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Adequate Protection and Secured Creditors' Strategies after Timbers

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ADEQUATE PROTECTION AND SECURED CREDITORS' STRATEGIES AFTER *Timbers*

*Pat H. Scanlon**

TABLE OF CONTENTS

I. INTRODUCTION

The United States Constitution vested Congress with the authority to establish laws on bankruptcy.[1] With the passage of the Bankruptcy Code of 1978,[2] Congress revamped and restructured the bankruptcy laws. Through enacting the Code, Congress sought to balance the rights of the debtor, its creditors, and other parties in interest.[3]

Congress used the theory of "adequate protection"[4] for the secured creditors' interests. The legislative history explains congressional intent as follows:

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1. U.S. CONST. art. I, § 8, cl. 4 (Congress has power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.").

2. 11 U.S.C. §§ 101-1330 (1988) [hereinafter Code].

3. H.R. REP. No. 595, 95th Cong., 2d Sess. 339, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6296.

4. "Adequate protection" is not defined in the Code, although three methods of providing adequate protection are described in 11 U.S.C. § 361 (1988).

> [T]he concept of adequate protection is based on as much policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain . . . Though the creditor might not receive his bargain in kind, the purpose of [adequate protection] . . . is to ensure that the secured creditor receives in value essentially what he bargained for.[5]

The Code contains three policies concerning secured creditors:

1. The secured creditor is entitled to the collateral or its full value.
2. For the benefit of the debtor and other creditors, the secured creditor must wait for a reasonable time to realize upon its collateral.
3. Because of this waiting period, the secured creditor is entitled adequate protection.[6]

If the Chapter 11 reorganization is successful, the secured creditor receives the value of the collateral under the plan of reorganization, which supersedes the creditor's prior rights under its loan documents. If, however, the reorganization fails, as is usually the case, the secured creditor receives the collateral or its value.

A simple hypothetical case illustrates the effect of filing a Chapter 11 petition. Suppose Apartments, Inc. owns a multi-unit apartment complex with a fair market value of $4,000,000. First Mortgage Corp. holds a $5,000,000 promissory note from Apartments, secured by a perfected first deed of trust on the apartments and real property and a perfected first security interest in the rents due from Apartments' tenants. If Apartments defaults, First Mortgage has a number of contractual and state law remedies, including suit on the promissory note, foreclosure of the deed of trust, and notification to Apartments' tenants to pay rent to First Mortgage. If First Mortgage's properly conducted foreclosure sale of the realty fails to bring sufficient sales proceeds to pay the indebtedness, First Mortgage can sue for the deficiency, costs, and fees.

Apartments can prevent a foreclosure by filing a petition under Chapter 11 of the Code. Under the "automatic stay" provision of the Code, the petition operates as an injunction against the world and prohibits any action to collect a debt or to enforce a security interest or other lien.[7] The purpose of the stay is to give the business a breathing spell and time to work constructively with its creditors.[8] The automatic stay also protects creditors by preventing other creditors from obtaining preferential treatment by quick action.[9]

Without the automatic stay, on default First Mortgage would have foreclosed its deed of trust, received the sales proceeds, and had use of those proceeds (and theoretically received interest on them) from the date of bankruptcy. The effect of the stay, therefore, is to cause the undersecured[10] creditor (i.e., collateral value is less than debt) to lose this hypothetical interest on the obtainable foreclosure sales proceeds during the stay period. This has been called the undersecured creditor's "lost opportunity costs."[11]

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5. H.R. REP. NO. 595, 95th Cong., 2d Sess. 339, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6295-96.

6. L. LOPUCKI, STRATEGIES FOR CREDITORS IN BANKRUPTCY PROCEEDINGS 441 (3d ed. 1985).

7. 11 U.S.C. § 362(a) (1988).

8. H.R. REP. NO. 595, 95th Cong., 2d Sess. 340, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6296.

9. *Id.*

10. "Undersecured creditor" is not used or defined in the Code, which refers to a "creditor secured by a lien." 11 U.S.C. § 506(a) (1988).

11. New York Life Ins. Co. v. Revco D.S., Inc. (*In re* Revco D.S., Inc.), 901 F.2d 1359 (6th Cir. 1990).

Prior to the United States Supreme Court's decision in *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.*,[12] decided January 20, 1988, courts were divided on the undersecured creditor's right to these lost opportunity costs.[13] The Supreme Court resolved these conflicts in *Timbers*, holding that an undersecured creditor was not entitled to compensation for the delay caused by the automatic stay in foreclosing on its collateral.

In view of *Timbers*, what strategies should a secured creditor use in a Chapter 11 bankruptcy case to protect its interests?

II. THE CODE

Under Code subsection 506(a), an undersecured creditor's claim is divided into two parts: (1) a secured claim equal to the value of the collateral on the date of filing and (2) an undersecured claim for the difference between the debt and the collateral value.[14] In the hypothetical situation, First Mortgage holds a secured claim for $4,000,000[15] and an undersecured claim for $1,000,000.

As noted, the automatic stay provision prevents the secured creditor from undertaking or continuing collection actions, from taking possession of the collateral, and from taking any action to enforce a lien against the collateral.[16] The bankruptcy court is the only source of relief for the secured creditor. The bankruptcy court can terminate, annul, modify, or condition the stay under Code subsection 362(d) which provides:

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay –
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or
>
> (2) with respect to a stay of an act against property under subsection (a) of this section, if –
>
> (A) the debtor does not have an equity in such property; and
>
> (B) such property is not necessary to an effective reorganization.[17]

A Chapter 11 debtor[18] may use, sell, or lease its property in the ordinary course of business without prior approval of the bankruptcy court or the secured creditor.[19] But "cash collateral,"[20] such as cash, deposit accounts, negotiable instruments, securities, and other

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12. 484 U.S. 365 (1988) (Mr. Justice Scalia wrote for a unanimous Court.).

13. Cases allowing were Grundy Nat'l Bank v. Tandem Mining Corp., 754 F.2d 1436 (4th Cir. 1985), and Crocker Nat'l Bank v. American Mariner Indus., Inc. (*In re* American Mariner Indus., Inc.), 734 F.2d 426 (9th Cir. 1984). Cases denying included Bankers Life Ins. Co. v. Alyucan Interstate Corp. (*In re* Alyucan Interstate Corp.), 12 Bankr. 803 (Bankr. D. Utah 1981). One circuit took a case-by-case view in Lendlease, a Div. of Nat'l Car Rental Sys., Inc. v. Briggs Transp. Co. (*In re* Briggs Transp. Co.), 780 F.2d 1339 (8th Cir. 1985).

14. 11 U.S.C. § 506(a) (1988).

15. Assume this as the amount of First Mortgage's allowed secured claim under 11 U.S.C. § 502 (1988). An allowed secured claim can be changed by the secured creditor taking the election granted by 11 U.S.C. § 1111(b)(2) (1988), which is beyond the scope of this article. *See* 5 COLLIER ON BANKRUPTCY ¶ 1111.02 at 1111-25 (15th ed. 1990).

16. 11 U.S.C. § 362(a) (1988).

17. 11 U.S.C. § 362(d) (1988).

18. In this article "debtor" includes the Chapter 11 debtor-in-possession and any trustee for the debtor. *See* 11 U.S.C. §§ 1101(1), 1106 (1988).

19. 11 U.S.C. § 363(c)(1) (1988).

20. 11 U.S.C. § 363(a) (1988).

cash equivalents, is treated differently by the Code. If the secured creditor's collateral is "cash collateral," the debtor may not use, sell, or lease the collateral unless each secured creditor consents or the bankruptcy court authorizes the debtor's actions.[21] The bankruptcy court may at any time prohibit or condition such use, sale, or lease "as is necessary to provide adequate protection of such interest."[22]

The Code gives three illustrations of adequate protection:

> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in value of such entity's interest in such property;
>
> (2) providing to such an entity an additional or replacement lien to the extent that such stay, use, sale, lease or grant results in a decrease in the value of such entity's interest in such property; or
>
> (3) granting such other relief . . . as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.[23]

These three illustrations are not the exclusive methods; many other forms of adequate protection have been used.

The Code provisions require the courts to balance the secured creditor's right to enforce a contract bargain with the debtor's right to reorganize.[24] What adequate protection, if any, should the undersecured creditor receive during the reorganization period? *Timbers* provides the answer.

III. *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.*

In *Timbers* the collateral was an apartment complex appreciating slightly in value, but worth less than the debt to the secured creditor.[25] The creditor was, therefore, undersecured. Even though the debtor agreed to pay the creditor post-petition rents from the apartments, less operating expenses, the creditor also wanted compensation for the delay caused by the automatic stay in foreclosing on the collateral (i.e., lost opportunity costs).[26] The creditor moved for relief from the automatic stay under subsection 363(d)(1),[27] alleging a lack of adequate protection for its interest. The issue for decision was "whether undersecured creditors are entitled to compensation under 11 U.S.C. § 362(d)(1) for the delay caused by the automatic stay in foreclosing on their collateral."[28] A unanimous United States Supreme Court affirmed the decision of the Fifth Circuit Court of Appeals[29] and held that:

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21. 11 U.S.C. § 363(c)(2) (1988).

22. 11 U.S.C. § 363(e) (1988).

23. 11 U.S.C. § 361(1)-(3) (1988).

24. United Va. Bank v. Slab Fork Coal Co. (*In re* Slab Fork Coal Co.), 784 F.2d 1188, 1191 (4th Cir. 1986) ("an appropriate balance between the rights of the secured creditors and the rehabilitative purposes of the Bankruptcy Code").

25. United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd. (*In re* Timbers of Inwood Forest Assocs., Ltd.), 793 F.2d 1380, 1383 (5th Cir. 1986), *aff'd*, 808 F.2d 363 (5th Cir. 1987), *aff'd*, 484 U.S. 365 (1988).

26. *Id.*

27. *Id.*

28. United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 369 (1988).

29. United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd. (*In re* Timbers of Inwood Forest Assocs., Ltd.), 808 F.2d 363 (5th Cir. 1987), *aff'g*, 793 F.2d 1380 (5th Cir. 1986), *aff'd*, 484 U.S. 365 (1988).

1. "[T]he undersecured [creditor] is not entitled to interest on its collateral during the stay to assure adequate protection under 11 U.S.C. § 362(d)(1)."[30]

2. "Since this provision [section 506(b)] permits postpetition interest to be paid only out of the 'security cushion,' the undersecured creditor, who has no such cushion, falls within the general rule disallowing postpetition interest."[31]

3. "[I]f the apartment project in this case had been declining in value petitioner would have been entitled, under § 362(d)(1), to cash payments or additional security in the amount of the decline, as § 361 describes."[32]

4. "Once the movant under § 362(d)(2) establishes that he is an undersecured creditor, it is the burden of the *debtor* to establish that the collateral at issue is 'necessary to an effective reorganization.' "[33]

5. "What this requires is not merely a showing that if there is conceivably to be an effective reorganization, this property will be needed for it; but the property is essential to an effective reorganization *that is in prospect.* This means . . . there must be 'a reasonable possibility of a successful reorganization within a reasonable time.' "[34]

6. "[W]hile the bankruptcy courts demand less detailed showings during the four months in which the debtor is given the exclusive right to put together a plan, see 11 U.S.C. §§ 1121(b), (c)(2), even within that period lack of any realistic prospect of an effective reorganization will require § 362(d)(2) relief."[35]

In summary, *Timbers* requires adequate protection when the collateral's value is declining, denies adequate protection to the undersecured creditor with stable value, and directs the bankruptcy courts to scrutinize the proceeding to see if an effective reorganization is in prospect within a reasonable time.

Three factors should narrow the *Timbers'* holding: (1) the secured creditor relied solely on the lack of adequate protection under subsection 362(d)(1); (2) the secured creditor did not request relief under subsection 362(d)(2); and (3) neither party offered evidence on the likelihood of a successful reorganization. For these reasons some courts view as dicta the discussion of subsection 362(d)(2) in the opinion.[36]

Since the *Timbers* opinion, courts have applied the decision both retroactively[37] and prospectively.[38] If applied retroactively to earlier final orders in pending bankruptcy cases a debtor could recover from the undersecured creditor the "lost opportunity" adequate protection payments made during the Chapter 11 proceeding or could have those payments applied to reduce the principal of the secured portion of the undersecured creditor's claim.

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30. 484 U.S. at 382.

31. *Id.* at 372-73.

32. *Id.* at 370.

33. *Id.* at 375 (quoting 11 U.S.C. § 362(d)(2) (1988)).

34. *Id.* at 375-76 (quoting *Timbers*, 808 F.2d at 370-71 & nn.12-13).

35. *Timbers*, 484 U.S. at 376.

36. *E.g.*, *In re* Rassier, 85 Bankr. 524, 529 (Bankr. D. Minn. 1988), in which the court stated:

> In holding that the debtor need not show a reasonable likelihood of reorganization under § 362(d)(2)(B), I am mindful of the United States Supreme Court's decision in [*Timbers*] . . . . The language in *Timbers*, however, is not controlling in this case. The issue before the Court was "whether undersecured creditors are entitled to compensation under 11 U.S.C. § 362(d)(1) for the delay caused by the automatic stay in foreclosing on their collateral." [*Timbers* at 369]. Any discussion of § 362(d)(2) is dictum.

Id.

37. Cimarron Investors v. WYID Properties (*In re* Cimarron Investors), 848 F.2d 974 (9th Cir. 1988).

38. *In re* Martin, 92 Bankr. 364 (Bankr. N.D. Ind. 1988); *In re* Rivers, 89 Bankr. 1006 (Bankr. N.D. Ga. 1988).

Retroactive application might also permit bankruptcy courts to modify final and agreed adequate protection orders.[39] Since the *Timbers* opinion does not speak to this issue, some courts hold that the decision should be applied only prospectively.

In re Sherwood Square Associates[40] examined the retroactive standards established by the Supreme Court[41] and stated:

> Since the Supreme Court in the *Timbers* case, effectively overruled the *Grundy* decision which had been the controlling law in this Circuit, the question arises whether the holding in *Timbers* should be applied retroactively to provide Debtor relief in this case. This Court concludes *Timbers* should not be applied retroactively.[42]

IV. UNDERSECURED CREDITORS' STRATEGIES

A. General

The adequate protection provisions of the Code are not self-executing; the creditor must ask for relief.[43] The secured creditor requests relief from the automatic stay by filing a motion for relief from the stay, for adequate protection, or to prohibit or condition the debtor's use of the collateral. The debtor, not the bankruptcy court, has the duty to propose adequate protection to the creditor.[44]

B. Negotiation with Debtor

A Chapter 11 debtor has three methods of dealing with the secured creditor. First, the debtor can negotiate with the secured creditor to settle disputes about adequate protection, the value of the secured creditor's collateral, the creditor's attorneys' fees and other expenses, the treatment of the secured creditor's claim in the debtor's plan, and many other matters. Chapter 11 was written with a purpose of motivating the parties to resolve their disputes through negotiation.[45] Undersecured creditors have incentive to settle because they do not receive interest payments during the stay period.

The debtor is granted a four-month exclusive period to file a plan of reorganization.[46] Often, this exclusive period is wasted in court fights with secured creditors on motions seeking relief from the stay. By settlement the debtor can reduce its costs and work toward a plan of reorganization acceptable to its creditors.

Second, the debtor can pay the secured creditor all delinquencies, arrearages, and damages suffered because of the debtor's default. The secured creditor is then deemed "unimpaired"[47] for the purpose of confirming the plan. While this alternative may not work in a large single-asset case, debtors can use this method to retain specific items of equipment.

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39. BANKR. R. 9024 concerns relief from judgments or orders.

40. Fairfax Sav. v. Sherwood Square Assocs. (*In re* Sherwood Square Assocs.), 87 Bankr. 388 (Bankr. D. Md. 1988).

41. Chevron Oil Co. v. Huson, 404 U.S. 97 (1971).

42. *In re Sherwood Square Assocs.*, 87 Bankr. at 392.

43. First Fed. Sav. & Loan Ass'n v. Shriver (*In re* Shriver), 33 Bankr. 176 (Bankr. N.D. Ohio 1983).

44. Travelers Ins. Co. v. American AG Credit Corp. (*In re* Blehm Land & Cattle Co.), 859 F.2d 137, 139 (10th Cir. 1988).

45. H.R. REP. No. 595, 95th Cong., 2d Sess. 224, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6183.

46. 11 U.S.C. § 1121(b)-(c) (1988).

47. 11 U.S.C. § 1124 (1988).

Third, the debtor can try to force the non-consenting secured creditor to take the plan under the "cram-down" provisions.[48] The cram-down provisions require difficult compliance with many stringent requirements. In the usual case cram-down is not a viable alternative for the debtor.[49]

As part of the negotiations, the debtor may deliver the collateral to the secured creditor. If the collateral is a burden to the estate, the debtor may voluntarily abandon the property to the secured creditor.[50] In such case the parties should file a motion for abandonment and to lift stay, give notice, and obtain an order of the bankruptcy court.

Although the stay prevents the creditor's collection efforts, it does not prevent voluntary payments by the debtor to a secured creditor.[51] But such voluntary payments may be recoverable by the debtor or its trustee from the secured creditor as post-petition preferences.[52] The secured creditor should obtain an order from the bankruptcy court authorizing these payments as adequate protection.[53] The order should specify the amounts, times of payments, and applications of these post-petition pre-plan payments. Some courts have required these payments to be applied to the principal of the undersecured creditor's debt.[54] In that event, the unsecured portion of the secured creditor's claim is paid first, and at confirmation the court determines the secured portion without regard to these payments.

A secured creditor can sometimes improve its position by making additional post-petition loans to the debtor. The debtor can use unsecured credit in the ordinary course of business, unless the court orders otherwise.[55] In the usual case the trade creditors are unsecured creditors and are unwilling to extend the debtor additional open account credit. To obtain secured credit by granting post-petition security interests, the debtor must first obtain court approval.[56] The secured creditor may be able to obtain adequate protection payments from the debtor or other concessions in exchange for the secured creditor extending additional secured credit. All such arrangements must be presented to the bankruptcy court after the required notice.[57]

C. Filing Proof of Claim

If the debtor's schedules accurately list the secured creditor's claim, no proof of claim need be filed.[58] If the creditor's claim is unlisted, incorrectly described, disputed, contingent, or unliquidated, the secured creditor must file a proof of claim. The secured creditor would be wise to file a proof of claim in every case unless the creditor wants to avoid the

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48. 11 U.S.C. § 1129(b)(1) (1988). The term "cram-down" is not used in the Code but was coined by the courts for the procedure to impose a plan on non-consenting parties. These matters are beyond the scope of this article. *See* Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979).

49. *See In re* EFH Grove Tower Assocs., 105 Bankr. 310 (Bankr. E.D.N.C. 1989).

50. 11 U.S.C. § 554 (1988).

51. John Fabick Tractor Co. v. Maun (*In re* Maun), 95 Bankr. 94 (Bankr. S.D. Ill. 1989).

52. 11 U.S.C. § 549(a)(2)(B) (1988).

53. Travelers Ins. Co. v. American AG Credit Corp. (*In re* Blehm Land & Cattle Co.), 859 F.2d 137 (10th Cir. 1988); BANKR. R. 4001.

54. *See In re* Kain, 86 Bankr. 506 (Bankr. W.D. Mich. 1988).

55. 11 U.S.C. § 364(a) (1988).

56. 11 U.S.C. § 364(d)(1) (1988).

57. 11 U.S.C. § 364(d) (1988).

58. 28 U.S.C. § 1111(a) (1988).

bankruptcy court's "core proceeding"[59] jurisdiction. By filing its claim, the secured creditor consents to this jurisdiction.

The claim must substantially conform to official form number 19.[60] The creditor should attach copies of its promissory note, security documents, and proof of perfection.[61] Although the form does not ask for collateral value, the secured creditor should make a strategic decision to state a value which may be accepted. A filed proof of claim supersedes the scheduling of the claim by the debtor.[62]

D. Motion for Relief from Stay Under Subsection 362(d)(2)

The secured creditor's first move is usually to file a motion for relief from the stay (sometimes called "a motion to lift stay"). The motion normally includes a request that the stay either be terminated or that the debtor provide the secured creditor with adequate protection. Subsection 362(d) contains two grounds for relief for the secured creditor: (1) "for cause," and (2) "the debtor does not have an equity in such property;" and the "property is not necessary to an effective reorganization."[63] In a hearing on a motion for relief from the stay, the secured creditor has "the burden of proof on the issue of the debtor's equity in property," and the debtor has "the burden of proof on all other issues."[64]

Under the *Timbers'* opinion, after the secured creditor establishes that it is undersecured, the burden shifts to the debtor to prove that:

1. The collateral is essential to the debtor;
2. An effective reorganization is in prospect;
3. The reorganization has a reasonable possibility of success; and
4. The reorganization can be accomplished within a reasonable time.[65]

Since *Timbers,* secured creditors have more often sought protection under subsection 362(d)(2). A number of decisions since *Timbers* have sustained the secured creditor's motion for relief from stay after finding that the debtor has no equity and that the collateral is unnecessary for an effective reorganization.[66] Courts have granted relief to the secured creditor during the debtor's four-month exclusive period.

Only three months after the petition filing, the bankruptcy court in *In re Diplomat Electronics Corp.*[67] allowed a secured creditor relief from the stay so the creditor could foreclose its security interest in the debtor's accounts receivable and inventory.[68] The court held that "[w]here the debtor has not shown that it can obtain confirmation of a plan, it has

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59. 28 U.S.C. § 157(b)-(c) (1988).

60. BANKR. R. Form No. 19—Proof of Claim.

61. BANKR. R. 3001(d).

62. 11 U.S.C. § 521 (1988); BANKR. R. 3003(c)(4).

63. 11 U.S.C. § 362(d)(1)-(2) (1988).

64. 11 U.S.C. § 362(g) (1988).

65. United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 375-76 (1988).

66. *In re* PMS Assocs. No. 2, 104 Bankr. 86, 89 (Bankr. E.D. Wis. 1989) ("The Court concludes that the Debtors have failed to present sufficient, credible evidence that there is a reasonable possibility of successful reorganization within a reasonable time."); *In re* Garsal Realty, Inc., 98 Bankr. 140 (Bankr. N.D.N.Y. 1989); *In re* Halvorson, 102 Bankr. 736 (Bankr. D.N.D. 1989) (also a danger to the secured creditor because the collateral was moved to another state); *In re* Century Inv. Fund VII Ltd. Partnership, 96 Bankr. 884 (Bankr. S.D. Ind. 1989) (parties stipulated the value of the collateral to equal the amount of outstanding liens).

67. *In re* Diplomat Elecs. Corp., 82 Bankr. 688 (Bankr. S.D.N.Y. 1988).

68. *Id.*

not met its burden of showing that the property is necessary to an effective reorganization."[69]

The debtor can no longer defend these motions by arguing, without supporting evidence, that the collateral is necessary for an effective reorganization.[70] *In re Kurth Ranch*[71] involved a Chapter 11 proceeding by a rancher whose lands were under liens to a bank.[72] The bank moved for relief from the stay under subsection 362(d); the debtors and their trustee objected on the grounds that the collateral was "essential to any reorganization" since the income produced from the lands was necessary to fund any plan of reorganization.[73] The bankruptcy court found that the secured creditor had proven the debtors held no equity in the lands and stated:

> The issue before the Court is thus whether the property is necessary for an effective reorganization. On this issue the Trustee and the Debtors argue that without the ranch property, no reorganization is possible. Such argument begs the issue, however, and is premised on a failure of such parties to recognize that the property must not only be necessary for reorganization, but that reorganization is feasible under the Code.[74] . . . [N]o Plan has been proposed by the Debtors or Trustee, nor did any Debtor or the Trustee testify at the hearing as to the contents of any prospective Plan which could be confirmed by the Court. Both the Debtors and the Trustee rested their case on an erroneous interpretation of § 362(d)(2), which is legally insufficient to satisfy § 362(g)(2). The Court is thus left with no alternative but to grant the [secured creditor's] motion for relief from the stay since it cannot conclude on the basis of the present record that an effective Plan of Reorganization is in prospect.[75]

In *In re Hanley*[76] the court granted the motion for relief from the stay of a judgment creditor with second and third liens against the Chapter 11 debtors' home.[77] When the debtors failed to offer evidence to meet their burden, the bankruptcy court found that the debtors had no equity[78] and that the home was "not necessary to an effective reorganization."[79] The district court affirmed, noting the long delay since the petition filing and lack of approval of a disclosure statement.

The debtor also failed in its burden of proof in *In re L & M Properties, Inc.*,[80] where the secured creditor held a deed of trust covering ground leases upon which the debtor operated a motel. At the hearing the parties agreed that the debtor had no equity in the property. The debtor's officers did not testify, but the debtor introduced evidence from a

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69. *Id.* at 693.

70. *Timbers* impliedly overruled a number of cases using a "necessity test" to judge the debtor's right to maintain the stay. Under this standard, the debtor was not required to show a reasonable likelihood of a successful reorganization. The debtor only had to show that no reorganization was possible with the property. *See In re* Rassier, 85 Bankr. 524 (Bankr. D. Minn. 1988); Hunter Sav. Ass'n v. Padgett (*In re* Padgett), 74 Bankr. 65 (Bankr. S.D. Ohio 1987).

71. *In re* Kurth Ranch, 97 Bankr. 33 (Bankr. D. Mont. 1989).

72. *Id.*

73. *Id.* at 34.

74. *Id.* at 35.

75. *Id.* at 36.

76. 102 Bankr. 36 (Bankr. W.D. Pa. 1989).

77. *Id.*

78. " 'Equity' for purposes of § 362(d)(2)(A) is the difference between the value of the property and the total of the claims it secures." *Id.* at 37 (citing *In re* Diplomat Elecs. Corp., 82 Bankr. at 692; Stewart v. Gurley, 745 F.2d 1194 (9th Cir. 1984)).

79. *Id.* at 37.

80. General Motor Inns, Inc. v. L & M Properties, Inc. (*In re* L & M Properties), 102 Bankr. 481 (Bankr. E.D. Va. 1989).

witness with experience in workouts of other distressed motel properties. According to the opinion, this witness "revealed, in the vaguest terms possible, that the debtor hoped to renovate the motel, improve its financial 'track record,' and thus find a purchaser or investor willing to take on the business."[81] The court described the debtor's burden of proof as follows:

> To successfully defend a request for relief under § 362(d)(2) a debtor must prove that a reasonable likelihood exists that an effective reorganization can be achieved within a reasonable period of time . . . . [Debtor's witness'] testimony before the Court concerning the debtor's plan for reorganization amounted to nothing more than an expression of hope that a buyer or investor may be found . . . . The debtor presented no evidence of any attempts to find a buyer for the business or to obtain new sources of capital . . . . Further, no credible income or profit projection or quantitative financial forecast was introduced by the debtor. To determine that there can be an effective reorganization of the debtor's business the debtor must persuade the Court that the operation of the business will generate sufficient income to pay debt service.[82]

Even when the debtor does offer substantial evidence, that proof must convince the bankruptcy court that the reorganization is feasible. In *In re National Real Estate Ltd. Partnership II*[83] the debtor introduced detailed evidence of its proposed plan of reorganization, but the bankruptcy court found the debtor's plan could not work, stating: "Sincerity, honesty and willingness are not sufficient to make the plan feasible, and neither are any visionary promises. The test is whether the things which are to be done after confirmation can be done as a practical matter under the facts."[84]

In *In re 8th Street Village Ltd. Partnership*[85] the district court affirmed the bankruptcy court's grant of relief to an undersecured creditor with a lien on the debtor's shopping center.[86] The debtor-appellant argued that the bankruptcy court erred in rejecting the testimony of its witness when there was no opposing evidence.[87] The district court held it was for the bankruptcy court to determine whether the witness' testimony was credible and based on sound reasoning, stating: "The bankruptcy court was not clearly erroneous in finding that debtor failed to satisfy its burden of proving there was a reasonable possibility of an effective plan. There being no feasible plan, the bankruptcy court did not abuse its discretion in lifting the stay."[88]

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81. *Id.* at 483.

82. *Id.* at 484-85.

83. 87 Bankr. 986 (Bankr. E.D. Wis. 1988).

84. *Id.* at 993 (quoting *In re* Bergman, 585 F.2d 1171, 1179 (2d Cir. 1978)).

85. 94 Bankr. 993 (N.D. Ill. 1988).

86. *Id.*

87. *Id.* at 996.

88. *Id.* at 998.

Many Chapter 11 debtors[89] have been successful in meeting the burden of proof required by *Timbers* and subsection 363(g).[90] Debtors have also been successful in confirming plans over the objections of secured creditors relying on *Timbers*.[91]

In *In re Triton/Richmond Associates Ltd. Partnership*[92] the bankruptcy court denied the secured creditor's motion for relief under subsection 362(d)(2) on two multi-family residential rental properties.[93] In holding that the debtor had met its proof burden, the court stated:

> The debtor is not required, however, to demonstrate that it has actually proposed a plan of reorganization acceptable to its creditors. Rather, the debtor need show only that there is a reasonable probability that it will be able to propose a plan that will result in a successful reorganization . . . . [T]he Court finds that the debtor provided credible, if not particularly detailed, evidence of its efforts to obtain additional financing for the apartment projects, and of its plans to possibly convert the townhouse apartments to condominiums.[94]

The district court reversed the bankruptcy court's termination of the stay in *In re East-West Associates*.[95] The secured creditor's motion was based upon alleged bad faith, subsections 362(d)(1) and (2) because there was no effective reorganization in prospect, as the proposed plan could not be confirmed.[96] In addressing the subsection 362(d)(2) argument, the court stated: "The feasibility test does not require that the debtor show that its reorganization plan is confirmable, i.e., acceptable to its creditors."[97]

Another district court[98] stated the standard of proof as follows:

> [T]he Court remands the motion with instructions that the [bankruptcy court] make explicit findings as to whether an effective reorganization is in prospect. The court need not determine whether the reorganization plan is confirmable. It need only determine whether the components of the plan which are to be done after confirmation can be accomplished as a practical matter. In making such findings, the bankruptcy court should examine the reorganization plan in sufficient depth to assess its feasibility.[99]

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89. Chapter 13 wage earner plans are beyond the scope of this article. See Lomas Mortgage USA, Inc. v. Elmore (*In re* Elmore), 94 Bankr. 670 (Bankr. C.D. Cal. 1988) for a Chapter 13 case discussing the applicability of *Timbers*.

90. *In re* Executive House Assocs., 99 Bankr. 266 (Bankr. E.D. Pa. 1989); *In re* Admiral's Gate Assocs., 106 Bankr. 20 (Bankr. D.R.I. 1989).

91. *See* Sandy Ridge Dev. Corp. v. Louisiana Nat'l Bank (*In re* Sandy Ridge Dev. Corp.), 881 F.2d 1346 (5th Cir. 1989) (a post-*Timbers* case involving a secured creditor's objection to the Chapter 11 plan in which the Fifth Circuit reversed the rulings of the district and bankruptcy courts and held the secured creditor was receiving "indubitable equivalent of its secured claim" under the plan); Great W. Bank & Trust v. Entz-White Lumber & Supply, Inc. (*In re* Entz-White Lumber & Supply, Inc.), 850 F.2d 1338 (9th Cir. 1988) (upholding the district court's granting debtor's motion for summary judgment on the secured creditor's objections to the Chapter 11 plan); *see also* Travelers Ins. Co. v. Bullington, 878 F.2d 354 (11th Cir. 1989) (where secured creditor's objection to confirmation of Chapter 12 plan was overruled).

92. Crestar Bank v. Triton/Richmond Assocs. Ltd. Partnership (*In re* Triton/Richmond Assocs. Ltd. Partnership), 103 Bankr. 764 (Bankr. E.D. Va. 1989).

93. *Id.*

94. *Id.* at 767-68.

95. Carteret Sav. Bank v. Nastasi-White, Inc. (*In re* East-West Assocs.), 106 Bankr. 767, 774 (Bankr. S.D.N.Y. 1989).

96. *Id.* at 769.

97. *Id.* at 774 (citations omitted).

98. Travelers Life & Annuity Co. v. Ritz-Carlton of D.C., Inc. (*In re* Ritz-Carlton of D.C., Inc.), 98 Bankr. 170 (S.D.N.Y. 1989).

99. *Id.* at 173.

Timbers has, therefore, caused the bankruptcy courts to examine more closely debtors' financial affairs and plans to see that they are feasible, realistic, and practical. In this regard *Timbers* has strengthened secured creditor's arguments on motions for relief from the stay under subsection 362(d)(2).

E. Motion for Relief from Stay Under Subsection 362(d)(1)

Under subsection 362(d)(1) on request of a secured creditor, the bankruptcy court may terminate, annul, modify, or condition the automatic stay "for cause, including the lack of adequate protection of an interest in property of such party in interest."[100] Even though *Timbers* held that the undersecured creditor with stable value collateral was not entitled to adequate protection for loss of the right to foreclose, subsection 362(d)(1) allows a secured creditor relief "for cause." As expressly recognized in *Timbers*, "cause" includes decline in the collateral's value during the stay period.[101] Thus, if the collateral is depreciating or is being dissipated, the secured creditor is entitled to full relief for such loss of value.[102]

The measure of relief is the decrease in value of the secured creditor's collateral occurring during the stay. For adequate protection purposes, a secured creditor's value is established as of the date of the petition for Chapter 11; that value is "entitled to adequate protection against deterioration."[103] Hearings under subsection 362(d)(1) will require proof of value and depreciation. Unless the secured creditor can show a declining value, the motion shall be denied.[104]

Timbers "does not eliminate actions [under subsection 362(d)(1)] for lack of adequate insurance or adequate maintenance or for demonstrable depreciation or obsolescence in the property."[105] Many other factual situations including movement of the collateral to another state,[106] commingling collateral, obsolescence, and poor maintenance can create a "cause" entitling the secured creditor to relief from the stay.

If the debtor fails to keep the collateral properly insured, the bankruptcy court should either lift the stay or prohibit the use of the property.[107] If a secured creditor pays for the insurance coverage on the debtor's default, "[a] secured creditor is entitled to receive insurance costs as part of adequate protection."[108]

Subsection 362(d)(1) continues to be an important avenue of redress for both the secured and the undersecured creditor. The "for cause" provision allows the bankruptcy courts wide latitude to protect the secured creditor's property interest in the collateral being used by the debtor.

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100. 11 U.S.C. § 362(d)(1) (1988).

101. United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 370 (1988).

102. 11 U.S.C. § 361(2) (1988).

103. Travelers Life & Annuity Co. v. Ritz-Carlton of D.C., Inc. (*In re* Ritz-Carlton of D.C., Inc.), 98 Bankr. 170, 173 (S.D.N.Y. 1989).

104. Lomas Mortgage USA, Inc. v. Elmore (*In re* Elmore), 94 Bankr. 670 (Bankr. C.D. Cal. 1988).

105. *In re* Lewis, 83 Bankr. 682, 683 (Bankr. W.D. Mo. 1988).

106. *In re* Halvorson, 102 Bankr. 736 (Bankr. D.N.D. 1989).

107. General Motors Acceptance Corp. v. Ryals (*In re* Ryals), 3 Bankr. 522 (Bankr. E.D. Tenn. 1980).

108. Carteret Sav. Bank v. Nastasi-White Inc. (*In re* East-West Assocs.), 106 Bankr. 767, 773 (S.D.N.Y. 1989).

F. Secured Creditors' Objection to Debtor's Motion for Use of Cash Collateral

The Chapter 11 debtor may use its property in the ordinary course of business without prior court approval.[109] However, cash collateral type property cannot be used until the debtor first obtains the bankruptcy court's approval.[110]

In the hypothetical, First Mortgage holds a perfected security interest in Apartments' rents.[111] Since rent is cash collateral,[112] Apartments must obtain court authority to use rents in its debtor-in-possession operations. The bankruptcy court is authorized "based on the equities of the case" to permit the debtor to use rents and other cash collateral.[113] Some bankruptcy courts have permitted use of rent to maintain and preserve the apartment collateral.[114]

In the customary situation the debtor needs the use of post-petition rents or accounts receivable under a security interest to a secured creditor. The debtor files a motion for leave to use cash collateral, usually identifying the adequate protection tendered the secured creditor for use of this collateral. The Code authorizes an expedited hearing on these motions "in accordance with the needs of the debtor."[115] The secured party is, of course, given notice and an opportunity for hearing on the debtor's motion.

Since the debtor must provide the secured creditor with adequate protection for the use of cash collateral,[116] one standard debtor approach is to claim an equity cushion in other collateral sufficient to protect the secured creditor's interests. In the case of an undersecured creditor there would be no equity cushion, and the debtor would have to propose some other method of adequately protecting the undersecured creditor's interest in the cash used.

The secured creditor's typical response to the debtor's motion is an objection, a demand for adequate protection for the use of the cash collateral, and a cross-motion for relief from the stay or to convert or dismiss the Chapter 11 proceeding. As of January, 1990, the only Mississippi bankruptcy case opinion relying on *Timbers* involved the debtor's motion to use cash collateral and the secured creditor's response by motion to convert to Chapter 7.[117]

In order to obtain relief, the secured party must, of course, hold a valid perfected security interest in the cash collateral. In *In re Multi-Group III Ltd. Partnership*[118] the secured creditor filed a motion to prohibit use of certain funds and to sequester rents.[119] The court

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109. 11 U.S.C. § 363(c)(1) (1988).

110. 11 U.S.C. § 363(c)(2)(B) (1988).

111. The secured creditor must hold a perfected non-voidable security interest on the cash collateral. The prior equitable doctrine affording mortgagees an automatic security interest in rents and profits was rejected in Butler v. United States, 440 U.S. 48 (1979).

112. 11 U.S.C. § 363(a) (1988).

113. 11 U.S.C. § 552(b) (1988).

114. *See, e.g.*, Hartigan v. Pine Lake Village Apartment Co. (*In re* Pine Lake Village Apartment Co.), 21 Bankr. 395 (S.D.N.Y. 1982).

115. 11 U.S.C. § 363(c)(3) (1988).

116. 11 U.S.C. § 363(e) (1988).

117. *See infra* notes 125-27 and accompanying text. Neither Bankruptcy Judge David W. Houston of the Northern District of Mississippi nor Bankruptcy Judge Edward Gaines of the Southern District of Mississippi has rendered an opinion involving *Timbers* during the two years after that decision.

118. 99 Bankr. 5 (Bankr. D. Ariz. 1989).

119. *Id.*

held that the secured creditor did not hold a properly perfected security interest in the rents and was therefore not entitled to relief.[120] The court noted that "[c]ash collateral is thus generally payable only to the lender secured by the income producing property, and is not available for equitable distribution among the general unsecured creditors of the debtor."[121]

If the debtor uses cash collateral without court authority, the secured creditor should immediately file a motion to prohibit use of cash collateral, for relief from the stay, and to dismiss. The secured creditor can also move for sequestration of rents and profits.[122]

G. Motion to Convert to Chapter 7 or to Dismiss

The bankruptcy court may convert the Chapter 11 case to a Chapter 7 liquidation case or may dismiss the Chapter 11 case "whichever is in the best interest of the creditors and the estate."[123] Although a number of grounds exist for conversion or dismissal, secured creditors most often use:

> (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
>
> (2) inability to effectuate a plan;
>
> (3) unreasonable delay by debtor that is prejudicial to the creditors; [and]
>
> (4) failure to propose a plan under section 1121 of this title within any time fixed by the court . . . .[124]

At the hearing to convert or dismiss, the secured creditor must prove that the debtor's estate is suffering loss or diminution and that there is absence of a reasonable likelihood of rehabilitation. The Bankruptcy Court for the Southern District of Mississippi recently converted a Chapter 11 proceeding to a Chapter 7 proceeding only one month after the filing.[125] The debtor had filed an emergency motion for authority to use cash collateral and pre-petition accounts receivable; the secured creditor had filed a motion to convert or dismiss.[126] The court relied upon the *Timbers* decision and subsection 1112(b) to rule that:

> [T]he debtor does not have a reasonable prospect for a successful reorganization and that any potential benefit to creditors which might be derived by the use of cash collateral is outweighed by the risk. The motion to use cash collateral is denied, and the motion to convert to a Chapter 7 is granted.[127]

A number of courts have used the debtor's "inability to effectuate a plan" as a basis for a conversion or dismissal.[128] As stated in the *Timbers* decision, even within the four-month exclusive period that the debtor has to file a plan, the court may grant relief when there is a

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120. *Id.* at 11.

121. *Id.* at 8.

122. *In re* Erickson, 83 Bankr. 701 (Bankr. D. Neb. 1988).

123. 11 U.S.C. § 1112(b) (1988).

124. 11 U.S.C. § 1121(b)(1)-(4) (1988).

125. *In re* Cook Constr. Co., No. 89-03488-JC, slip op. at 2 (Bankr. S.D. Miss. Dec. 4, 1989).

126. *Id.*

127. *Id.* at 12.

128. *In re* CCN Realty Corp., 23 Bankr. 261, 262 (Bankr. S.D.N.Y. 1982) (six months after filing of petition); *In re* Lamar Estates, Inc., 6 Bankr. 933, 934 (Bankr. E.D.N.Y. 1980) (seven months after filing of petition).

"lack of any realistic prospect of effective reorganization."[129] When a motion to convert or dismiss is based upon "unreasonable delay by the debtor that is prejudicial to creditors," the courts look to the benefit of the creditors as a whole, rather than just to the benefit of the moving creditor.[130]

When a debtor is unable to present a plan of confirmation within the four-month exclusive period, the debtor usually requests the court to extend the exclusive period.[131] According to the Code's legislative history, such extensions should be granted "on a showing of some promise of probable success" to avoid use of extensions "as a tactical device to put pressure on parties in interest to yield to a plan they consider unsatisfactory."[132]

The secured creditor usually opposes the debtor's request for an extension of the exclusive period. The secured creditor and the unsecured creditors committee may wish to propose a plan of their own. "The debtor bears the burden of establishing 'cause' for an extension of its exclusive period."[133] Where the case is complex with a number of creditors, large assets and liabilities, and difficult legal issues, the bankruptcy courts will usually grant the debtor some extension of the exclusive period.

The bankruptcy court can also convert to a Chapter 7 liquidation proceeding or dismiss a Chapter 11 proceeding for "failure to propose a plan under section 1121 of this title within any time fixed by the court."[134] Although this provision implies authority for the bankruptcy court to fix a time for the proposing of a plan, the Code provides no such express power. Bankruptcy courts have relied on this implied authority to enter orders scheduling the time for the debtor to file plans.

When the debtor is guilty of a bad faith proceeding, the bankruptcy court can grant relief under the "for cause" provisions of subsection 362(d)(1) on relief from the stay or of subsection 1112(b) on conversions and dismissals.[135] In reviewing the debtor's good faith, bankruptcy courts look to see if the debtor has any assets, real debts, and real creditors, or if the debtor is abusing the jurisdiction of the bankruptcy court.[136] One court listed these factors for consideration:

> (1) the debtor has only one asset, the property; (2) the debtor has few unsecured creditors whose claims are small in relation to the claims of the secured creditors; (3) the debtor has few employees; (4) the property is the subject of a foreclosure action as a result of arrearages on the debt; (5) the timing of the debtor's filing evidences an intent to delay or frustrate the legitimate efforts of the debtor's secured creditors to enforce their rights.[137]

The bankruptcy courts must consider each case on its own facts when faced with a motion to dismiss for a bad-faith filing. The bankruptcy court in *In re Sarasota Plaza Associ-*

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129. United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 376 (1988). *Timbers* impliedly overruled the line of cases, such as *In re* Ault, 63 Bankr. 638 (Bankr. C.D. Ill. 1986), holding that an unreasonable delay cannot occur during the debtor's four-month exclusive period to file a plan of reorganization.

130. H.R. REP. No. 595, 95th Cong., 2d Sess. 405, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6361.

131. 11 U.S.C. § 1121(d) (1988).

132. S. REP. No. 989, 95th Cong., 2d Sess. 118, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5904.

133. *In re* Washington-St. Tammany Elec. Coop., Inc., 97 Bankr. 852, 854 (E.D. La. 1989).

134. 11 U.S.C. § 1112(b)(4) (1988).

135. Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (*In re* Little Creek Dev. Co.), 779 F.2d 1068, 1072 (5th Cir. 1986).

136. *In re* Cardi Ventures, Inc., 59 Bankr. 18, 21-22 (Bankr. S.D.N.Y. 1985).

137. Carteret Sav. Bank v. Nastasi-White, Inc. (*In re* East-West Assocs., 106 Bankr. 767, 771-72 (Bankr. S.D.N.Y. 1989).

ates Ltd. Partnership[138] held:

> There is still room for debtors with a single real estate asset in the bankruptcy court; first, to receive protection in the bankruptcy court and, ultimately, to achieve rehabilitation under the provisions of new Chapter 11. The ultimate test is still as it was under the pre-Code law: first, whether there is a "real need" of reorganization and, second, the debtor demonstrates an ability to effectuate a reorganization without inordinate delay . . . . In sum, when a Chapter 11 case of a debtor with one single asset which is sought to be dismissed for "bad faith" the court must consider all circumstances surrounding the case and none of the traditionally recognized elements of "bad faith" are controlling.[139]

Absent these elements of bad faith and some abusive tactics by the debtor, such as repeated filings and dismissals, the secured creditor has a difficult burden to meet. Motions for bad faith should be used by a secured creditor only when the circumstances demand its application by the court.

H. Motion to Shorten Time for Debtor to File Plan

Relying on the inferential power of subsection 1112(b)(4), the moving creditor has the burden of showing "cause" for such shortening of time. The creditor filing such motion would ordinarily join it with a motion for relief from the stay.

I. Motion for Valuation of Security

The secured creditor may move the bankruptcy court to determine the value of its collateral. According to one authority, the secured creditor should seek the highest possible value.[140] This is especially important when the secured party's collateral value only marginally exceeds the amount of the debt. The higher the value, the larger the secured claim held by the secured creditor.

The valuation of a secured creditor's collateral is important in many different contexts: to determine the issue of adequate protection under section 361, impairment of the claim under section 1124, or treatment of the claim in a plan pursuant to subsection 1129(b) of the Code. Since an evaluation under subsection 506(a) ("determination of secured status") is based on a different standard from a claim evaluation for the plan of confirmation, a secured creditor could receive two differing evaluations of its collateral at different times in the Chapter 11 proceeding.

J. Motion for Appointment of Examiner or Trustee

The bankruptcy court may appoint "an examiner to conduct such investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor."[141] A successful motion by a secured party for an examiner shifts the cost of the examiner to the estate, so that the secured party does not incur additional expenses for its own investigating accountants.

If the court believes that cause exists—such as fraud, dishonesty, incompetence, or gross mismanagement of the debtor by current management—the court may also appoint a

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138. *In re* Sarasota Plaza Assocs. Ltd. Partnership, 102 Bankr. 257 (Bankr. M.D. Fla. 1989).

139. *Id.* at 258-59 (citations omitted).

140. L. LoPucki, *supra* note 6, at 483.

141. 11 U.S.C. § 1104(b) (1988).

trustee to take charge of the debtor's affairs. While the trustee may operate the debtor's business, the trustee usually seeks to sell the business or liquidate its assets as soon as possible. A trustee is more likely to abandon property to a secured creditor than is a debtor in possession who is operating the business. The secured creditor should not seek a trustee when it has received voidable payments or property from the debtor. The trustee has a duty to investigate transactions between the debtor and the secured party to find voidable preferential transfers, fraudulent conveyances, and unperfected liens.

K. Objection to Disclosure Statement and to Confirmation

The confirmation process involves two separate hearings: first, the approval of the disclosure statement, and second, the confirmation hearing. The disclosure statement is required to provide "adequate information," meaning information of a kind and in sufficient detail to enable a reasonable investor typical of the holders of claims or interests to make an informed judgment about the plan.[142] A secured creditor can object to the adequacy of the information provided in the debtor's proposed disclosure statement. "The court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets."[143] Objections to the disclosure statement are usually more matters of form than substance.

Confirmation of a plan of reorganization is a difficult task, as the plan can be confirmed "only if all" of numerous requirements are met.[144] The debtor must provide the secured creditor with deferred cash payments equal to the present value of the collateral (i.e., the allowed secured claim) or its "indubitable equivalent."[145] In addition, the plan must "not discriminate unfairly" and must be "fair and equitable" for each non-accepting class or interest impaired.[146]

The secured creditor has a right to vote against the plan and can file an objection to confirmation.[147] Unless the debtor can fulfill the stringent requirements for a "cram-down," the secured party's objection effectively kills the plan.

V. STRATEGIES FOR THE OVERSECURED CREDITOR

A. General

The secured creditor holding a lien against collateral worth more than the debt ("oversecured creditor") continues to accrue as part of the secured debt interest on the claim and any reasonable fees, costs, or charges under the agreement between the parties.[148] If the oversecured creditor is not concerned about dissipation or depreciation of the collateral, it can simply do nothing and wait for the debtor's proposal of a plan of reorganization. If concerned about decreasing collateral value, the oversecured creditor should either request adequate protection from the debtor or file a motion for relief from the stay, to condition use of the property, or for adequate protection.

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142. 11 U.S.C. § 1125(a)(1) (1988).
143. 11 U.S.C. § 1125(b) (1988).
144. 11 U.S.C. § 1129(a) (1988).
145. 11 U.S.C. § 1129(b)(2)(A)(i)(II)-(A)(iii) (1988).
146. 11 U.S.C. § 1129(b)(1) (1988).
147. BANKR. R. 3018, 3020(b)(1).
148. 11 U.S.C. § 506(b) (1988).

B. Equity Cushion Adequate Protection

Many courts have used an "equity cushion" theory to provide the oversecured creditor the adequate protection required by the Code. Equity cushion means "value in the property above the amount owed to the creditor with a secured claim, that will shield [the creditor's] interest from loss due to any decrease in the value of the property during the time the automatic stay remains in effect."[149] *In re WRB West Associates Joint Venture*[150] is a typical case. The debtor was allowed use of cash collateral with the creditor's adequate protection coming from a "substantial equity cushion of 40%."[151]

Some cases have discussed "ownership of the equity cushion." For example, *In re McCombs Properties VI Ltd.*[152] the Chapter 11 debtor moved for authority to use cash collateral (rents of an apartment project) to pay operating expenses and to protect the property from deterioration. The court granted the debtor's motion based on an equity cushion providing adequate protection to the secured creditor and made several important rulings:

> [A]dequate protection under § 363 should be treated the same as under § 362 . . . . A secured creditor has no right to the equity cushion in its collateral. It only has a right to look to the collateral for payment of its claim "upon completion of the reorganization. It is *then* that he must be assured 'realization . . . of the indubitable equivalent' of his collateral."[Citing *Timbers*] The unsecured creditors and the debtor have rights to the cushion. Section 506(a) reinforces this view by limiting the secured status of a creditor to the lesser of the claim or the value of the collateral. Furthermore, § 506(b) requires any payment of interest on a secured creditor's claim during the bankruptcy to be taken from the cushion. . . . For these reasons, I reject any inference that *Timbers* limits the use of an equity cushion for adequate protection. To the contrary, by implication it supports such use.[153]

If the secured creditor is to recover all its principal, interest, fees, and other costs, the collateral value must cover the total expected debt. After the equity cushion is used, the secured creditor's right to interest and fees ends. Since cash collateral is easily and quickly dissipated, the secured creditor must be alert to unauthorized use by a debtor and seek prompt relief from the bankruptcy court. In defending the debtor's motion, the secured creditor should present valuation evidence to rebut the debtor's use of equity cushion for adequate protection.

VI. CONCLUSION

The vast majority of Chapter 11 proceedings fail. Too often a debtor files a petition for the sole purpose of stopping a foreclosure or suit. Too many petitioners have no long-term resolutions for their financial problems. In the past these proceedings have often taken years before a conversion or dismissal has been ordered. The secured creditors, especially those with little or no equity cushion, are harmed by these delays in realizing upon the value of their collateral.

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149. La Jolla Mortgage Fund v. Rancho El Cajon Assocs., 18 Bankr. 283, 287 (Bankr. S.D. Cal. 1982).

150. 106 Bankr. 215 (Bankr. D. Mont. 1989).

151. *Id.* at 220.

152. McCombs Properties VI, Ltd. v. First Tex. Sav. Ass'n (*In re* McCombs Properties VI, Ltd.), 88 Bankr. 261 (Bankr. C.D. Cal. 1988).

153. *Id.* at 266-67.

Under *Timbers* the bankruptcy courts across the nation are now more closely scrutinizing the debtor's realistic prospects of a successful reorganization. Those proceedings with a true prospect of reorganization will be permitted to proceed in accord with the design of the Code. Those filed merely to delay the creditor or to stop a foreclosure will be converted or dismissed earlier. The United States Supreme Court has, by the *Timbers* opinion, reestablished the delicate balance Congress intended between the good faith debtor's right to seek a rehabilitative reorganization and the secured creditor's constitutional rights in its collateral. In the long view the secured creditors, particularly the undersecured creditors, will benefit from the *Timbers* decision.