BALANCING OF INTERESTS IN ORDERS AUTHORIZING THE USE OF CASH COLLATERAL IN CHAPTER 11

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I. INTRODUCTION

An order authorizing the debtor's use of cash collateral is often the most important order entered in a chapter 11 case.[1] Such an order is essential both to the debtor's survival as a going concern and to preserve the value of the secured creditor's lien on cash collateral.[2] The purpose of such an order is to simultaneously accommodate those conflicting needs—no mean feat in many cases.

Secured creditors often compound the inherent difficulty of the task by taking the opportunity presented by negotiations over use of cash collateral to press for concessions from debtors on issues that have little to do with protecting the value of the creditor's lien on cash collateral. Debtors often agree to such concessions out of fear that if they do not, the bankruptcy court may not authorize use of cash collateral over the secured creditor's objection.[3] The result is often the presentation to the court of a consensual cash collateral order which if entered, may increase the

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[1] WEINTRAUB & RESNICK, *The Use of Cash Collateral in Reorganization Cases*, 15 U.C.C. L.J. 168, 168 (1982) ("A debtor's ability to use its assets immediately after the filing of a Chapter 11 petition is often crucial to the success of the reorganization process."). Broadly stated, cash collateral is the proceeds derived from the sale of a debtor's assets when those assets are the subject of a creditor's security interest. 11 U.S.C. § 363(a) (1988). For a detailed definition of cash collateral, *see infra* note 14 and accompanying text. *See also* Mount, *Standards and Sanctions for the Use of Cash Collateral Under the Bankruptcy Code*, 63 TEX. L. REV. 341, 342 (1984). Unless otherwise indicated, all textual references to Chapter 11 refer to 11 U.S.C. §§ 1101-1174 (1988).

[2] WEINTRAUB & RESNICK, *supra* note 1, at 168.

[3] In order to utilize cash collateral the debtor must comply with procedural safeguards of the Bankruptcy Code. *See* 11 U.S.C. § 363(c) (1988). The secured

aggregate value of the liens securing the creditor's prepetition claim, confirm the validity of otherwise questionable liens, release the creditor from any existing liability to the debtor, and give the creditor substantial control over the progress and outcome of the case, including the right to seize all collateral without court order upon the debtor's default.[4] Moreover, presentation of the order usually occurs at the inception of the case, with little or no notice to other creditors. There is, however, ordinarily a provision that the order is binding on every present or future party in the case.

It is the thesis of this article that the entry of consensual cash collateral orders with such provisions may violate the rights of other creditors to due process and fair treatment. Therefore, the bankruptcy court, as a court of equity, has the right and obligation to modify such orders *sua sponte* in order to balance the interests of all parties in the case.

II. THE DEBTOR'S AND SECURED CREDITOR'S COMPETING INTERESTS IN CASH COLLATERAL IN CHAPTER 11

The purpose of chapter 11 of the Bankruptcy Code[5] (the Code) is to provide methods for the financial reorganization of distressed debtors.[6] One of the cornerstones of chapter 11 is the premise that the going concern value of an enterprise is generally greater than the aggregate forced sale value of its assets.[7] Ideally, the preservation of the enterprise as a going concern serves the public purpose of maximizing the values of the stakes held by all interested parties—the debtor, stockholders, secured and unsecured creditors, vendors, customers, and the general public. Conversely, if the debtor's operations terminate and its assets are liquidated the interested parties generally lose the difference between the going concern value and the forced sale value of the

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creditor is entitled to both notice and a hearing before the debtor can make use of the cash collateral. *Id.* at § 363(c)(2)(B).

4 *See infra* notes 50-69 and accompanying text.

5 11 U.S.C. §§ 1101-1174 (1988).

6 *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 220, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6179. There are, of course, other methods of financial reorganization. Chapter 11 is unique for, among other things, its ability to affect reorganization over the objection of creditors through the use of provisions such as the automatic stay of section 362 and the ability to bind dissenting creditors under sections 1126(c), 1129(a)(8) and 1129(b). *See* 11 U.S.C. §§ 362, 1126(c), 1129(a)(8)(b) (1988).

7 Fortgang & Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061, 1064 (1985).

debtor's assets. Thus, chapter 11 provides for the continuation of the debtor as a going concern.[8]

Most debtors in chapter 11 are businesses, and most businesses need cash to operate. The Code authorizes the debtor[9] to use its cash in the ordinary course of business without notice, hearing, or court order if the cash is unencumbered by liens or other interests of third parties.[10] Many debtors in chapter 11, however, have granted lenders security interests in accounts receivable, inventory and proceeds as collateral for prepetition loans. Under Article 9 of the Uniform Commercial Code (U.C.C.), a lender can perfect a security interest in cash proceeds.[11] If a security interest in cash proceeds has been properly perfected before the bankruptcy petition is filed, the security interest generally continues postpetition.[12] A security interest is property which is protected by the United States Constitution.[13] Thus, there is an inherent tension between a debtor's need to use

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8 The debtor may eventually be liquidated within chapter 11, rather than reorganized. *See* 11 U.S.C. § 1123(a)(5)(D) (1988) (providing that a chapter 11 plan may call for the liquidation of the debtor's assets and distribution of the proceeds). Liquidation of the assets as a going concern or in an orderly manner, however, tends to result in greater recoveries than through forced auction sales, such as sheriff's sales. Fortgang & Mayer, *supra* note 7, at 1064; Queenan, *Standards for Valuation of Security Interests in Chapter 11*, 92 COM. L.J. 18 (1987). Thus, the continuation of the debtor as a going concern during Chapter 11 serves a salutary purpose even if liquidation is the end result.

9 A debtor is presumptively entitled, under section 1107(a), to remain in possession of its property and in control of its affairs. 11 U.S.C. § 1107(a) (1988). Such debtors are defined as "debtors in possession." 11 U.S.C. § 1101 (1988). There are distinctions between the terms "debtor" and "debtor in possession" for certain purposes, but those distinctions need not be addressed for purposes of this article. Henceforth, the term "debtor" shall be used for convenience, and shall be intended to mean "debtor in possession."

10 11 U.S.C. § 363(c)(1) (1988).

11 U.C.C. § 9-306.

12 11 U.S.C. § 552(b) (1988).

13 U.S. CONST. amend. V states in pertinent part: "No person shall . . . be deprived of life, liberty or property, without due process of law; nor shall private property be taken for public use, without just compensation." It has been held that a creditor's security interest is property within the meaning of the fifth amendment. Wright v. Union Central Life Ins. Co., 304 U.S. 502, 516-17 (1938) (extension of time for a debtor to exercise redemption from a foreclosure sale does not constitute an impermissible modification of the creditor-mortgagee's property rights in violation of the due process clause of the fifth amendment). *See* Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 602 (1935) (holding that a mortgage is property which cannot be taken without just compensation). *See also* Dodd, *Obtaining Operating Capital in a Chapter 11 Reorganization Proceeding Under § 363(c) and § 364(d) of the Bankruptcy Code*, 1983 ANN. SURV. BANKR. L. 217, 218 (1983); Mount, *supra* note 1, at 349.

its cash to continue operating and a secured creditor's right to preserve its security interest in the debtor's cash proceeds.

The Code defines cash owned by a debtor but subject to a security interest as "cash collateral."[14] In recognition of the importance of cash collateral to both the debtor and the secured creditor, the Code contains special provisions dealing with this subject. The debtor may not use cash collateral unless either the secured creditor consents or the bankruptcy court authorizes such use after notice and hearing.[15] Any hearing must be scheduled in accordance with the debtor's needs, and the court must act promptly on any request for authorization to use cash collateral.[16] Upon request of the secured creditor, the court must prohibit or condition use of cash collateral, with or without a hearing, as is necessary to provide adequate protection.[17] Thus, the purpose of a hearing on an application to use cash collateral is to provide adequate protection for the secured creditor's interest in cash collateral.[18] The debtor has the burden of proving that the secured creditor's interest is adequately protected.[19]

III. Adequate Protection for Security Interests in Cash Collateral

The concept of adequate protection is based on the fifth amendment's command that no private property shall be taken for public use without just compensation.[20] Because a security interest is property within the meaning of the fifth amendment, a reduction in the value of a security interest is a "taking" for

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[14] 11 U.S.C. § 363(a) (1988). The section provides:

> (a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

Id.

[15] *Id.* at § 363(c)(2). As a practical matter, a court order is virtually always entered even if the secured creditor consents to use of cash collateral, because the creditor cannot obtain the compensation it desires under section 361 for use of cash collateral without court approval.

[16] *Id.* at § 363(c)(3).

[17] *Id.* at § 363(e).

[18] Dodd, *supra* note 13, at 221.

[19] 11 U.S.C. § 363(o)(1) (1988).

[20] U.S. CONST. amend. V. *See* 11 U.S.C. § 363(o)(1) (1988) (trustee in bankruptcy has burden of proving that a secured creditor's security interest is adequately protected).

which just compensation must be provided.[21] Adequate protection of a security interest in cash collateral therefore ensures just compensation for the loss of the secured creditor's right to use cash collateral to repay debt.[22]

One conclusion implicit in the concept of adequate protection is that, although the fifth amendment entitles the secured creditor to the benefit of his bargain, there is no requirement that he receive this benefit in kind.[23] Ultimately, the fifth amendment does not protect the secured creditor's right to sell or retain a particular piece of property in satisfaction of a debt; rather, it protects the creditor's right to receive the cash value of such property.[24] If this value can be secured for the creditor by means other than receiving the cash collateral, the mandate of the fifth amendment and the purpose of adequate protection are fulfilled.

Section 361 of the Code states that when adequate protection is required it may be provided by three means. First, the debtor may make cash payments to the extent that the use of property results in a decrease in the value of a secured creditor's interest.[25] Second, the debtor may provide an additional or replacement lien to the extent of such decrease in value.[26] Third, the debtor may grant such other relief as will, in the elegant language of Judge Learned Hand,[27] provide the creditor with the

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21 *See* Dodd, *supra* note 13, at 217-18 & n.10. Initially, confusion existed as to whether a secured creditor's property rights in a security interest implicated the takings clause, or alternatively, the due process clause of the fifth amendment. *Compare* Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 601-02 (1935) (holding a bankruptcy provision unconstitutional because it effectuated a deprivation of a mortgagee's security interest in violation of the takings clause) *with* Wright v. Vinton Branch, 300 U.S. 440, 470 (1937) (declaring that the bankruptcy provision in question did not modify mortgagee's property rights in violation of the due process clause of the fifth amendment). *See also* Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 BUS. LAW. 15, 26 (1974) (suggesting that the Supreme Court's jurisprudential approach regards the two constitutional clauses as functionally the same).

22 *See* 11 U.S.C. § 363(o)(1) (1988); Dodd, *supra* note 13, at 218; Mount, *supra* note 1, at 350.

23 *See* Dodd, *supra* note 13, at 218; Wright v. Union Central Life Ins. Co., 311 U.S. 273, 278 (1940) ("Safeguards were provided to protect the rights of secured creditors, throughout the proceedings, to the extent of the *value* of the property. [citations omitted] There is no constitutional claim of the creditor to more than that.") (emphasis added).

24 H.R. REP. No. 595, *supra* note 6, at 339, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS at 6295.

25 11 U.S.C. § 361(1) (1988).

26 *Id.* at § 361(2).

27 Metropolitan Life Ins. Co. v. Murel Holding Corp. (*In re* Murel Holding

"indubitable equivalent" of its interest in such property.[28]

Adequate protection cannot be fully understood without a working knowledge of the principles used to measure the secured creditor's interest in property of the estate. Section 506(a) of the Code provides that an allowed claim secured by a lien on property in which the estate has an interest is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, and is an unsecured claim to the extent of any deficiency. Section 502(b) further provides that the amount of a claim shall be determined as of the petition date. The value of the property and the amount of the secured claim should also be determined as of the petition date.[29] If the value of the property is less than the amount of the claim (the claim is undersecured), the amount of the secured claim is the value of the property.[30] If, however, the value of the property is greater than the amount of the claim (the claim is oversecured), the amount of the secured claim is the entire amount due on the petition date plus postpetition interest and expenses accruing under section 506(b) of the Code.[31]

The secured creditor has a constitutional right to preserve the value of its secured claim on the petition date.[32] Thus, if the claim is oversecured on the petition date the creditor has a right under section 506(b) to postpetition interest and expenses up to the value of the property on the petition date. This, however, does *not* mean that the creditor is entitled to have the amount of the equity "cushion" which existed on the petition date continue at the same level throughout the case; this would force the estate to provide additional value to the secured creditor as the case progresses in an amount equal to postpetition interest and expenses accruing. There is no constitutional or statutory right to

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Corp.), 75 F.2d 941, 942 (2d Cir. 1935) (Judge Learned Hand set forth the constitutional requisites for the adequate protection of lienholders).

28 11 U.S.C. § 361(3) (1988).

29 *In re* Reddington/Sun-Arrow Ltd. Partnership, 119 Bankr. 809, 813 (Bankr. D.N.M. 1990); Bank of New Jersey v. Larson (*In re* Kennedy Mortgage Co.), 23 Bankr. 466, 469 (Bankr. D.N.J. 1982); *In re* Beard, 108 Bankr. 322, 326 (Bankr. N.D. Ala. 1989).

30 United Savings Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 373 (1988).

31 Bankers Life v. Alyucan Interstate Corp. (*In re* Alyucan Interstate Corp), 12 Bankr. 803, 808 n 10 (Bankr. D. Utah 1981). *See generally* Franzese, *Secured Financing's Uneasy Place in Bankruptcy: Claims for Interest in Chapter 11*, 19 HOFSTRA L. REV. 1 (1991) (thorough discussion of postpetition interest at contract default rates).

32 2 COLLIER ON BANKRUPTCY ¶ 362.01, at 362-17 (15th ed. 1982) (citing Wright v. Union Central Life Ins. Co., 311 U.S. 273, 278 (1940)).

such postpetition interest and expenses beyond the value of the encumbered property on the date of petition.[33]

The fifth amendment and section 361 of the Code require that the estate compensate the secured creditor for any decrease in the value of the creditor's interest in the property after the petition date.[34] The secured creditor is not necessarily entitled to any increase in the value of such property unless such increase must be used as adequate protection to compensate for a decrease in value of other collateral. It has been noted that, "in any particular case, especially a reorganization case, the determination of which entity should be entitled to the difference between the going concern value and the liquidation value must be based on equitable considerations arising from the facts of the case."[35]

The bankruptcy court has considerable discretion in determining the appropriate method of valuation.[36] In the seminal case of *In re American Kitchen Foods, Inc.*,[37] the court held that the value to be ascribed to collateral in bankruptcy should be equal to the amount that the creditor would likely realize if it obtained possession of the collateral and effected "the most commercially reasonable disposition practicable in the circumstances."[38] This analysis recognizes that the secured creditor has essentially bargained for the right to seize and sell the collateral upon default. This is further consistent with U.C.C. section 9-504(3) which requires that every aspect of such a sale must be commercially rea-

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[33] *Timbers of Inwood*, 484 U.S. at 372; 2 COLLIER, *supra* note 32, ¶ 362.01, at 362-17.

[34] *In re* Yale Express, Inc., 384 F.2d 990, 992 (2d Cir. 1967). *But see Alyucan Interstate Corp.*, 12 Bankr. at 809. The *Alyucan* court stated that "not every decline in value must be recompensed, only those which, but for the [automatic] stay, could be and probably would be prevented or mitigated." *Id.* A close reading of section 361 reveals that this observation is correct — only decreases in value *caused by* sections 362, 363 or 364 must be compensated. Thus, if the debtor demonstrates that any decrease in value of the creditor's lien would occur even without the bankruptcy case and that the bankruptcy case was not exacerbating the decrease in value, adequate protection would not be necessary. I have not yet seen such arguments raised in any cases before me. Moreover, if such arguments are available it would most likely be in regard to assets other than cash collateral, receivables, and inventory.

[35] S. REP. NO. 989, 95th Cong., 2d Sess. 54, *reprinted in* 1978 U. S. CODE CONG. & ADMIN. NEWS 5840; H.R. REP. NO. 595, *supra* note 6, at 339, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS at 6295.

[36] WEINTRAUB & RESNICK, BANKRUPTCY LAW MANUAL ¶ 5.11[1], at 5-54-55 (1980).

[37] 2 Bankr. Ct. Dec. (C.R.R.) 715 (Bankr. D. Me. 1976).

[38] *Id.* at 722.

sonable.[39] Although *American Kitchen Foods* was decided under the prior Bankruptcy Act its reasoning is still valid under the Code. Section 506(a) provides that it is the creditor's interest in the collateral, rather than the collateral, which is ultimately being valued.[40] A sheriff's sale or other auction conducted by the secured creditor would not necessarily be the most commercially reasonable disposition. Factors such as the nature of the collateral, market conditions and other facts peculiar to the individual case must be considered. Where, however, it has not been established that the debtor will probably be sold as a going concern, valuation of security interests at going concern values may not be warranted.[41]

It is not an easy task to grasp the relationships between these principles and apply them correctly to the facts of a particular case. The emergent circumstances which attend most cash collateral hearings at the inception of a chapter 11 case often leave the court and most parties other than the debtor substantially in the dark as to many pertinent facts. Even the debtor often has little information regarding the value of its property other than book value based on historical cost. Moreover, even book value is not always available. Typically, the parties rely on book value at the preliminary cash collateral hearing, perhaps supplemented by hastily obtained appraised values at a final hearing. The courts' decisions regarding valuation and adequate protection, of course, can only be as good as the evidence presented, and book value may have little relationship to going concern value, forced sale value or any other value which would result from the most

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39 U.C.C. § 9-504(3).

40 Queenan, *supra* note 8, at 33.

41 *Id.* at 49. In *In re* George Ruggiere Chrysler-Plymouth, 727 F.2d 1017 (11th Cir. 1984), the court held that gross profits from the sale of inventory in the ordinary course of business go to the estate, rather than to the secured creditor. Moreover, the court determined that the secured creditor is entitled only to the wholesale value of inventory if that is what the creditor would likely receive if the inventory was repossessed and sold. *Id.* at 1020 (citations omitted). In *In re* Phoenix Steel Corp., 39 Bankr. 218 (D. Del. 1984), the court, applying a different approach held that where the debtor's prospects for successful reorganization are uncertain, collateral can be valued by using the mean of going concern value and liquidation value. *Id.* at 226-27. In *Ruggiere*, the court focused on the creditor's likely recovery if the collateral was turned over. In *Phoenix Steel*, however, the court focused on the creditor's likely recovery if the collateral remained in the debtor's hands. *See Ruggiere*, 727 F.2d at 1020; *Phoenix Steel*, 39 Bankr. at 232. As noted above, the most commercially reasonable manner of disposing of the property will depend upon the facts of the particular case. One factual question may concern whether the debtor or the creditor is best situated to dispose of the collateral for the highest value.

commercially reasonable disposition. Section 506(a) makes it clear that such determinations shall not have a *res judicata* or law-of-the-case effect for other purposes later in the case.[42] Notwithstanding that qualification, such determinations often dispose of valuable property rights, at least *de facto*, for the entire case when the parties assume that such determinations were accurate for all future purposes.[43] It is therefore essential that the parties and the court exercise as much care as possible in making such determinations.

IV. THE PRINCIPLE OF EQUALITY OF DISTRIBUTION

The principle of adequate protection prevents involuntary reduction in the value of security interests without just compensation. There is, however, another bankruptcy principle to which equal attention must be paid in connection with consensual cash collateral orders. The concept that "the theme of the Bankruptcy Act is equality of distribution" has long been recognized as a fundamental principle.[44] This same principle permeates the Bankruptcy Code.[45] Application of this principle requires knowledge of the different manner in which the Code treats secured and unsecured claims, as well as secured and unsecured parts of the same claim.

To the extent that a creditor is undersecured, he has no greater rights under the Code than creditors who are completely unsecured. Section 506(a) provides that a creditor holds a secured claim to the extent of the value of his collateral, and an unsecured claim to the extent that the amount of the claim exceeds this value. Generally, the unsecured portion of the claim, which is often referred to as the "deficiency claim," will be classified for purposes of a chapter 11 plan of reorganization with

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42 2 COLLIER, *supra* note 32, ¶ 361.02, at 361-21 -22.

43 This conclusion follows from the fact that in many cases, initial determinations or stipulations of value are never formally challenged or later questioned. Most likely, this occurs because some parties do not understand the limitations of such initial valuations, and other parties need only a rough idea as to asset values for purposes of negotiations in a particular case.

44 3 COLLIER ON BANKRUPTCY ¶ 60.01, at 743 (14th ed. 1977) (citing Stickney v. Kerry, 55 Wash. 2d 535, 348 P.2d 655, 657 (1960)); Tabb, *A Critical Reappraisal of Cross-Collateralization in Bankruptcy*, 60 S. CAL. L. REV. 109, 145-153 (1986).

45 *See* 11 U.S.C. §§ 726(b), 1122(a), 1123(a)(4), 1129(b), 1322(a)(3), (b)(1) (1988). Moreover, the primary purpose of the "avoiding powers" in Code sections 544 through 549 of the Code is to ensure that a debtor's property is shared equally by creditors of the same level of priority under the Code, rather than distributed to those who seize it first or to whomever the debtor has preferred.

other unsecured claims.[46] Section 1123(a)(4) requires that a plan provide the same treatment for each claim of a particular class unless the holder of a particular claim agrees to less favorable treatment of the claim. Thus, an undersecured creditor will generally receive the same distribution on its deficiency claim as that received by completely unsecured creditors.[47] Conversely, if a creditor is oversecured section 506(b) of the Code limits the amount of postpetition interest, costs and fees to the value of the collateral on the petition date.[48]

Regardless of whether the creditor is oversecured or undersecured, any postpetition improvement in the creditor's position violates the principle of equality of distribution, except in the uncommon cases providing full payment of all claims, because any improvement in one creditor's position is at the expense of other creditors. Secured creditors often request everything they can possibly get in the name of adequate protection and thus, care must be taken to ensure that they do not receive more than they are entitled to in violation of the principle of equality of distribution.[49]

V. Context of Cash Collateral Hearings

Balancing the divergent needs of the debtor and creditor on short notice in the emergent circumstances of the typical cash collateral hearing is often difficult. Although the sole purpose of adequate protection is to prevent the aggregate value of the se-

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[46] Section 1122(a) of the Code provides that a plan may place substantially similar claims in the same class. 11 U.S.C. § 1122(a) (1988).

[47] Section 1111(b) of the Code provides an exception to this rule, but is infrequently applied. 11 U.S.C. § 1111(b) (1985). See Klee, *All You Ever Wanted to Know About 'Cram Down' Under the New Bankruptcy Code*, 53 Am. Bankr. L.J. 133 (1979); Stein, *Section 1111(b): Providing Undersecured Creditors with Postconfirmation Appreciation in the Value of the Collateral*, 56 Am. Bankr. L.J. 195 (1982).

[48] *See supra* text accompanying notes 32-33.

[49] Unlike adequate protection, which must be provided under section 363(e) of the Code, there is no explicit requirement that the court must adhere to the principle of equality of distribution in orders authorizing the use of cash collateral. As noted above, however, the principle is nevertheless fundamental and should not be ignored. Before approving provisions which violate the principle, courts should require proof that the estate is receiving benefits with an economic value roughly equivalent to the improvement in position which the secured creditor is receiving. Only ten to fifteen percent of chapter 11 cases are successful. The court must therefore decide whether the improvements in the secured creditor's position at the expense of other parties in a subsequent chapter 7 case are justified by what the secured creditor is offering to the chapter 11 case. The answer depends upon the individual facts of each case. *See* Section VI, *infra*, regarding questionable types of improvement in the secured creditor's position.

cured creditor's liens from decreasing, and the sole purpose of a cash collateral hearing is to provide adequate protection, secured creditors typically use the opportunity presented by negotiations over adequate protection to attempt to resolve in advance as many other issues as they possibly can, and to improve their position to the greatest extent possible. If the secured creditor and the debtor were the only parties to the case, they could generally reach any agreements which they deemed appropriate. In most instances, however, there are other creditors involved. Because the assets generally are not of sufficient value to satisfy all claims in full, any improvement in one party's position is generally at the expense of others. Both secured and unsecured creditors therefore have the right to be heard regarding use of cash collateral and adequate protection.

Bankruptcy Rule 4001(b) provides that the secured creditor and the twenty largest unsecured creditors (or creditors committee if one has been formed) must receive at least fifteen days' notice of a final hearing on use of cash collateral. The court, however, may conduct a preliminary hearing on shorter notice and authorize the use of cash collateral to the extent necessary to avoid immediate and irreparable harm to the estate pending a final hearing. Because the debtor usually needs cash collateral to survive, and must obtain either the secured creditor's consent or a court order prior to such use, the preliminary hearing on use of cash collateral usually takes place within several days after the bankruptcy petition is filed. The preliminary hearing is often conducted on one or two days' telephonic notice, with supporting papers served upon the secured creditors at or shortly before the hearing. If preliminary use of cash collateral is authorized the final hearing is usually set for fifteen to thirty days thereafter. An interim consent order is often presented at the preliminary hearing, with a more elaborate order presented at the final hearing. Bankruptcy Rule 4001(d) provides that the twenty largest unsecured creditors or the creditors committee must be served with a motion for approval of such agreements, and must receive at least fifteen days to object. Under normal circumstances, however, a creditors committee has not been formed before the time for objections to a cash collateral order has passed. This occurrence is due to the fact that committee formation ordinarily does not take place until the first creditors meeting which is held approximately forty-five days after the filing of the petition.

In light of the important and complex issues which the court

is asked to resolve in the typical consensual cash collateral order at the inception of a case, such limited notice and opportunity for hearing on such orders is often disturbing, for reasons that are more fully explained in Section VII.

VI. Questionable Provisions in Agreements Regarding The Use of Cash Collateral

Due to the fact that secured creditors want to improve as well as protect their position, and debtors want to avoid a costly and dangerous battle over adequate protection, agreements regarding use of cash collateral often contain provisions which exceed the requirements of adequate protection delineated in section 361 of the Code.[50] The following is an analysis of such dubious provisions and the concerns which they raise.

A. Provisions Binding Parties Other Than the Signatories

These provisions are ultimately the most troubling of all, because other terms of such orders often dispose of important issues such as the amount due on the secured claim, the validity, priority and extent of liens,[51] and the secured creditor's right to a release from any prior liability. If the debtor and secured creditor have stipulated to these matters, little or no evidence may have been presented to the court on such matters other than the stipulations. In essence, the court is asked to take the word of the debtor and secured creditor that these stipulations are warranted by the facts. There are, however, other parties in interest who have received little or no notice prior to entry of such orders

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[50] In addition to replacement liens and/or cash payments to the extent of any decrease in the value of the collateral, which are set forth in Code section 361(1) and (2) as examples of adequate protection, a typical agreement regarding use of cash collateral will contain some or all of the following:

(a) a stipulation of the amount due and the validity, priority and extent of liens;

(b) cross-collateralization of prepetition debt with postpetition assets;

(c) a general release of the secured creditor from all prior liability;

(d) a provision for payment of postpetition interest;

(e) a prohibition against postpetition financing by third parties;

(f) waiver of claims for expenses of preserving or disposing of collateral;

(g) a provision for relief from the automatic stay without hearing or court order in the event of default by the debtor; and

(h) a provision that the agreement is binding upon parties other than the signatories.

[51] Section 363(o)(2) of the Code provides that an entity asserting an interest in property which requires adequate protection has the burden of proving the validity, priority and extent of such interest. 11 U.S.C. § 363(o)(2) (1988).

who may unknowingly be deprived of valuable rights against secured creditors. For example, secured creditors sometimes make mistakes regarding matters such as calculation of the amount due or perfection of a security interest. Moreover, issues may arise concerning preferential payments to an undersecured creditor, or perfection of a security interest within the preference period. Additionally, the debtor may have lender liability claims against the secured creditor, or a basis may exist for claiming equitable subordination of the secured creditor's claim.[52] The validity of a provision that such an order is binding on all other parties, in spite of little or no notice, is highly questionable.[53]

B. Cross-collateralization of Prepetition Debt with Postpetition Assets

The term "cross-collateralization" refers to provisions designating all property of the estate as additional security for part or all of a secured creditor's prepetition debt.[54] Cross-collateralization situations typically involve a secured creditor with a lien on all prepetition inventory, accounts receivable and proceeds receiving a lien on all property of the estate, including postpetition inventory, accounts receivable and proceeds, as adequate protection for use of cash collateral. It is not improper to grant a replacement lien on postpetition assets as adequate protection for use of cash collateral. Close reading of cross-collateralization provisions, however, often reveals that a lien on postpetition assets is granted not merely to replace cash collateral used in operations, but also to secure the entire prepetition debt. If there is estate property on which the creditor did not have a lien as of the petition date, cross-collateralization grants the secured creditor an increase in the aggregate value of its collateral. This may sometimes eliminate or decrease the potential deficiency claim of an undersecured creditor.[55] As previously noted, the purpose of adequate protection is merely to preserve

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52 *See id.* at § 510(c).

53 *See infra* Section VII for further analysis of this issue.

54 Weintraub & Resnick, *Cross-Collateralization of Prepetition Indebtedness as an Inducement for Postpetition Financing: A Euphemism Comes of Age*, 14 U.C.C. L.J. 86 (1981).

55 Under section 552(a) of the Code, unless property acquired postpetition constitutes proceeds of prepetition collateral it is not subject to a prepetition lien. 11 U.S.C. § 552(a) (1988). Thus, without cross-collateralization, property which is acquired postpetition will be available to priority creditors under section 507(a), as well as to unsecured creditors. Further, there may be assets owned prepetition on which there were no liens. For example, in New Jersey, a lien cannot be placed on a liquor license under state law. However, it can be pledged as collateral under the Bankruptcy Code by virtue of the supremacy clause. U.S. CONST. art. VI, cl. 2.

the value of the secured creditor's claim on the petition date. Cross-collateralization, therefore, goes beyond adequate protection because its purpose is to increase the aggregate value of the secured claim, rather than to prevent a diminution in such value. Thus, because cross-collateralization violates the principle of equality of distribution, it has been argued with some force that such provisions should never be approved.[56]

C. *Liens on "Avoiding Power" Causes of Action*

Another type of provision which has the potential to reduce an undersecured creditor's deficiency claim is a lien on "avoiding power" actions under sections 544 through 548 of the Code. A secured creditor's prepetition lien on general intangibles does not extend to such assets.[57] In many cases, causes of action under the avoiding powers are the only unencumbered asset of value. As such, they will sometimes offer the only real possibility of recovery to unsecured creditors, particularly if the case is converted.

Further, cases will arise where the estate has a cause of action under one or more avoiding powers against the secured creditor itself. I am personally aware of one recent case in this district which involved an undersecured creditor who demanded a lien on all preference recoveries as adequate protection for use of cash collateral. My colleague determined that the secured creditor's adamance was based on the knowledge that it had received substantial preferential payments, and a desire to avoid liability thereon. The creditor in question was not granted a lien on preferences, which in that case, would have abused the purpose of adequate protection.

Theer may be cases where it is appropriate to grant liens on avoiding power causes of action, but for the reasons stated above the courts should do so only reluctantly, after ascertaining that adequate protection is impossible without it.

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[56] *See* Tabb, *supra* note 44, at 175. Although courts have approved cross-collateralization clauses upon fulfillment of certain conditions, such cases deal primarily with applications under section 364 of the Code for new loans. The argument in these cases is that the debtor needs the new loan to survive but the creditor will not grant it without cross-collateralization. *See In re* Vanguard Diversified, Inc., 31 Bankr. 364 (Bankr. E.D.N.Y. 1983). In cash collateral situations, however, there is ordinarily little or no justification for approving cross-collateralization, because the court can authorize use of cash collateral regardless of whether the creditor agrees, as long as adequate protection is provided.

[57] Mellon Bank (East), N.A. v. Glick (*In re* Integrated Testing Prods. Corp.), 69 Bankr. 901 (D.N.J. 1987).

D. Prohibitions against Postpetition Financing by Third Parties

Secured creditors fear the possibility that third parties who provide postpetition financing may receive senior or equal liens on their collateral, or may influence or control the case to the detriment of those creditors with prepetition security interests. Thus, secured creditors commonly insert provisions in consensual cash collateral orders that either prohibit financing under section 364 of the Code by third parties, or provide that the proceeds of any such financing must be paid to the secured creditor. Because the purpose of adequate protection is merely to prevent the value of the secured creditor's lien from decreasing, it is difficult to justify such provisions as part of adequate protection for use of cash collateral. If such a provision is approved, the estate has lost any possibility (remote though it usually is) of alternative financing, even though there may be assets with sufficient value to provide both adequate protection of a prepetition lien and a senior or equal lien to a new lender. Further, if another lender wishes to make a loan to a debtor secured by a junior lien or super-priority administration expense, it should be able to do so. It is difficult to see any justification for giving a secured creditor the additional control over a case that a prohibition against additional financing provides.

E. Payment of Postpetition Interest without the Findings Required by Code Section 506(b)

As previously noted, adequate protection can be provided by periodic cash payments to the extent that use of collateral results in a decrease in its value. Creditors often request payment of postpetition interest as adequate protection. Under section 506(b) of the Code, however,[58] a creditor is only entitled to postpetition interest if it is oversecured. Payments to an undersecured creditor are compensation for reduction in value of collateral and are not interest. If the secured creditor and debtor wish to provide for payments described as postpetition interest without first proving that the creditor is oversecured, the rights of other parties to challenge the classification as postpetition interest, and to argue that such payments are reductions in the amount due on an undersecured claim, should be reserved. With regard to the payment of attorneys fees under section 506(b) of

[58] United Savings Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365 (1988); *see also In re* Reddington/Sun Arrow Ltd. Partnership, 119 Bankr. 809 (Bankr. D.N.M. 1990).

the Code, such payments require both excess value and a finding by the court as to reasonableness.[59]

F. *Relief from the Automatic Stay without Hearing or Court Order in the Event of Debtor Default*

Secured creditors frequently request "drop dead" clauses, under which designated events of default by the debtor result in immediate termination of both the right to use cash collateral and the automatic stay[60] without further hearing or order. Such clauses are usually accompanied by provisions which define events of default to include, *inter alia*, failure to make adequate protection payments when due, appointment of a trustee, incurring debt from third parties, and other events. The effect of such provisions is to permit the secured creditor to exercise substantial or complete control over the case, and to eliminate the court's discretion to fashion a remedy if the debtor defaults. These provisions in essence mean that if the debtor does anything which the secured creditor finds unacceptable, the secured creditor has absolute discretion to seize its collateral and terminate the reorganization. These provisions are usually considered unacceptable.[61] Decisions regarding relief from the automatic stay and termination of the chapter 11 should be made by the court and not the secured creditor.

G. *Waiver of Claims for Expenses of Preserving or Disposing of Collateral*

Judging by their actions, many secured creditors would like to repeal section 506(c) of the Code. This section provides that a trustee or debtor in possession may recover from the collateral any reasonable and necessary expenses of preserving or disposing of the property, to the extent that the secured creditor received any benefit. Applications for allowance of fees and costs under section 506(c) of the Code are often vigorously contested by secured creditors. Many consensual cash collateral orders therefore contain provisions that a secured creditor's lien takes

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59 *In re* Stanwood DeVries, Inc., 72 Bankr. 140 (Bankr. D.N.J. 1987).

60 The automatic stay is defined in 11 U.S.C. § 362(a) (1988).

61 The circumstances of any one case, particularly the type of collateral and its importance to reorganization, may create exceptions to this rule. Moreover, some courts apparently prefer to approve drop dead clauses with a right in the debtor to apply for injunctive relief if the clause is triggered. *See In re* FCX, Inc., 54 Bankr. 833, 843 (Bankr. E.D.N.C. 1985). I personally prefer to require the creditor to apply for relief in the event of default.

priority over all section 506(c) expenses, or that claims under section 506(c) will not be allowed.

It is permissible for the debtor's attorney to waive any 506(c) claim which he or she may have. This may happen in exchange for a "carve out" agreement under which the secured creditor will permit payment from its collateral of a limited amount for debtor's attorney's fees. The debtor, however, should generally not be permitted to waive any 506(c) claims. If there is such a waiver and the debtor's budget does not include all possible expenses of preserving or disposing of the collateral, the result may be that the unsecured creditors may have to bear an expense which has primarily or exclusively benefitted the secured creditor. Moreover, a subsequent trustee, or a party acting in lieu of the trustee,[62] may incur costs and expenses in preserving or disposing of collateral in some manner. If parties other than the debtor are barred from making claims under section 506(c) of the Code, the secured creditor may receive unjust enrichment. There is generally no sufficient reason to preclude the filing of section 506(c) claims by third parties. When the secured creditor disputes such claims the claimant always will have the burden of proving that the secured creditor received a benefit and that the expenses were reasonable and necessary. That is sufficient protection for the secured creditor against unwarranted claims against its collateral.

H. "Pre-Approved" Superpriority Claims Under Code Section 507(b).

Code section 507(b) provides in substance that if a trustee or debtor in possession provides adequation protection to a lienholder, but such protection fails, the lienholder shall have an administrative claim which takes priority over all other administrative claims to the extent of such failure.[63] This is sometimes

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[62] *See* Equitable Gas Co. v. Equibank N.A. (*In re* McKeesport Steel Castings Co.), 799 F.2d 91 (3d Cir. 1986).

[63] Code section 507(b) states:

> (b) If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

referred to as a "superpriority" claim. Section 507(b) provides "a statutory fail-safe system" in the event that adequate protection turns out to be inadequate.[64]

Agreements regarding use of cash collateral often contain provisions that the secured creditor's entire claim shall automatically be entitled to superpriority under Code section 507(b), and that it shall have priority over competing claims of every type. Such provisions are intended to subordinate to the secured creditor's claim professional fees and other administrative claims which are not expressly authorized under the agreement. In this manner, secured creditors often prevent the retention of counsel by a creditor committees, since counsel are usually unwilling to serve without payment in such cases. If this occurs, there is usually no one left in the case to challenge the secured creditor's interest on behalf of unsecured creditors.

Once again, as with other typical provisions addressed in this article, secured creditors attempt to rewrite the Code by adding such provisions. The purpose of superpriority under section 507(b) is not to provide adequate protection to a secured creditor, rather, its purpose is "to recapture value unexpectedly lost during the course of a case."[65] To obtain a superpriority under section 507(b), a creditor which has been provided adequate protection must prove that such protection has failed.[66]

Moreover, a secured creditor asserting a claim under section 507(b) which has been added to a cash collateral agreement is basing such claim on a stipulation that the collateral had a certain value and that such value has deteriorated. However, it should not necessarily be assumed that such stipulations are accurate; if the stipulated value of the collateral was excessive, it can be cor-

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11 U.S.C. § 507(b) (1988).

64 *In re* Marine Optical, Inc., 10 Bankr. 893, 894 (Bankr. D. Mass 1981).

65 *In re* Callister, 15 Bankr. 521, 529 (Bankr. D. Utah 1981), *aff'd. sub. nom.* Ingersoll Rand Fin. Corp. v. Callister, 13 BANKR. CT. DEC. 21 (10th Cir. 1984). *But see In re* California Devices, Inc., 1991 WL 45889 (Bankr. N.D. Cal. 1991) (suggesting that two distinct lines of authority have developed on this question, and that the *Callister* view is too restrictive.) The author submits that the differing results in the cases summarized in *California Devices* which interpret section 507(b) are primarily due to differing facts, rather than differences of opinion as to the purpose of section 507(b). Since the terms of section 507(b) provide that a superpriority claim shall arise where "adequate" protection turns out to be inadequate, it can hardly be questioned that *Callister* is correct in rephrasing the purpose as the "recapture of value unexpectedly lost during the course of the case."

66 *In re* California Devices, Inc., 1991 WL 45889 (Bankr. N.D. Cal. 1991); *Callister*, 13 BANKR. CT. DEC. at 530-34; *In re* Airlift Intern., Inc., 26 Bankr. 61, 64 (Bankr. S.D. Fla. 1982).

rected later by the court.[67] Further, the extent to which claims proven under section 507(b) actually do take priority over other administrative claims is open to question.[68]

If adequate protection fails, a secured creditor may assert a claim under section 507(b) regardless of whether a cash collateral order expressly authorizes it. Therefore, the presence of such provisions in cash collateral orders is at best, unnecessary surplusage, and at worst, an attempt to subordinate competing claims in a wrongful manner.

For these reasons, provisions for "pre-approved" section 507(b) claims with priority over every conceivable type of administrative claim are presumptively improper.

I. Similar Provisions in Orders Authorizing Postpetition Loans

Many of the same observations previously made regarding abusive provisions in cash collateral orders also apply to orders authorizing postpetition loans under section 364 of the Code.[69] The court in *In re Tenney Village Co.*, reached the following conclusions regarding a proposed financing order under section 364 of the Code which included provisions of the type which are the subject of this article:

> Under the guise of financing a reorganization, the Bank would disarm the Debtor of all weapons usable against it for the bankruptcy estate's benefit, place the Debtor in bondage working for the Bank, seize control of the reins of reorganization, and steal a march on other creditors in numerous ways. The Financing Agreement would pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the bene-

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[67] *Callister*, 13 BANKR. CT. DEC. at 524, 531-34; *In re Nordyke*, 43 Bankr. 856, 860 (Bankr. D. Ore. 1984) ("Under *Callister*, a creditor should not be rewarded for carelessness, much less greed, in negotiating a stipulation for adequate protection that overstates entitlement.").

[68] See *In re California Devices, Inc.*, 13 BANKR. CT. DEC. at 534-35 (administrative expenses of superseding chapter 7 case take priority over section 507(b) expenses of a prior chapter 11 case); *see also In re Callister*, 1991 WL 45889 (there is a presumption that interim allowances for professional fees under section 331 take priority over section 507(b) expenses); *but see* General Elec. Credit Corp. v. Leven & Weintraub (*In re* Flagstaff Foodservice Corp.), 739 F.2d 73 (2d Cir. 1984) (a secured creditor may object to payment of interim fees from its collateral absent a showing that the services were for its benefit).

[69] *See* Tabb, *Lender Preference Clauses and the Destruction of Appealability and Finality: Resolving a Chapter 11 Dilemma*, 50 OHIO ST. L.J. 109 (1989); *In re* Roblin Indus., Inc., 52 Bankr. 241 (Bankr. W.D.N.Y. 1985); *In re* Vanguard Diversified, Inc., 31 Bankr. 364 (Bankr. E.D.N.Y. 1983).

> fit of the Bank and the Debtor's principals who guaranteed its debt. It runs roughshod over numerous sections of the Bankruptcy Code. . . .
>
> And the Bank would have the ultimate say over the very goal of this chapter 11 case, a confirmed plan of reorganization. No longer could a plan be confirmed over the Bank's objection under the cramdown provisions of § 1129(b)(2)(A). Such a confirmation is a "termination event" which gives the Bank the right to foreclose upon all the Debtor's property without further order of court, assuming "no material change in circumstances," whatever that means. The automatic stay against foreclosure, and all questions concerning the Bank's adequate protection, become irrelevant despite the strictures of § 362.[70]
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> * * *
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> Equally shocking is the Bank's attempt to disarm the representative of the bankruptcy estate. Its existing liens would become unassailable even before appointment of counsel to the creditors' committee, and it is given iron-clad defenses to all claims that might be asserted on the estate's behalf, whether they pertain to preference, fraudulent transfer, lender liability, subordination or any other matter.[71]

There are several significant differences between the use of cash collateral under section 363 of the Code and financing through new postpetition loans under section 364. Under section 363, for example, the estate already has legal title to, and actual or constructive possession of cash collateral, and the court can authorize use of cash collateral over the objection of the secured creditor if adequate protection is provided. By contrast, section 364 permits the court to authorize new loans. However, the court cannot order a lender to make a loan to the debtor. If the lender does not accept terms which the court decides to add to the order authorizing new loans in order to protect other interests, it may decline to extend the loan. This difference tends to give the lender more leverage in negotiating the terms of a new loan than it has with cash collateral. The debtor, however, usually has some leverage, because the lender is usually a secured creditor with an interest in preserving the debtor as a going concern to maximize its recovery on its secured claim.[72]

Regardless of the exigencies of a given situation, there are stat-

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70 *In re* Tenney Village Co., 104 Bankr. 562 (Bankr. D.N.H. 1989).

71 *Id.* at 568.

72 Tabb, *supra* note 63, at 115 ("[The] lender has a vested interest in seeing the reorganization succeed so that it can realize more on its prepetition secured and unsecured claims.").

utory and constitutional requirements which must be adhered to. Section 364 of the Code requires notice and a hearing prior to authorization of loans which are out of the ordinary course of business, or which are secured by liens on estate property or which have priority over administrative expenses.[73] If the debtor wishes to secure a loan by a lien on estate property that is senior or equal to an existing lien, the debtor must provide adequate protection to the holder of the existing lien.[74]

As an incentive to make such loans, section 364(e) of the Code provides that the reversal or modification on appeal of an authorization for a loan under section 364 does not affect the validity of any debt incurred, or priority or lien granted, to a lender that made the loan in good faith. Loans made under this provision must, however, pass constitutional muster as well.[75]

VII. Due Process Concerns

Consent orders regarding use of cash collateral which contain provisions of the types discussed above can be presented with little notice to some parties and no notice to others under Bankruptcy Rule 4001(d). Because such provisions can affect the interests of such parties adversely, a question exists as to whether such orders may violate the rights of such parties to due process.

American notions of due process require that parties who may be adversely affected by a court order have an opportunity to be heard:

> An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections. The notice must be of such nature as reasonably to convey the required information, and it must afford a reasonable time for those interested to make their appearance. . . .[W]hen notice is a person's

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73 11 U.S.C. § 364(b),(c) and (d) (1988).

74 *Id.* at § 364(d)(1)(B).

75 Credit Alliance Corp. v. Dunning-Ray Ins. Agency (*In re* Blumer), 66 Bankr. 109, 114 (Bankr. 9th Cir. 1986) (Court held that section 364(e) of the Code does not apply where an order under section 364 is void because an unsecured creditor has been denied due process by a failure to provide notice); *but see* Owens-Corning Fiberglas Corp. v. Center Wholesale, Inc. (*In re* Center Wholesale, Inc.), 759 F.2d 1440, 1451 n.24 (9th Cir. 1985) (Court recognized that although an order under section 364 is void because one day's notice violates due process, section 364(e) still protects the lender to the extent that loans have been made in reliance on the order).

due, process which is a mere gesture is not due process.[76]

Creditors are entitled to due process in bankruptcy cases.[77] Considering the stakes and the complexity of the issues typically involved in applications for use of cash collateral and for approval of agreements regarding such use, the amount of time provided by Bankruptcy Rule 4001 for objections is disturbingly short. Such short notice is justified by the urgency of the debtor's need to use cash collateral and the requirement that adequate protection must be provided—*but only to that extent*. For example, it is ordinarily not necessary that the court make a final determination of the amount due on a secured claim or the validity, priority or extent of a lien on fifteen days' notice to the twenty largest unsecured creditors. Rather, it is only necessary that the court determine that the creditor has made a *prima facie* showing on such issues.[78] It is also unnecessary to make more than a preliminary determination as to the value of collateral; all parties should have the right to subsequently take more time to make a more careful and thorough determination of such value.[79] The issue of the necessity for, and extent of, adequate protection also can be revisited where appropriate.[80]

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76 Mullane v. Central Hanover Bank & Trust, 339 U.S. 306, 314-15 (1949) (citations omitted).

77 *See* New York v. New York, New Haven & Hartford R.R. Co., 344 U.S. 293 (1953). *See* Reliable Elec. Co., v. Olson Const. Co., 726 F.2d 620, 623 (10th Cir. 1984) (holding that discharge of a debt without reasonable notice and opportunity for hearing violates the due process clause of the fifth amendment).

78 Section 363(o)(2) of the Code provides that an entity asserting an interest in property has the burden of proof on the issue of the validity, priority and extent of such interest. 11 U.S.C. § 363(0)(2)(1988). In *In re* FCX, Inc., 54 Bankr. 833 (Bankr. E.D.N.C. 1985), the court held that it was unreasonable, based on the facts of that case, to expect unsecured creditors to form an opinion as to the amount and validity of a bank's secured claim, and as to the existence of claims against the bank, within the time provided by Bankruptcy Rule 4001. *Id.* at 841-42. In addition to the 50 day period which had passed from the date of entry of the subject order to the date of the court's decision on the unsecured creditors committees' objections, the *FCX, Inc.* court gave the committee an additional 30 days to determine the amount and validity of the secured claim, and an additional 60 days to determine the existence of any claims against the bank. *Id.* at 842.

79 Section 506(a) of the Code provides that valuation for one purpose in a particular case is not dispositive for all other purposes. *See* 11 U.S.C. § 506(a) (1988). Thus, if a consensual cash collateral order provides for payment of postpetition interest and it is later determined that the creditor was undersecured on the petition date, unsecured creditors should have the right to require that any such "interest" payments must be redefined and credited as payments in reduction of the secured portion of the creditor's claim. *See* United Savings Assoc. v. Timbers of Inwood Assocs., 484 U.S. 365 (1988).

80 Because section 507(b) of the Code provides that a secured creditor has a super-priority administrative claim to the extent that adequate protection turns out to be inadequate, unsecured creditors should likewise have the right to argue that

Cash collateral orders are usually entered prior to the first meeting of creditors and formation of an unsecured creditors committee. Because the Code contemplates that the creditors committee shall be the principal representative of the unsecured creditors in chapter 11 cases,[81] it is fundamentally unfair, and arguably a deprivation of due process, to resolve issues on short notice in cash collateral orders other than those which the circumstances absolutely require. Although the provisions in the Code and Rules for notice and opportunity to be heard are undoubtedly not unconstitutional per se,[82] the manner in which they are interpreted in particular cases may lead to unconstitutional results to the extent that cash collateral orders purport to resolve more than they absolutely have to and do so, sooner than they absolutely have to.

The concerns expressed above are allayed somewhat if consensual cash collateral orders are not final in nature, are not binding on parties other than the signatories, and are subject to subsequent modification as developments in the case require.

A. Are Cash Collateral Orders Interlocutory or Final?

The threshold question in determining the standards for subsequent modification of cash collateral orders is whether such orders are interlocutory or final in nature.[83] If an order is interlocutory, then under Rule 54(b) of the Federal Rules of Civil Pro-

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adequate protection was unnecessary, or excessive. 11 U.S.C. § 507(b) (1988). Thus, if the threatened decrease in the aggregate value of the secured claim does not occur or is less than expected, the unsecured creditors should have the right to argue that the purpose of adequate protection has been served and that the principle of equality of distribution requires removal or modification of any liens provided as adequate protection.

81 *See* 11 U.S.C. §§ 1102, 1103 (1988).

82 For an excellent discussion of the notice problem in connection with postpetition financing orders under 11 U.S.C. § 364, see Tabb, *supra* note 63, at 147-61. Most of the principles and concerns addressed therein apply to cash collateral orders as well.

83 This discussion shall focus on the standards for modification of such orders by the bankruptcy court, as the trial court. Whether an order is interlocutory or final also controls appellate jurisdiction of the district court and court of appeals under 28 U.S.C. § 158 (1988). Most of the case law on standards for determining the finality of orders in bankruptcy cases focuses on appellate jurisdiction. *See, e.g.*, Towber, *A Uniform Approach to Determining Finality in Bankruptcy Appeals Under 28 U.S.C. Section 158(d)*, 28 S. TEX. L. REV. 587 (1988) (collecting cases). However, the finality of a bankruptcy court order also determines the standards for modification of such orders by the court. Although there is substantial overlap between the standards, they are not identical. *See* Clark v. First State Bank (*In re* White Beauty View, Inc.), 841 F.2d 524 (3rd Cir. 1988) (discussing both standards). The question also affects the extent to which decisions of the bankruptcy court are binding on other cases in the bankruptcy court or other courts, because one of the elements of both

cedure, it is subject to revision at any time before a final order or judgment is entered disposing of all of the matters at issue.[84] If, however, an order is final, then once the period for seeking appellate review under Bankruptcy Rule 8002 has expired, the order can be modified by the bankruptcy court under Rule 60(b) of the Federal Rules of Civil Procedure only for certain reasons, including mistake, inadvertence, surprise, excusable neglect, fraud by an adverse party, or any other reason justifying relief from the order.[85] It is beyond reasonable dispute that a preliminary order authorizing use of cash collateral on an emergent basis under Bankruptcy Rule 4001(b)(2) pending a final hearing is interlocutory. However, whether an order entered after a final hearing under Bankruptcy Rule 4001(b) or (d) is a final order depends

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res judicata and collateral estoppel is that the judgment or finding in question must have been final.

[84] Rule 54(b) of the Federal Rules of Civil Procedure, incorporated by reference in Bankruptcy Rules 7054 and 9014, provides in pertinent part:

> When more than one claim for relief is presented in an action, . . . or when multiple parties are involved, the court may direct the entry of a final judgment as to one or more but fewer than all of the claims or parties only upon an express determination that there is no just reason for delay and upon an express direction for the entry of judgment. In the absence of such determination and direction, any order or other form of decision, however designated, which adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties shall not terminate the action as to any of the claims or parties, and the order . . . is subject to revision at any time before the entry of judgment adjudicating all the claims and the rights and liabilities of all the parties.

FED. R. CIV. P. 54(b).

[85] Rule 60(b) of the Federal Rules of Civil Procedure incorporated by reference in Bankruptcy Rule 9024, provides in pertinent part:

> On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence which by due diligence could not have been discovered in time to move for a new trial under Rule 59(b) of the Federal Rules of Civil Procedure; (3) fraud (whether denominated intrinsic or extrinsic), misrepresentation, or other misconduct of an adverse party; (4) the judgment is deemed void; (5) the judgment has been satisfied, released, or discharged, or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective application; or (6) any other reason justifying relief from the operation of the judgment. The motion shall be made within a reasonable time, and for reasons (1), (2), and (3) not more than one year after the judgment, order, or proceeding was entered or taken.

FED. R. CIV. P. 60(b).

upon whether the order finally determines all of the claims, rights and liabilities of the parties at issue therein.

The fact that the hearing which results in the order is designated as a final hearing, or that the order is entitled as a final order, is not controlling. Unless the order either (a) adjudicates all of the claims or rights and liabilities of all of the parties, or (b) expressly determines with respect to any one issue that there is no just reason for delay, and expressly directs the entry of judgment as to such issue, the order is not final.[86] The "express determination and direction for entry of judgment" referred to in the second sentence of Rule 54(b) of the Federal Rules of Civil Procedure is generally referred to as "certification" of such issues as final by the trial court.[87]

A "final order is one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment."[88] To be final, the order must be more than just a provisional disposition of the issues.[89] Finality, however, is interpreted pragmatically in bankruptcy cases.[90] Types of orders which have been held to be final for purposes of appellate review include orders determining the amount of claims[91] and orders vacating the automatic stay to permit foreclosure of mortgages on real property.[92] Types of orders which have been held to be interlocutory include orders determining the unsecured part of an undersecured creditor's claim where the amount to be realized and properly credited for the sale of collateral has not been determined,[93] and orders determining liability but not damages.[94]

No reported decisions exist concerning the issue of whether an order authorizing use of cash collateral is interlocutory or final for purposes of either 28 U.S.C. section 158 or Bankruptcy Rule 7054.[95] It is submitted that such orders are usually interloc-

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86 Central Ill. Sav. & Loan Ass'n v. Rittenberg Co., 85 Bankr. 473, 476-477 (N.D. Ill. 1988); 6 MOORE'S FEDERAL PRACTICE ¶ 54.28[2], at 54-133 (1990) [hereinafter Moore's].

87 6 MOORE'S, *supra* note 80, ¶ 54.04[3-6], at 54-55 and ¶ 54.28[2], at 54-133.

88 Catlin v. United States, 324 U.S. 229, 233 (1945).

89 *In re* MMS Builders, Inc., 101 Bankr. 426, 429 (D.N.J. 1989).

90 Clark v. First State Bank (*In re* White Beauty View, Inc.), 841 F.2d 524, 526 (3rd Cir. 1988).

91 *In re* Saco Local Dev. Corp., 711 F.2d 441, 446-48 (1st Cir. 1983).

92 Moxley v. Comer (*In re* Comer), 716 F.2d 168, 172 (3d Cir. 1983).

93 *In re* Fox, 762 F.2d 54 (7th Cir. 1985); MMS Builders, 101 Bankr. at 430.

94 Fox, 762 F.2d at 55.

95 *But see In re* Charter Co., 778 F.2d 617 (11th Cir. 1985) ("Cash Management

utory. First, as is discussed throughout this article, the amount of the secured creditor's claim, the validity of its liens and related issues should not be determined summarily at the inception of the case on limited notice, and the tentative findings regarding such issues in the cash collateral order should be left open for further review. Second, even if the *amount* of the claim and the *validity* of the liens are finally determined, the *treatment* of the secured creditor's claim or liens in the case may subsequently change. This change may occur if, for example, "adequate protection" turns out to be inadequate[96] or excessive,[97] or substitution or modification of liens is required by developments in the case.

Moreover, the Code itself does not make cash collateral orders final. In contrast, section 364(e) of the Code provides that the reversal or modification on appeal of an order authorizing a postpetition loan does not affect the validity of the loan or any priority or lien granted for it, unless the lender was not acting in good faith or the order was stayed pending appeal. Similarly, section 363(m) of the Code provides that reversal or modification on appeal of an order authorizing sale or lease of property of the estate does not affect the validity of the sale or lease unless the purchaser or lessee was not in good faith or the order was stayed pending appeal. Section 363(m) does not extend such protection to orders authorizing use of cash collateral and providing adequate protection under sections 363(c) of the Code.[98] If there are compelling reasons to do so, the bankruptcy court can always provide its certification in a cash collateral order that a particular

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Order" authorizing transfers of cash among debtor and non-debtor affiliates was held to be interlocutory for purposes of 28 U.S.C. § 158).

96 Section 507(b) of the Code provides that if adequate protection turns out to be inadequate, the secured creditor has an administrative expense claim with priority over all other administrative expenses. *See* 11 U.S.C. § 507(b) (1988).

97 Although it would be unusual, it is nevertheless possible that one asset subject to a prepetition lien (for example, real property) could increase in value after the petition date in an amount equal to or greater than the decrease in value caused by the debtor's use of other assets, such as cash collateral. This would thereby justifying a reduction in adequate protection required under section 361 of the Code. 11 U.S.C. § 361 (1988).

98 Sections 364(e) and 363(m) of the Code have a broader meaning than orders authorizing postpetition loans, sales or leases are final; those sections also create an irrebuttable presumption of mootness on appeal unless either the order is stayed or the lender, purchaser or lessee is not acting in good faith. 11 U.S.C. §§ 364(e), 363(m) (1988). *See also In re Nordyke*, 43 Bankr. 856, 860 (Bankr. D. Ore. 1984)("By its nature, adequate protection is not final unless all parties later treat it as final.").

issue has been finally determined in the form required by Rule 54(b) of the Federal Rules of Civil Procedure.

Notwithstanding the foregoing, it is possible that the facts of a particular case may give rise to a final cash collateral order even if such orders are usually interlocutory. The next section of this article therefore discusses the extent to which consensual cash collateral orders, if final, or parts thereof which are certified by the court as final, are binding on parties other than the signatories.[99]

B. *If an Order Is Final, or a Part of It Is Certified As Final, Is It Binding on Creditors Who Have Not Received Individual Notice?*

The extent to which a cash collateral order is binding on creditors who have not received notice is certainly questionable. First, consensual cash collateral orders sometimes contain provisions, such as releases or waivers of claims or defenses against the secured creditor, which are in the nature of a settlement, and Bankruptcy Rule 2002(a)(3) requires notice to all creditors of proposed settlements.[100] Moreover, at this stage of the case the court and all parties except the secured creditor and the debtor are usually completely in the dark as to what rights are being released or waived. "A blanket waiver of unspecified rights in the early stages of a complex corporate reorganization would not appear to manifest prudent judgment."[101]

Second, the extent to which representative notice under Bankruptcy Rule 4001 comports with due process is uncertain.[102]

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99 To a large extent, the discussion which follows in the remainder of Section VII regarding the extent to which parties other than the immediate contestants or signatories are bound by orders in a bankruptcy case may also apply to many other types of orders in addition to cash collateral orders.

100 *See In re* FCX, Inc., 54 Bankr. 833, 839 (Bankr E.D.N.C. 1985).

101 *In re* Roblin Indus., Inc., 52 Bankr. 241, 243 (Bankr. W.D.N.Y. 1985).

102 The United States Supreme Court has held in nonbankruptcy cases that due process requires individual notice to the extent possible, notwithstanding that inconvenience and expense may be considerable. In Mullane v. Central Hanover Bank & Trust, 339 U.S. 306 (1950), the Court held that notice by publication of judicial settlement of trust accounts did not provide due process to beneficiaries whose addresses were known to the trustee. *Id.* at 318. In Eisen v. Carlisle & Jacqueline, 417 U.S. 156 (1974), the Court held that the notice provisions of Rule 23(c)(2) of the Federal Rules of Civil Procedure, regarding the effect of inclusion in a class, required individual notice to each of 2,250,000 identifiable class members. *Id.* at 175-76. The Court expressly rejected arguments that notice to only part of the class could be justified due to the tremendous cost of individual notice or because those notified would be adequate representatives. *Id.* at 176-77. See Tabb, *supra* note 63, at 152 n.290.

It has been argued that bankruptcy reorganization cases are analogous to class action cases, in which representative notice has been held to satisfy due process.[103] However, the standards for determining the adequacy of representation in class action cases under Rule 23 of the Federal Rules of Civil Procedure are stringent. The court must determine that both the class representative and his counsel are adequate.[104] A finding of adequacy may later be revised.[105] An unwilling representative and counsel is not an adequate representative.[106] If the same principles apply in bankruptcy cases, it is difficult to see how the twenty largest unsecured creditors who have not yet been able or willing to form a creditors committee and retain counsel could be considered adequate representatives of the class of unsecured creditors.

Where a creditors committee has been appointed, however, it and its attorney have a fiduciary duty to the unsecured creditors who they represent.[107] Their duties include investigation of the debtor's acts, conduct, assets, liabilities and financial condition.[108] It follows that if a creditors committee has been appointed, has retained counsel, and has had reasonable notice and opportunity for hearing regarding any *final* order, or any issue which has been certified by the court as finally determined, a presumption should arise that the order is binding on all unsecured creditors, whether or not they receive individual notice of the hearing on the order.[109]

C. *If an Order Is Final, or a Part of It Is Certified As Final, Is It Binding on Creditors Who Have Received Individual Notice?*

As discussed in Section VIIB above, if a creditors committee and its counsel have properly reviewed the order, this question should be answered affirmatively. If, however, there is no creditors committee or it has not retained counsel, this question becomes much more difficult.

One reason for the existence of creditors committees and

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103 Tabb, *supra* note 62, at 151.

104 MOORE'S FEDERAL PRACTICE ¶ 23.07[1], at 23-202 (2d ed. 1990).

105 *Id.* at 23-190.

106 *Id.* at 23-192.

107 Woods v. City Nat. Bank and Trust, 312 U.S. 262 (1941); United Steelworkers of America v. Lampl (*In re* Mesta Mach. Co.), 67 Bankr. 151, 156-57 (Bankr. W.D. Pa. 1986).

108 11 U.S.C. § 1103(c)(2) (1988).

109 *In re* Photo Promotion Assocs., Inc., 53 Bankr. 759, 763 (Bankr. S.D.N.Y. 1985).

their attorneys is to spread the cost of representation of the unsecured creditors and investigation of the debtors assets and liabilities equitably within the estate.[110] The Code provisions which authorize such cost-spreading recognize the inherent unfairness of expecting any one unsecured creditor to assume the cost of such investigation. Compounding such unfairness, the secured creditor typically insists on super-priority status for its interests, thereby effectively prohibiting compensation to the professionals for a creditors committee which might assert positions which are adverse to the secured creditor's interests. Under these circumstances, it is at least arguable that even a final cash collateral order or a final portion of an interlocutory cash collateral order is not binding on unsecured creditors who have received individual notice of the hearing on the cash collateral order until someone with a fiduciary duty to such unsecured creditors has had a reasonable opportunity to review such an order. Alternatively, these factors should weigh in favor of an application by such creditor to modify such an order under Bankruptcy Rule 9024 and Rule 60(b) of the Federal Rules of Civil Procedure.

D. If An Order is Final, Or if Part of It Is Certified as Final, Is It Binding on a Subsequently Appointed Trustee?

The courts have generally held that a subsequently appointed trustee is bound by the previous acts of the debtor in possession.[111] One court has opined that this rule is necessary so that third parties will not be discouraged from dealing with a debtor in possession.[112] Another, more fundamental reason is undoubtedly the desirability of encouraging finality in judicial proceedings as a means of avoiding waste of scarce judicial time in duplicative proceedings.

While those considerations are unquestionably important, there are other considerations of equal importance in bankruptcy cases. It has therefore been stated that the following factors have

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[110] Section 1103(b) authorizes creditors committees to retain professionals, and sections 330(a) and 503(b)(2) provide that compensation to such professionals shall be paid from the estate as an administrative expense. *See* 11 U.S.C. §§ 1103(b) 330(a), 503(b)(2) (1988).

[111] *See* Jonas v. United States Small Business Admin. (*In re* Southland Supply, Inc.), 657 F.2d 1076, 1080 (9th Cir. 1981); Feldman v. Trans-East Air, Inc., 497 F.2d 352, 355 (2d Cir. 1974); Siegel v. Schulte (*In re* Wil-Low Cafeterias), 111 F.2d 83, 85-86 (2d Cir. 1940); *In re* Tandem Group, Inc., 61 Bankr. 738, 741 (Bankr. C.D. Cal. 1986); *In re* Fashion World, Inc., 49 Bankr. 690, 693 (Bankr. D. Mass. 1985); Seidle v. GATX Leasing Corp., 45 Bankr. 327 (Bankr. S.D. Fl. 1984).

[112] *In re* Philadelphia Athletic Club, 17 Bankr. 345, 347 (Bankr. E.D. Pa. 1982).

a bearing on whether a trustee shall be bound by a debtor in possession's actions: (i) evidence of fraud or prejudice to the estate;[113] (ii) ambiguity in a stipulation regarding its applicability in the event of conversion to chapter 7;[114] (iii) the extent and quality of notice;[115] (iv) whether the actions were taken in an emergency;[116] and (v) the presence of cause to appoint a trustee.[117] These factors reflect the efforts by bankruptcy courts to balance policy considerations to effect justice.

The general rule that a subsequently appointed trustee is bound by the previous acts of a debtor in possession is based upon the doctrine of *res judicata*, under which "a final judgment on the merits precludes the parties or their privies from relitigating issues that were or could have been raised in that action."[118] Privity means identity of interests: "Privity exists where 'successive parties . . . adequately represent the same legal interests.' "[119] Privity is based upon "similar incentives, powers and opportunities to investigate and litigate."[120]

It is beyond dispute that with exceptions not pertinent here, a debtor in possession has all of the rights, powers and duties of a trustee.[121] A debtor in possession, however, often lacks incentives similar to those of a trustee regarding investigation of, and litigation over, the claims of a secured creditor. One obvious and common example is where the principals of a corporate debtor have personally guaranteed a claim secured by assets of the corporate debtor. In such situations, the principals have an inherent conflict of interest which will likely cause them to favor the interests of the secured creditor in order to maximize the secured creditor's collection from the debtor and minimize the principals' personal exposure. To hold that there is an identity of interests between the debtor in possession and trustee in such situations is to ignore reality.

Where a creditors committee has been appointed and has

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113 *Id.*

114 *In re* Delafield Dev., 54 Bankr. 442 (Bankr. E.D. Wisc. 1985).

115 Begler v. American Express, Inc. (*In re* American Int'l Airways, Inc.), 74 Bankr. 691, 696 (Bankr. E.D. Pa. 1987).

116 *Id.*

117 *Id.* at 694. *See also In re* Bettis, 97 Bankr. 344 (Bankr. W.D. Texas 1989).

118 Allen v. McCurry, 449 U.S. 90, 94 (1980).

119 Pollack v. Federal Deposit Ins. Corp. (*In re* Monument Record Corp.), 71 Bankr. 853, 861 (Bankr. M.D. Tenn. 1987) (quoting Donovan v. Estate of Fitzsimmons, 778 F.2d 298, 301 (7th Cir. 1985)).

120 *Id.*

121 11 U.S.C. § 1107 (1988).

retained counsel, however, the situation is quite different. As with the trustee, a primary duty of the creditors committee, is to protect the interests of unsecured creditors.[122] Thus, where there is a creditors committee and it has retained counsel, there generally will be privity, and the trustee will be bound by the prior acts of the debtor in possession. Many of the cases finding privity have pointed out the role of the creditors committee in such cases.[123]

It must also be noted that very often, the first and only party in interest, other than the signatories, who is willing to undertake a review of a consensual cash collateral order is the trustee in the chapter 7 case which this case follows the chapter 11 proceeding approximately ninety percent of the time. However, in addition to inserting super-priority provisions which effectively preclude payment and hence retention of an attorney for a creditors committee, the secured creditor has often attempted to add a provision that the order is binding on any subsequently-appointed trustee. In so doing, the secured creditor clearly hopes to preclude any meaningful review of its claim and lien at any stage of the case, and such a scheme is often successful if an order of the type in question is entered.

In such circumstances, is justice served by holding the trustee bound by actions of the debtor in possession? It behooves us to remember the Supreme Court's warning in *Brown v. Felsen*:[124]

> Because res judicata may govern grounds and defenses not previously litigated, however, it blockades unexplored paths that may lead to truth. For the sake of repose, res judicata shields the fraud and the cheat as well as the honest person. It therefore is to be invoked only after careful inquiry.[125]

This analysis leads to the conclusion that privity does not necessarily exist between the debtor in possession and trustee unless there was a creditors committee to keep the debtor honest and protect the interest of unsecured creditors. The presence of a creditors committee and counsel at all relevant times should create the presumption that the trustee is bound by the actions of the debtor in

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122 *See In re* Medomak Canning, 992 F.2d 895 (1st Cir. 1990).

123 *See* Monument Record Corp., 71 Bankr. at 861; *In re* Delafield Development, 54 Bankr. 442 (Bankr. E.D. Wisc. 1985); Jonas v. United States Small Business Admin. (*In re* Southland Supply, Inc.), 657 F.2d 1076 (9th Cir. 1981); *In re* Fashion World, Inc., 49 Bankr. 690 (Bankr. D. Mass. 1985).

124 442 U.S. 127 (1979).

125 *Id.* at 132.

possession. Where, however, no creditors committee exists, or it did not have counsel at all relevant times, a presumption should arise that the trustee is *not* bound by the actions of the debtor in possession.

E. Summary of Conclusions Regarding the Finality and Binding Effect of Cash Collateral Orders

The foregoing analysis in Section VII can be summarized as follows:

1. Cash collateral orders are usually interlocutory in nature. It is possible, however, that the facts of a particular case may give rise to a final cash collateral order, or that the bankruptcy court may certify that part of a cash collateral order is final pursuant to Rule 54(b) of the Federal Rules of Civil Procedure. If an order is interlocutory, any part of it is subject to revision under this rule at any time before a final order is entered.

2. If a particular cash collateral order is final, or if part of it is certified as final, a presumption should arise that it is nevertheless not binding upon unsecured creditors unless a creditors committee's attorney or trustee's attorney has had reasonable notice and opportunity for hearing prior to entry of the order. Conversely, to the extent that part or all of a cash collateral order is final and the attorney for a creditors committee or trustee had reasonable notice and opportunity for hearing, a presumption should arise that the final portion of such order is binding upon unsecured creditors. These presumptions should apply regardless of whether or not a particular unsecured creditor received individual notice of the hearing on such order.

3. If a particular cash collateral order is final, or if part of it is certified as final, a presumption should arise that it is nevertheless not binding upon a subsequently appointed trustee unless an attorney for a creditors committee had reasonable notice and opportunity for hearing on such order prior to its entry. Conversely, to the extent that such an order is final and the attorney for a creditors committee had reasonable notice and opportunity to be heard, a presumption should arise that the final portion of such order is binding upon a subsequently appointed trustee.

VIII. A Standard Form of Equitable Cash Collateral Order

If consensual cash collateral orders often contain provisions which are improper or misleading, what should an ideal cash col-

lateral order look like? The unlimited variety of facts and circumstances which exist from case to case make it unlikely that a form of order can be prepared which would meet all of the needs of every case. It is submitted, however, that acceptable prototypes may be developed.[126] The following suggested provisions assume a debtor whose business is the sale of goods and who has a secured creditor which apparently has a valid first lien on inventory, accounts receivable and proceeds under the Uniform Commercial Code. It is also assumed that this order would be entered following a typical cash collateral hearing at the inception of the case on notice under Bankruptcy Rule 4001. The decretal paragraphs of the order might provide as follows:

> For cause shown, it is ordered and adjudged as follows:
>
> 1. The Debtor has complied with the notice requirements of Bankruptcy Rule 4001(b) [and/or (d)].
>
> 2. The Bank has made a *prima facie* showing that it has a duly perfected first lien on the Debtor's inventory, accounts receivable and proceeds, which secures a claim in the amount of _____ as of the petition date. The Debtor's cash generated from sale of prepetition inventory and collection of prepetition accounts receivable is therefore "cash collateral" as defined by Code § 363(a).
>
> 3. The Debtor has made a *prima facie* showing that its income from postpetition operations shall be at least equal to its postpetition expenses, and that the aggregate value of its postpetition purchases of inventory, postpetition accounts receivable and proceeds shall be at least equal to the amount of cash collateral used by the Debtor in its operations.[127]
>
> 4. As adequate protection for the use of its cash collateral, the Bank is granted a replacement lien on the Debtor's postpetition inventory, accounts receivable and proceeds, to the extent that use of cash collateral results in any decrease in

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126 My colleague, the Honorable Daniel J. Moore, has suggested that the Bankruptcy Court in this District develop a standard form of cash collateral order which can be used or adapted for use in all cases. It is my hope that this article will stimulate discussion leading to the development of such an order. Such prototypes presently exist in collections of sample forms, but for the reasons discussed above, some of these apparently have been written by attorneys for secured creditors. It is time to prepare a standard form of cash collateral order which takes into account the rights of all parties in interest. In addition, it may be appropriate to adopt local bankruptcy court rules listing provisions which are required or prohibited in cash collateral orders.

127 If the debtor has not made this showing then a replacement lien on postpetition assets of the same type would not be adequate protection and additional protection would have to be provided.

> the aggregate value of the Bank's liens on the Debtor's property on the petition date.
>
> 5. The Debtor and the Bank stipulate that the amount due to the Bank is as set forth above, and that the Bank held a duly perfected first lien on the Debtor's inventory, accounts receivable and proceeds as of the petition date. This stipulation is only binding upon the Bank and the Debtor.
>
> 6. This is an interlocutory order. Except for the stipulation in paragraph 5, it may be modified for cause shown on application by the Debtor, the Bank or any other party in interest on due notice. However, no such modification shall deprive the Bank of adequate protection of its interest in the Debtor's property to the extent that such protection is required by the Bankruptcy Code and other applicable law.

Such an order may not provide secured creditors with as much protection as they would like, but it provides them with as much protection as they are entitled to under the circumstances existing at that stage of the case. Adequate protection does not require elimination of all uncertainty. Under section 361 of the Code, adequate protection only has to compensate for any decrease in value of the secured creditor's lien. The above provisions accomplish that end. Beyond that, there is no reason why a secured creditor is entitled to a summary disposition of other issues at the inception of the case. On the other hand, in view of the requirements of due process and the principles of equality of distribution and fundamental fairness, there is every reason to delay final determination of other issues of interest to both secured and unsecured creditors to increase the likelihood that justice will be done.

The bankruptcy court has the right and the obligation to see to it that no party to a bankruptcy case takes unfair advantage of other parties. In that regard, Bankruptcy Rule 4001(d)(3) provides that if no objection is filed to a motion for approval of an agreement for the use of cash collateral or to provide adequate protection, the court may enter an order approving *or disapproving* the agreement *without conducting a hearing*. Thus, if the court determines that a consensual cash collateral order contains provisions that are inappropriate at that stage of the case, the court may either decline to enter the order or make such modifications as justice requires. This conclusion is based upon the fact that the bankruptcy court is a court of equity, possessing the power, under section 105(a) of the Code to issue, *sua sponte*, any order, process or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code. The court has a mandate to keep the playing field level.

IX. CONCLUSION

The purpose of chapter 11 is reorganization and its hallmark is flexibility.[128] However, that laudable purpose does not justify ignoring statutory or constitutional provisions intended to protect all parties. The fifth amendment is the basis for the Code's requirements of both adequate protection and notice. Adequate protection prevents any taking of property without just compensation, and notice requirements protect the right to be heard before one's interests are adversely affected. Hearings on applications to use cash collateral typically arise in emergent circumstances requiring balancing of the interests of all parties. In view of the limited notice provided, the fact that unsecured creditors usually fail to appear at such hearings is not a justification for impairing their rights to the extent it can be avoided. Consensual cash collateral orders must be closely scrutinized to ensure that the secured creditor receives no more, and other parties in interest receive no less, than the Code and Constitution require.

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[128] 2 COLLIER, *supra* note 32, ¶ 1100.01, at 1100-22.