notice valid.[142] Rather, the bankruptcy court will make a determination of voidability based upon the equities of the situation.[143] The evidentiary burdens placed upon the debtor under such a rule instead reveal the punitive component of the voidable rule. These burdens compel the debtor to expend its resources in convincing the bankruptcy court that it should nullify the creditor action in question.[144] Most debtors, having neither the time nor the funds to spend on such burdensome concerns, will instead choose to opt out of the penalty default. Since debtors can only effectuate this choice by giving creditors proper notice, the voidable rule will thus operate to facilitate an efficient, low-cost information transfer between debtor and creditor. The debtor not only becomes fully protected once it gives notice, thus upholding the protective functions of the automatic stay,[145] but society as a whole is also better off because fewer resources are wasted as a result of uninformed creditor action.[146]

The most likely response of the void rule proponents to this analysis is that the protective purposes of the stay are far too important to the goals of bankruptcy to allow a court to consider any thought of costs or burdens upon the debtor in connection with automatic stay analysis. In other words, they would argue that the stay is absolute, and that courts should therefore treat the void rule as immutable.[147]

Treating a legal rule as immutable, however, is justified only if holding otherwise "would be socially deleterious because parties internal or external to the [situation] . . . cannot adequately protect them-

142. Courts following the voidable rule are already aware of this fact. See, for example, *Oliver*, 38 Bankr. at 248 (noting that holding a stay violation to be voidable "is not to say that this court will not void acts which violate the automatic stay in appropriate circumstances").

143. The voidable courts have demonstrated their ability to make this determination. See note 78. Given that equitable principles govern in the exercise of bankruptcy jurisdiction, see note 132, this type of determination is not only legitimate, but basic to the role of the bankruptcy court.

144. See *Williams*, 124 Bankr. at 318 (recognizing that "[t]he 'voidable' rule implicitly imposes on the debtor (or trustee) the burden of persuading the court that the transfer should be set aside"). See also note 10.

145. See notes 129-32 and accompanying text.

146. See generally Johnston, 100 Yale L. J. at 616 (cited in note 96) (discussing the *Hadley* consequential damage situation and noting that "[t]he promisee and society must be better off with such a rule, because the information which the promisee is 'forced' to reveal allows the promisor to take the optimal, fully informed level of precaution"); Bishop, 12 J. Legal Stud. at 263 (cited in note 101) (stating that the "[f]ailure of victims to take cheap precautions that would contribute to avoidance is wasteful of resources").

147. See Ayres and Gertner, 99 Yale L. J. at 87 (cited in note 92) (defining immutable rules as "rules [that] govern even if the parties attempt to contract around them").

selves."[148] With this justification as a starting point, there are several reasons courts should not grant the void rule immutable status. First, the voidable rule does not render debtors defenseless. By giving creditors timely notice of filing, debtors are able to construct a strong barricade against violations of the stay.[149] Since a debtor can effectively protect itself from creditors by its own action, application of an immutable rule seems both redundant and wasteful.

Second, use of the voidable rule provides tangible benefits to both creditors[150] and society as a whole.[151] Furthermore, these benefits are achieved with only negligible cost imposition on the debtor.[152] These do not seem to be the type of "socially deleterious" results necessary to justify the imposition of a rigidly immutable rule.

Finally, the demand for the classification of the void rule as immutable is essentially based on the conceptualization of the automatic stay as all-encompassing and all-powerful.[153] Such a conceptualization, however, is simply thin "judicial gloss."[154] The law-and-economics movement has battled for years to curb the use of immutable rules.[155] Further, various legal commentators have already recognized and embraced the major role that costs and incentives play in bankruptcy discharge analysis.[156] The time has come to recognize the similarly important role that costs and incentives play within the arena of the "all-powerful" automatic stay.

Undoubtedly, some difficulties will develop with the adoption of the voidable rule. Any change in legal rules is costly during the transition period.[157] Moreover, problems may arise in situations such as tort cases in which the debtor is not aware of the identity of all of its possible creditors.[158] Nevertheless, these issues can be resolved. Utilization

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148. Id. at 88 (discussing immutability in a contractual context).

149. See notes 129-32 and accompanying text.

150. The value to creditors of prompt notice is the savings in both resources and opportunity costs that the creditor would have lost had it commenced an action only to have a court later negate it due to the stay's operation.

151. See note 146 and accompanying text.

152. See notes 134-36 and accompanying text.

153. For examples of this type of conceptualization, see notes 2 and 31.

154. See note 39.

155. See Ayres and Gertner, 99 Yale L. J. at 89 (cited in note 92) (stating that "[t]he law-and-economics movement has fought long and hard to convince courts to restrict the use of immutable rules") (footnote omitted).

156. See note 41.

157. See Ayres and Gertner, 99 Yale L. J. at 128 n. 179 (cited in note 92) (explaining that "[a] legal change from one default to another can be costly — especially if the move is to a penalty default. Until parties become informed about the new default, there may be transitional costs").

158. In mass tort cases, giving notice by means reasonably designed to inform the majority of possible claimants may be sufficient to opt out of the penalty default. In accordance, see *Vancouver Women's Health Soc. v. A. H. Robins Co.*, 820 F.2d 1359, 1364 (4th Cir. 1987). In individual

of the voidable rule will result in substantial benefits with only minimal costs. Such a result strongly supports the adoption of the voidable rule.

2. The Automatic Stay and Moral Hazard

The concept of moral hazard, borrowed from insurance terminology, provides another justification for the voidable rule. When fully insured, one no longer bears the economic consequences of loss.[159] As a result, the insured's incentives to avoid risk and to take precautions against loss are significantly reduced.[160] This phenomenon is known as moral hazard, and commentators agree that it is pervasive throughout the economy.[161]

Moral hazard is basically a function of economic rationality.[162] An example may help to illustrate this principle. An entrepreneur owns a warehouse which is only seasonally operated. Defective wiring in the warehouse is a hazard that greatly increases the risk of fire.[163] Without insurance, the entrepreneur has a strong incentive to have the wiring fixed because she bears the full cost of any accident. If the warehouse is fully insured, however, so that the entrepreneur no longer bears the risk of loss, she may choose not to spend her own money to have the wiring fixed. Rather, the entrepreneur may reason that insurance will cover any costs associated with fire. Furthermore, not expending money to fix the wiring will increase the entrepreneur's profits.[164] The entrepreneur's decision not to fix the wiring, therefore, is economically rational because the existence of insurance has rendered the benefit derived from any repair work negligible. Therefore, the moral hazard of failing to

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tort cases, the debtor will often be aware of the identity of the claimant, given the individualized nature of these cases. If a claimant's identity is unknown, equity may dictate application of the voidable rule anyway. See *Sikes v. Global Marine, Inc.*, 881 F.2d 176 (5th Cir. 1989) (addressing a tort claim filed postpetition).

159. See Carol A. Heimer, *Reactive Risk and Rational Action: Managing Moral Hazard in Insurance Contracts* 35 (Univ. of Cal., 1985).

160. See id. See also Richard Arnott and Joseph Stiglitz, *The Welfare Economics of Moral Hazard* in Henri Louberge, ed., *Risk, Information and Insurance* 91-92 (Kluwer Academic, 1990).

161. See id. at 91 (stating that "[i]t is now widely recognized that the phenomenon of moral hazard, which arises whenever risk-averse individuals obtain insurance and their accident avoidance activities cannot be perfectly monitored, is pervasive in the economy") (footnote omitted).

162. Contrary to what the term might suggest, moral hazard does not necessarily involve questions of morality or character. This common assumption is discussed in Heimer, *Reactive Risk* at 35 (noting that "[t]he insurance literature most often discusses moral hazard as if it were a question of character"). Instead, see id. at 35-37 (discussing the reasons that moral hazard is a function of economic rationality).

163. The basic idea for this example was suggested by id. at 29.

164. For the sake of simplicity, I am assuming in this example that there is no personal danger to the entrepreneur or any of her employees from a fire, that warehouses of equivalent economic value are essentially fungible goods, and that the transactional costs associated with purchasing a new warehouse are minimal.

take precautions against the possibility of accidents can be an economically rational response for a fully insured individual.

Legal scholars have already recognized moral hazard as an inherent consequence of the debtor's right to discharge.[165] What has not yet been considered, however, is the void rule's creation of an equally powerful moral hazard problem. Absolute application of the void rule is analogous to full insurance. If a debtor knows that every violation of the stay is void, it has no incentive to give creditors notice once it files its bankruptcy petition. In fact, its failure to give notice is economically rational.[166] In effect, the void rule fully insures the debtor against stay violations, and the debtor therefore has a perverse incentive to remain silent. Thus, the problems associated with the void rule are apparent.[167]

Insurers generally solve the problem of moral hazard through the use of copayment mechanisms. These copayment mechanisms induce precautions by placing certain burdens upon the insured.[168] Application of the voidable rule is analogous to compelling individuals to make copayments in order to obtain insurance protection. By assessing a penalty for failure to provide timely notice, the penalty being the burden of proving that the court should nullify the creditor action, the voidable rule creates strong incentives for the debtor to act responsibly from the outset. This incentive, in turn, acts to eliminate moral hazard. Therefore, the function of the voidable rule as an analogous copayment mechanism also justifies its adoption.

VI. CONCLUSION

The automatic stay is undeniably an important part of bankruptcy law. This importance, however, does not necessarily override all other goals, or resolve all other questions. Thus far, the void-voidable debate has been a continual and repetitive clash between the purposivistic need for debtor protection and the textualist demand for accuracy and horizontal coherence. In order to effectively resolve this issue, however, courts need to move beyond this limited argumentative arena.

Through application of the penalty aspects of the voidable rule, the efficient transfer of information can be achieved while preserving the important protective purposes of the stay. Not only will the proper in-

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165. See Keating, 45 Vand. L. Rev. at 126 (footnote omitted) (cited in note 3) (commenting that "[t]he notion of discharge as insurance highlights the reality that discharge presents a moral hazard for debtors"). See also Jackson, 98 Harv. L. Rev. at 1428 n.114 (cited in note 41).

166. In accord, see note 162.

167. For examples of this scenario, see note 137.

168. See Jackson, 98 Harv. L. Rev. at 1428 n.114 (stating that "[i]n order to minimize moral hazard, most [insurance] policies contain deductibles or other means of coinsurance"); Keating, 45 Vand. L. Rev. at 126-27.

centives induce debtors to give creditors timely notice of filing, but wasteful creditor action will also be avoided, and the moral hazard intrinsic to the void rule will be eliminated. The time has come, therefore, to adopt the voidable rule, and thereby to accept the vital role that information and incentives play in the operation of the automatic stay.

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